Review of the Personal Property Securities Act 2009

FINAL REPORT

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Partner, Ashurst

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Letter of Transmittal

Senator the Hon George Brandis QC
Attorney-General
Parliament House
CANBERRA ACT 2600

The Hon Christian Porter MP
Parliamentary Secretary to the Prime Minister
Parliament House
CANBERRA ACT 2600

Dear Attorney-General and Parliamentary Secretary,

Report on the Review of the Personal Property Securities Act 2009

I am pleased to present you with my final *Report on the Review of the Personal Property Securities Act 2009*.

The *Personal Property Securities Act 2009* established a single, national set of rules for secured credit using personal property. The Act sought to provide greater certainty for Australian businesses, credit providers and consumers, and so to reduce the cost of secured finance and to make it easier for businesses and consumers to use their assets as security. As I explained in the Interim Report that I delivered on 31 July 2014, stakeholders have made it clear that much can be done to help the Act to better achieve these objectives.

This *Report* considers:

- the effect of the reforms introduced by the Act;
- the level of awareness and understanding of the Act;
- the incidence and causes of non-compliance with the Act;
- opportunities for minimising regulatory and administrative burdens including cost; and
- opportunities for further efficiencies.

In looking at these matters, this *Report* also considers:

- the scope and definitions of personal property;
- the desirability of introducing thresholds;
- the interaction of the Act with other legislation; and
- other relevant matters.

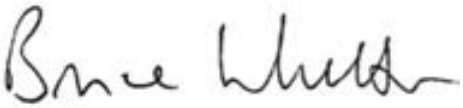
This *Report* includes extensive recommendations on how to improve the Act, including simplification of the Act and of the register established by the Act, as required by the terms of reference for the review.

The review has undertaken extensive consultation with stakeholders. Stakeholders were invited to make submissions at two stages of the review, and to submit responses to four separate consultation papers. In all, the review received a total of 171 submissions and responses, from a wide range of stakeholders including industry organisations, individual businesses, law firms and law societies, Government bodies representing business, consumer and privacy interests, and members of the academic legal community. Their input has been key to the formulation of my recommendations.

I have benefitted greatly from the input from all stakeholders over the course of the review. I have been particularly appreciative, however, of the contributions that I have received from colleagues in the legal community, many of whom have provided their input as an addition to their working day, rather than as part of it. While it is not possible to list all of those who have supported me, I would like in particular to acknowledge the wise counsel that I have received from: Helena Busljeta, at King & Wood Mallesons; Anthony Duggan, Honourable Frank Iacobucci Chair in Capital Markets Regulation at the University of Toronto; Diccon Loxton, at Allens Linklaters; Professor Sheelagh McCracken, at the University of Sydney; Lionel Meehan, at my firm Ashurst; and Craig Wappett, at Johnson Winter & Slattery.

I am confident that the recommendations in this *Report* will help to unlock the Act's potential, and assist it to achieve its objectives. I would be happy to meet with you to discuss my recommendations, and I look forward to seeing the completion of this next stage of reform of Australia's secured transaction laws.

Yours sincerely,



Bruce Whittaker

27 February 2015

Terms of Reference

I, George Brandis QC, Attorney-General, request Mr Bruce Whittaker to undertake a review of the operation of the *Personal Property Securities Act 2009* (PPS Act).

The review should consider:

(a) the effects of the reforms introduced by the PPS Act on:

  (i) Australian businesses, particularly small business

  (ii) Australian consumers

  (iii) the market for business finance in Australia, and

  (iv) the market for consumer finance in Australia

(b) the level of awareness and understanding of the PPS Act at all levels of business, particularly small business

(c) the incidence and, where applicable, causes of non-compliance with the requirements of the PPS Act particularly among small businesses

(d) opportunities for minimising regulatory and administrative burdens, including costs, on businesses, particularly small business, and consumers

(e) opportunities for further efficiencies in the PPS Act regime including (but not limited to) simplification of the Personal Property Securities Register and its use

(f) the scope and definitions of personal property covered by the PPS Act

(g) the desirability of specifying thresholds for the operation of the PPS Act regime in respect of particular types of personal property

(h) the interaction of the PPS Act with other legislation including the *Corporations Act 2001*, and

(i) any other relevant matters.

The review must include consultation with relevant stakeholders.

An interim report is to be provided jointly to me and the Hon Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister, by 31 July 2014 on the impact of the PPS Act on small businesses with recommendations on any priority actions (including legislative) that should be considered by Government in respect of issues raised in the review that concern small business stakeholders.

The final report on the review, which should include recommendations on how to improve the PPS Act, including simplification of the Act where appropriate, must be provided jointly to me and the Hon Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister by 30 January 2015.

George Brandis QC

Attorney-General

[Authority: Section 343 of the *Personal Property Securities Act 2009*]

Chapter 1
Executive Summary

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1.1 A paradigm shift in our law

The *Personal Property Securities Act 2009* (the *Act*) revolutionised the law and practice of secured transactions in Australia. It established an entirely new regime for the creation, legal effect and enforcement of security interests in personal property. In doing so, it replaced a number of complex and fragmented sets of rules with a single set of rules that apply to security interests in personal property.

The Act did not do this by simply standardising the rules for existing legal structures. Instead, the Act took an entirely new approach to secured transactions laws, based on principles that had been developed and implemented in a number of overseas jurisdictions, most notably in the United States, Canada and New Zealand. This approach largely ignores the form that parties choose for their transaction or even who has title to the property, and instead focuses on the transaction's commercial substance to determine whether it should be treated as a security interest. This was a radical shift in approach for Australian law.

1.2 Effect of the reforms

The Replacement Explanatory Memorandum for the Act stated that the purpose of the Act was to provide "more certain, consistent, simpler and cheaper arrangements for personal property securities". The clear feedback from submissions to the review is that much still needs to be done if the Act is to achieve these goals. The Act has improved consistency in Australia's secured transactions laws, but submissions emphasised that the Act and the Register are far too complex and that their meaning is often unclear, and that the resultant uncertainty has not allowed the Act to reach its potential.

Submissions maintained that much can be done to simplify the content of the Act, and that this would make the Act much more accessible to users and easier to work with. Simplifying the Act will help it to achieve its objectives, as simpler and clearer rules can lead to more predictable outcomes. More predictable outcomes would give financiers greater confidence in the Act and in their ability to take effective security interests under it. That, in turn, would assist borrowers to use their assets as collateral, and enhance their ability to raise cost-effective finance.

1.3 What can be done?

Much can be done to improve the Act. The Act is significantly longer than the corresponding legislation in other jurisdictions, and while some of that additional length is attributable to constitutional or other machinery provisions, much of it flows from the very prescriptive nature of some of the drafting, and from the inclusion of additional provisions that may be of only marginal benefit. The Act has also adopted a number of concepts and policy choices from overseas models without it being clear as to what extent those concepts and policy choices were appropriate for Australian business conditions. The Act will be much more effective as a piece of Australian legislation if these concepts and policy choices can be tested against Australian operating conditions and expectations, and modified where this is needed.

There is no one single step that by itself will produce a major improvement to the Act. Rather, improvement needs to come from the making of many small changes.

1.4 Stakeholder input

The work of the review has relied very heavily on input from stakeholders. The review sought the views of stakeholders through two rounds of submissions, and four consultation papers. In all, the review received 88 submissions and 83 responses to the consultation papers, from stakeholders such as industry organisations, individual businesses, law firms and law societies, government organisations representing business, consumer and privacy interests, and members of the academic legal community. Their views underpin the recommendations in this report.

1.5 Recommendations for change

The outcomes of the review as they relate to the Act and the Register are set out in Chapters 4 to 9 of this report. Those Chapters group the many issues by topic. The discussion of each issue consists of an explanation of the issue, consideration of the feedback received from stakeholders, and my recommendations in relation to it. For convenience, all the recommendations are also listed separately at the end of this report, in Annexure E.

There was a strong consensus in the views of stakeholders on the great majority of issues. There were a number of issues, however, on which stakeholders were more divided, often because of differing philosophical starting points or competing policy preferences. My recommendations on those issues reflect what I believe, after careful consideration, to be the appropriate balance of the competing perspectives.

I was not in a position to make a properly–informed recommendation on a small number of questions, mostly as the result of a lack of information. In those cases, I have instead recommended a path that Government could follow in order to reach an appropriate resolution of the issue.

1.6 Implementation will be critical

Making major changes to legislation of this complexity is itself a complex task. Care will need to be taken to ensure that the changes do not inadvertently upset existing rights, to ensure that the amended Act is internally consistent, and to ensure that the detail of the drafting is effective to respond to the concerns that it is designed to address. I make some recommendations on these matters in Chapter 10.

1.7 A fresh education campaign

The reforms introduced by the Act will only realise their objectives if the people that it affects are aware of it, and understand how it affects them. Government went to considerable efforts to raise awareness of the Act around the time that the Act was passed, but general awareness of the Act appears to have remained low, and the complexity and unfamiliarity of the content of the Act have meant that many do not know how to work with it.

My anecdotal understanding is that there is now a higher level of awareness of the Act, especially among small businesses, but that more can still be done to ensure that businesses and consumers that are affected by the Act are aware of it.

I believe that the recommendations in Chapters 4 to 9 will help to make the Act simpler and clearer, and so much easier to understand and work with. The Act will always be a complex piece of legislation, however, and its implications for businesses and consumers will not always be straight-forward. In addition to increasing public awareness of the existence of the Act, Government should also take steps to increase understanding, among both businesses and the legal community, of the detailed effects of the Act. I make some recommendations on these matters in Chapter 10 as well.

1.8 Location of responses to the Terms of Reference

The table below shows where this report responds to the issues that the Terms of Reference identified for investigation by the review.

Issue identified by the Terms of Reference		Where it is addressed in the report
1.	Effect of the reforms introduced by the Act	Section 3.3.
2.	Levels of awareness and understanding of the Act	Section 3.1.
3.	Incidence and causes of non-compliance with the Act	Section 3.2.
4.	Opportunities for minimising regulatory and administrative burdens, including costs	Section 3.4; Chapters 4 to 9.
5.	Opportunities for further efficiencies	Section 3.4; Chapters 4 to 9.
6.	Scope and definitions of personal property covered by the Act	Chapter 4.
7.	Desirability of specifying thresholds for the operation of the Act	Section 4.5.17.
8.	Interaction of the Act with other legislation	Section 9.2.
9.	Other relevant matters	Chapters 4 to 9; Chapter 10.

Chapter 2
Introductory matters

CHAPTER 2

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2.1 The objectives of the Act, and of this review

2.1.1 The role of secured credit in our economy

Credit can be secured or unsecured. If a lender provides a borrower with unsecured credit, the lender is relying solely on the borrower's promise that the borrower will repay the credit. If the borrower fails to make the repayment, the lender's only remedy is to go to court and get a judgment that orders the borrower to do so. Even if the lender gets the court order, if the borrower then fails to comply with the order there is still very little that the lender can do itself to recover the payment. The lender's best option is most likely to be to have the judgment executed against the borrower's property, but this is not something that the lender can do itself. Rather, the lender needs to involve the court system again, and to ask the court to arrange for a court-appointed sheriff to seize some of the borrower's property, sell it, and use the proceeds to pay the lender what it is owed.

If the lender takes security over some of the borrower's property to secure the borrower's obligations, the lender's position is much improved. The lender still has the same remedies as if it had provided unsecured credit. In addition, though, the lender can endeavour to recover what it is owed by taking its own action against the secured property (or collateral), without the need to obtain a court order. Typically, the lender would seize the secured property, sell it, and use the sale proceeds to repay itself. This is likely to provide the lender with a better and faster outcome than if the credit had been unsecured.

Secured credit also has another distinct advantage over unsecured credit. If the lender only provides the borrower with unsecured credit and the borrower becomes bankrupt or goes into liquidation, the lender is at risk of recovering little or none of what it is owed, as the lender and all other unsecured creditors will only get to share in whatever money remains available for this purpose after all the senior-ranking creditors have been paid in full. If the lender takes security for its debt, however, it will generally rank ahead of unsecured creditors to the value of the property that it has security over. This greatly enhances the lender's ability to recover what it is owed.

For these reasons, security can greatly reduce the risks that are inherent in the provision of credit. Because the risk of secured credit is lower, a secured creditor may be more willing to provide finance, or may be prepared to provide the finance at a lower rate of interest. This can improve the flow of credit through the economy, and stimulate both commercial and private activity by making it easier and more cost-efficient for businesses and consumers to fund themselves.

As a matter of economic theory, however, it is not clear why this should be so. If one creditor is able to offer more competitive terms because it has reduced its risk by taking security, the risk to other creditors will have correspondingly increased. In theory, this means that those other creditors should want to reduce the amount of credit that they are prepared to make available, or to increase its cost. As a matter of mathematics, this should be a zero sum game – the advantages produced by secured credit should be counter-balanced by the corresponding detriments to the debtor's ability to raise unsecured credit. This means in theory that debtors should be at best indifferent to whether or not they use secured credit.

As one commentator has pointed out, though, there is an embarrassing mismatch between theory and practice.[1] Borrowers regularly provide lenders with security in support of their obligations, and in my experience borrowers believe that it is advantageous for them to be able to do so. A number of theories have been put forward to explain this.[2] Whatever the reasons, though, it is clear that the ability to use assets as security for obligations is an established and desired feature of our legal system.

2.1.2 The objectives of the Act – an entirely new regime for secured transactions

The reforms implemented by the *Personal Property Securities Act 2009* (referred to in this report as the *Act*) and the associated *Personal Property Securities Regulations 2010* (the *Regulations*) have wrought profound change to the fabric of Australian commercial law.

The Act established an entirely new regime for the creation, legal effect and enforcement of security interests in personal property. It replaced a number of complex and fragmented sets of rules – rules that were scattered across more than 70 Commonwealth, State and Territory statutes and the general law – with a single set of rules that apply to security interests in personal property regardless of their form, the location or nature of the grantor or the location or nature of the collateral.

The secured transactions laws across Australia before the introduction of the Act were confused and disjointed. While the rules affecting secured finance to large companies were relatively well understood within the legal and business communities and were only infrequently the source of confusion or controversy, the position in relation to the provision of secured finance to small businesses and individuals was much less satisfactory. Many State or Territory laws were inherited remnants of older legislative packages that did not fit comfortably with modern commercial practices, or often with other laws of the same jurisdiction. The legal requirements in one State or Territory could also be at odds with those of other States or Territories, and while this may have been a less pressing concern in earlier times it presented a considerable challenge for financiers in today's economy. Capital, property and people are all much more mobile than in the past, and financiers need to ensure as a result that their documents and procedures are capable of meeting the relevant legal requirements in multiple jurisdictions. This was not conducive to market efficiency, and resulted in unnecessary cost to borrowers and inflexible lending practices. The uncertain and at times archaic state of the previous laws also made financiers reluctant to accept some types of property as collateral.

The Act was intended to reduce the costs of borrowing and increase the range of property available to secure finance, especially for smaller businesses, by replacing the previous messy patchwork of old laws with a single set of rules that apply consistently and predictably to all types of security interest and all types of personal property, regardless of the location or nature of the personal property or the grantor. As the Government put it, the over-arching goals of the Act were to:

1 Duggan & Brown, para 1.9.

2 For a discussion of the reasons, see J Armour, *The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?* (2008) 5 European Company and Financial Law Review 3.

- increase the consistency and certainty of secured finance in Australia;
- reduce the complexity and cost of secured finance in Australia; and
- enhance the ability of businesses and consumers to use their assets as security, and improve their ability to access cost-effective finance in Australia.

The Act did not attempt to do this by simply standardising the rules for existing legal structures. While this would have improved consistency of treatment across Australia for individual types of financial products, it would not have improved a business's ability to use all its types of property as collateral. Also, because the tradition of our legal system is to base the legal effect of a transaction on the form that the parties choose for the transaction rather than its underlying commercial substance, this approach would have failed to eliminate much of the complexity of the previous rules, as different financing products would have continued to have quite different legal effects, even where they were designed to achieve a similar commercial purpose.

Rather than retain existing legal concepts and standardise them, the Act took a very different approach. It largely ignores the form that parties choose for their transaction or even who has title to the property, and instead focuses on the transaction's commercial substance to determine whether it should be treated as a security interest. In doing this, the Act draws on principles that have been developed and implemented in a number of overseas jurisdictions, most notably in the United States (in Article 9 of its Uniform Commercial Code), Canada and New Zealand.

This was a radical shift in approach. Before the commencement of the Act, Australian secured transactions law recognised only four types of transaction (mortgages, charges, pledges and liens) as a security interest. Other types of transactions were not treated by the law as security arrangements, even if they achieved a similar commercial effect, and were governed by different sets of rules. This gave the parties to a transaction the liberty to determine the legal consequences of their arrangement by choosing the form of transaction that most suited them.

It was not uncommon for a finance-like transaction to be structured in a manner that fell outside the boundaries of secured transactions law. For example, it is very common for a manufacturer or supplier of goods to sell the goods on retention of title terms, or for an owner of goods to make the goods available to a third party by way of lease. Both arrangements allowed the owner of the goods to "secure" its position in the transaction through the fact that it retained title to the goods, rather than by taking a formal security over them. These types of transactions relied for their efficacy on the well-established principle of sanctity of ownership, enshrined for lawyers in the Latin expression *nemo dat quod non habet* (a person cannot give that which they do not have).

This ability of contracting parties to choose the structure of their transaction came however at the expense of transparency to outsiders, as the existence of a finance-like transaction might or might not be apparent to others, depending on the form that the parties chose for the transaction. The Act seeks to redress this by regulating transactions according to their commercial substance rather than their legal form. Perhaps the most notable (and for many the most surprising) consequence of this approach is that ownership of an asset is no longer sufficient to protect a party, as an ownership interest in property can become subordinate to the interest of a third party, or even lost entirely, in some circumstances.

This change is the underlying source of many of the concerns that have been expressed in relation to the Act, and is a recurring theme in many of the matters that are discussed in the main body of this report.

2.1.3 The task of the review is to recommend changes to the Act, not to re-write it

The Act raises many issues on which reasonable minds can and do differ. While it was clear from information provided to the review that there are many issues on which there is a strong consensus for change, there were also a number of issues on which views were more divided, with some stakeholders in favour of change, and others against it.

The approach I have taken in this report is to not recommend a change unless there is a clear case for it. This reflects the fact that the task for the review as set out in the Terms of Reference was to recommend amendments to the Act, not to design a fresh version of the Act from the ground up.

For the most part, my recommendations reflect the majority view of respondents. There are a small number of issues on which I have recommended a change that did not enjoy clear support, however, particularly where the views of respondents did not provide a clear consensus position. Those issues, and the reasons for the recommendations I have made, will be apparent from the discussion of the Act in the main body of this report.

2.1.4 Criteria used to assess proposed changes

In formulating my recommendations, I have endeavoured to assess proposed amendments by reference to:

- the significance of the concern that the amendment sought to address;
- the impact that the proposed change would have on all parties; and
- the impact that the proposed change would have on the ability of the Act to achieve its over-arching aims as set out above in Section 2.1.2.

The over-arching aims of the Act are very general in nature, however, and do not provide much concrete guidance for the task of assessing the merits of individual proposed amendments. For that a set of more specific guidelines was needed, so I set out in the Interim Report the guidelines that I proposed to use for this task. For convenience, those guidelines are repeated in Annexure B to this report.

2.2 The history of personal property securities reform in Australia

2.2.1 The early years

The passage of the Act through Parliament in late 2009, and the commencement of the Act's operative provisions some two years later on 30 January 2012, were the culmination of reform efforts that stretched back over almost four decades.

A reform initiative for Australia along the lines of the Act was first proposed by an *ad hoc* committee of the Law Council of Australia in the early 1970s.[3] That committee had been tasked to undertake a broad review of Australian consumer credit laws. In its report, the committee recommended among other things that

3 Law Council of Australia, 'Report on Fair Consumer Credit Laws Laws' (Committee Report, 18 January 1972). The committee is often referred to as the Molomby Committee.

Australia reform its secured transactions laws along the lines of Article 9 of the Uniform Commercial Code in the United States. The report expressed the view that it was "plain" that transactions with the same commercial substance should be regulated in the same way, and that:

> [t]here ought to be no distinction between the manner of regulation of the security aspects, on the one hand, of hire-purchase and conditional sale agreements, and on the other of bills of sale and chattel mortgage securities.[4]

That report led ultimately to the enactment of comprehensive consumer credit laws across Australia. The recommendations relating to secured transactions laws were not acted on, however.[5]

In the early 1990s, the Law Reform Commissions in each of Victoria, New South Wales and Queensland, as well as the Australian Law Reform Commission, were asked to undertake reviews of personal property securities laws. The expectation had been that the four law reform commissions would work together and produce a joint report. However, while there was a high degree of consensus across the four bodies on most issues, including on the need for reform, there were a number of important areas on which they were not able to agree. As a result, the Victorian and Queensland Law Reform Commissions published a joint discussion paper in August 1992 without the participation of the other two bodies.[6] The Australian Law Reform Commission then published a separate discussion paper, prepared in conjunction with the New South Wales Law Reform Commission, a short time later.[7] The Australian Law Reform Commission followed its discussion paper up with an interim report, in May 1993.[8]

2.2.2 The lead-up to the Act

Even though the four law reform commissions were unanimous in their agreement on the need for reform, their inability to agree on some key issues appears to have robbed the reform process of most of its momentum. Much of the credit for keeping the cause alive over the following years goes to the late Professor David Allan of the Bond University Law School. In early 2005, Professor Allan was able to convince the then Commonwealth Attorney-General, Phillip Ruddock, that he should consider reform of Australia's personal property securities laws. Professor Allan was invited to present on that topic to a meeting of the Standing Committee of Attorneys-General (*SCAG*), and SCAG then formed a working group to consider the proposal further.

SCAG issued an options paper on personal property securities reform in April 2006,[9] and followed it up with three discussion papers over the ensuing 12 months.[10] That then led to the publication in May 2008 of a Consultation Draft

4 Ibid, para 5.9.5.

5 But did lead to the enactment in Victoria of the *Chattel Securities Act 1987* (Vic).

6 Queensland Law Reform Commission and Victoria Law Reform Commission, 'Personal Property Securities Law: A blueprint for reform' (QLRC Discussion Paper Number 39 and VLRC Discussion Paper Number 28, August 1992).

7 Australian Law Reform Commission and New South Wales Law Reform Commission, 'Personal Property Securities' (ALRC Discussion Paper Number 52, NSWLRC Discussion Paper 28, August 1992).

8 Australian Law Reform Commission, 'Personal Property Securities' (Interim Report, Number 64, May 1993).

9 Standing Council of Attorneys-General, 'Review of the law on Personal Property Securities' (Options Paper, April 2006).

10 Standing Council of Attorneys-General, 'Review of the law on Personal Property Securities – Registration and Search Issues' (Discussion paper 1, November 2006); Standing Council of Attorneys-General, 'Review of the law on Personal Property Securities – Extinguishment, Priorities, Conflict of Laws, Enforcement, Insolvency' (Discussion paper 2, March 2007); Standing Council of Attorneys-General, 'Review of the law on Personal Property Securities – Possessory Security Interests' (Discussion paper 3, April 2007).

of a *Personal Property Securities Bill 2008*.[11] The Consultation Draft was reworked and reissued in November 2008, as an Exposure Draft.[12] That Exposure Draft was further reworked, and then re-issued in March 2009.[13] That revised draft formed the basis of a Bill that was introduced into the Commonwealth Parliament on 24 June 2009. That Bill was passed by Parliament on 26 November 2009, and received Royal Assent on 14 December 2009.

Although the Act is an enactment of the Commonwealth Parliament, the personal property securities reforms were very much a Federal initiative, under the auspices of the Council of Australian Governments (*COAG*). Indeed, the Act relies in part for its constitutional efficacy on a referral of powers from the States, under paragraph 51(xxxvii) of the Australian Constitution. The basis on which the States were prepared to refer the necessary powers to the Commonwealth is set out in a *Personal Property Securities Law Agreement* that was entered into between the Commonwealth and the States and Territories in October 2008.[14]

Each State referred to the Commonwealth the power to pass the Act in the form that was attached to that State's referral legislation.[15] That legislation also referred to the Commonwealth the power to make certain types of amendments to the Act.[16] This proved to be important, as the Commonwealth Government continued to fine-tune the legislation in consultation with stakeholders after the time at which some of the States had already passed their referral legislation. This explains why Commonwealth Parliament passed legislation to amend the Act, the *Personal Property Securities (Consequential Amendments) Act 2009*, immediately after it passed the Act itself – the Act was passed in the form provided to the States for the purposes of their referral legislation, and was then immediately amended by the *Personal Property Securities (Consequential Amendments) Act 2009* to reflect amendments that the Commonwealth Government had agreed to make in the intervening period.

The Commonwealth Government also went to considerable lengths to bring other Commonwealth legislation into line with the Act. In July 2010, Commonwealth Parliament enacted the *Personal Property Securities (Corporations and Other Amendments) Act 2010*. Commonwealth Parliament then followed that up in May 2011 with the *Personal Property Securities (Corporations and other Amendments) Act 2011*. These Acts amended the Corporations Act and other Commonwealth legislation to keep them consistent with the Act – for example, to reflect the fact that all security interests were now to be perfected by registration on the Personal Property Securities Register, to replace references in that other legislation to "charges", "mortgages" or similar with references to "security interests", and to make other consequential amendments. Both amending Acts also made further amendments to the Act itself.

The States and Territories were not as alacritous as the Commonwealth in amending their legislation to bring it into accord with the Act. In addition to passing

11 *Personal Property Securities Bill 2008* (Cth), May 2008 Consultation Draft.

12 *Personal Property Securities Bill 2008* (Cth), November 2008 Exposure Draft.

13 *Personal Property Securities Bill 2008* (Cth), March 2009 Exposure Draft.

14 *Personal Property Securities Law Agreement* (entered into 2 October 2008).

15 *Personal Property Securities (Commonwealth Powers) Amendment Act 2009* (NSW), *Personal Property Securities (Commonwealth Powers) Act 2009* (Qld) , *Personal Property Securities (Commonwealth Powers) Act 2009* (SA), *Personal Property Securities (Commonwealth Powers) Act 2010* (Tas), *Personal Property Securities (Commonwealth Powers) Act 2009* (Vic), *Personal Property Securities (Commonwealth Laws) Act 2011* (WA),

16 See, for example, section 6(2) of the *Personal Property Securities (Commonwealth Powers) Act 2009* (NSW).

their referral legislation, all States did pass legislation that had the effect of keeping a range of their statutory licences out of the regime established by the Act.[17] The Territories did the same.[18] This is an issue to which I return in Section 4.4.6 below. Apart from this, only New South Wales made any changes to its other legislation to reflect the content of the Act.

2.2.3 Senate inquiries

The Commonwealth Senate conducted four separate inquiries into matters relating to the Act:

- The Senate Standing Committee on Legal and Constitutional Affairs conducted an extensive review into the November 2008 Exposure Draft of the *Personal Property Securities Bill 2008*. It reported in March 2009.[19]
- The Senate Legal and Constitutional Affairs Legislation Committee conducted a further review of the next public draft of the Act, the *Personal Property Securities Bill 2009*. It reported in August 2009.[20]
- The same Committee also conducted a review of the *Personal Property Securities (Consequential Amendments) Bill 2009*, and a separate review of the *Personal Property Securities Amendment (Registration Commencement) Bill 2011*. Those reviews reported in November 2009 and November 2011 respectively.[21]

2.2.4 Private sector input

The Commonwealth Government provided the private sector with a number of opportunities to provide input into the shape of the Act – by responding to the initial options and discussion papers, by providing commentary on successive drafts of the Bill and related legislation, and by making submissions to the Senate inquiries. Despite this, it is clear from submissions to the review that there continues to be a high level of dissatisfaction with aspects of the Act across the private sector. As I see it, there are a number of reasons for this:

- **Novelty of the concepts** – the principles that underpin the Act derive in large part from the North American legislative models of Article 9 of the Uniform Commercial Code in the United States, and the *Personal Property Security Acts* in Canada. This has the result that the Act relies in part on concepts that are unfamiliar to Australian eyes, and not necessarily reflective of Australian conditions. This made it difficult to provide meaningful comments on the draft legislation.

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17 *Personal Property Securities Legislation Amendment Act 2010* (NSW), *Personal Property Securities (Ancillary Provisions) Act 2010* (Qld) , *Statutes Amendment (Personal Property Securities) Act 2011* (SA), *Personal Property Securities (National Uniform Legislation) Implementation Act 2010* (Tas), *Personal Property Securities (Statute Law Revision and Implementation) Act 2009* (Vic), *Personal Property Securities (Consequential Repeals and Amendments) Act 2011* (WA),

18 *Personal Property Securities Act 2010* (ACT); *Personal Property Securities (National Uniform Legislation) Implementation Act 2011* (NT).

19 Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, *Personal Property Securities Bill 2008 [Exposure Draft]* (2009).

20 Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, *Personal Property Securities Bill 2009 [Provisions]* (2009).

21 Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, *Personal Property Securities (Consequential Amendments) Bill 2009 [Provisions]* (2009); Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, *Personal Property Securities (Registration Commencement) Bill 2011 [Provisions]* (2011).

- **Size of the task** – the Act is a substantial body of work (running to over 320 pages), and applies in often unexpected ways to many facets of our economy. Commenting on drafts of the Act was a time-consuming task. Resource limitations meant that commentators were forced to be selective in the matters that they chose to address in their comments, and that commentators focussed for the most part on just key issues. This in turn had the result that many second-order issues remained unaddressed, even though they were by no means unimportant.

  The task of commenting on the draft legislation was exacerbated by the tight timeframes that Government set for finalising the content of the Act.

- **Complexity of the subject matter** – the Act affects many areas of economic activity, and many of those areas are themselves complex. This made it difficult for the Government officers who were charged with settling the content of the Act to assess the impact of many of the comments that were being made by the private sector. As a result, many worthwhile comments were not adopted.

2.2.5 Proposals for a review

A number of submissions to the 2008-2009 Senate inquiry into the Exposure Draft of the *Personal Property Securities Bill 2008* said that the Act should be reviewed after it had been in operation for a period of time. The Standing Committee on Legal and Constitutional Affairs agreed in its report that such a review would be warranted. The committee made this recommendation:

> The committee recommends that the bill include a requirement that the operation of the bill be reviewed three years after it commences in a process that includes extensive consultation with industry, governments, lawyers, consumers and academics.[22]

That recommendation led to the inclusion in the Act of s 343, the last section in the Act. That section provides the legislative basis for this review.

2.3 International precedents

Australia is not the first country to pass legislation along the lines of the Act. The principles that underpin the Act were first developed in the United States in the 1940s and 1950s, in an ambitious project to standardise US secured transactions laws that resulted in the promulgation in the early 1950s of Article 9 of the Uniform Commercial Code. Similar to Australia, secured transactions laws in the United States are primarily a responsibility of the states rather than the federal government, but all the US states have adopted Article 9 with just minor local variations, with the result that the secured transaction laws across the United States are now largely uniform.

The core principle that underpins Article 9, and what is said to be its most significant intellectual achievement, is the recognition that secured transactions should be regulated on the basis of their commercial substance, not their legal form. If a transaction operates in commercial substance to secure payment or performance of an obligation, then it should be subject to the same rules as all other secured transactions, regardless of the form of the transaction or the location of title to the collateral.

22 Senate Legal and Constitutional Affairs Legislation Committee, Parliament of Australia, Personal Property Securities Bill 2008 [Exposure Draft] (2009) 33.

Article 9 has been revised on a number of occasions. It has remained true, however, to that unifying principle, that all transactions that are in substance security transactions should have the same legal implications.

Canadian provinces started to follow the US lead some two decades after Article 9 was first adopted in the United States. The largest Canadian province, Ontario, was the first to do so, enacting a *Personal Property Security Act* in 1967 (although that Act did not come into operation until 1976). Other Canadian provinces then did the same over the following decades, and a *Personal Property Security Act* (*Canadian PPSA*) is now in operation in all the Canadian provinces other than the civil law province of Quebec. The legislation in force in all the Canadian provinces other than Ontario is based substantially on a model statute that was prepared by what is now the Canadian Conference on Personal Property Security Law. Ontario's *Personal Property Security Act* is based on the same principles and is in many respects very similar, but differs from the model statute in a number of respects.

The next large common law jurisdiction to adopt similar legislation was New Zealand. New Zealand's *Personal Property Securities Act* (*NZ PPSA*) was passed in 1999, and commenced operation in 2002. The NZ PPSA is based very closely on the Canadian model statute, and in particular follows very closely the legislation enacted in the Canadian province of Saskatchewan.

The broad architecture of the Act is based on the same principles as were used to frame Article 9, the Canadian PPSAs and the NZ PPSA. This was confirmed by the Replacement Explanatory Memorandum for the Act, which stated:

> The Bill is modelled on the New Zealand, Canadian and US legislation. It also draws on work by the United Nations Commission on International Trade Law (UNCITRAL) and the International Institute for the Unification of Private Law (UNIDROIT).[23]

As the quoted text notes, the Act also draws on work by UNCITRAL and UNIDROIT. The principal body of work prepared by UNCITRAL on secured transactions law is its *Legislative Guide on Secured Transactions*, published in 2007.[24]

UNIDROIT has promulgated conventions on a range of matters relevant to commercial law. The Convention that is most obviously of potential relevance to the content of the Act is the *Convention on International Interests in Mobile Equipment* (also known as the *Cape Town Convention*) of 2001.

2.4 How the review has been conducted

2.4.1 Launch of the review by the Attorney-General

The Attorney-General, Senator the Hon George Brandis QC launched the review on 4 April 2014, and issued terms of reference for its conduct. The Terms of Reference are set out at the start of this report.

The legislative basis for the review is s 343 of the Act. Section 343 says this:

> (1) The Minister must cause a review of the operation of this Act to be undertaken and completed within 3 years after the registration commencement time.
>
> Note: For ***registration commencement time***, see section 306.

23 Replacement Explanatory Memorandum, page 11.

24 UNCITRAL has since supplemented that work with two further publications: its *Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property* (published in 2010), and its *Guide on the Implementation of a Security Rights Registry* (published in 2013). However, the final forms of these two documents were both published after 2009, so they are less likely to have influenced the content of the Act.

(2) The persons who undertake the review under subsection (1) must give the Minister a written report of the review.

(3) The Minister must cause a copy of the report of the review under subsection (1) to be tabled in each House of the Parliament within 15 sitting days of the day on which the report is given to the Minister.

2.4.2 First-round submissions, and the Interim Report

The Terms of Reference called for the preparation of an interim report by 31 July 2014 on the impact of the Act on small business. The Terms of Reference also required that the review include consultation with relevant stakeholders. To that end, the Attorney-General's Department established a website for the review, and on 14 April 2014 issued a call for submissions on issues particularly affecting small business.

The review employed a targeted campaign to engage with key small business stakeholders about the review. Steps taken to raise awareness of the review included:

- social media advertising on Facebook and Google;
- the issue of over 100 letters to small business industry organisations, advocates and advisers;
- advertising of the review through the homepage of the Register and via the Registrar's monthly newsletter;
- notifications of the review and the call for submissions that were sent to the AFSA's Personal Property Securities Stakeholder forum, for distribution to their members; and
- advertising of the review and call for submissions on a number of communication channels through business.gov.au.

The deadline for submissions for the Interim Report was 6 June 2014. The review received 37 submissions for the Interim Report, 35 of which have been published on the review website. These submissions came from a wide range of stakeholders, including:

- industry organisations;
- individual businesses;
- law firms (large, medium and small);
- law societies; and
- government organisations representing small businesses, consumers and privacy interests.

The Interim Report was delivered to the Attorney-General and the Hon Josh Frydenberg MP, Parliamentary Secretary to the Prime Minister on 31 July 2014, as required by the Terms of Reference. It was released to the public on 15 August 2014.

2.4.3 Second-round submissions

On the same day as the review called for submissions to the Interim Report, the review also invited stakeholders to make submissions on issues relating to the Act more generally. Stakeholders were asked to lodge these second-round submissions by 25 July 2014.

The review received 55 second-round submissions, 53 of which have been published on the review website. Similar to the first-round submissions for the Interim Report, these submissions also came from stakeholders with a wide range of backgrounds, including:

- industry organisations;
- individual businesses;
- law firms (large, medium and small);
- law societies; and
- government organisations representing small businesses, consumers and privacy interests.

The review also received a number of submissions from organisations and political representatives in the United States of America.

2.4.4 Consultation Papers

Following receipt of the second-round submissions, the review issued four Consultation Papers:

	Topic	Release Date
1.	Reach of the Act	22 September 2014
2.	Creation and perfection of security interests; taking free rules; priority rules; and other dealings in collateral	3 October 2014
3.	Enforcement of security interests; vesting of security interests on a grantor's insolvency; interaction with other legislation; governing law rules; other provisions in the Act; layout of the Act and related matters	17 October 2014
4.	The register	10 November 2014

The Consultation Papers pulled together the issues that had been raised in the submissions, and a range of other questions for consideration. The Consultation Papers summarised the policy and other matters that are relevant to each of the issues, and invited stakeholders to comment on them. Where appropriate, the Consultation Papers also indicated the recommendations that I was proposing to make.

The review secretariat prepared and issued a response template for each Consultation Paper. The response templates assisted respondents with the structure of their responses, and me with the task of reviewing and comparing the many comments.

The review received a total of 83 responses:

	Consultation Paper	Number of responses
1.	Reach of the Act	27
2.	Creation and perfection of security interests; taking free rules; priority rules; and other dealings in collateral	20
3.	Enforcement of security interests; vesting of security interests on a grantor's insolvency; interaction with other legislation; governing law rules; other provisions in the Act; layout of the Act and related matters	15
4.	The register	21

Respondents again represented a wide range of stakeholders, including:

- industry organisations;
- individual businesses;
- law firms (large, medium and small);
- law societies;
- government bodies; and
- academics (based both in Australia, and overseas).

Their responses provided the foundation for most of the recommendations in this report.

2.4.5 This report

This report was delivered to the Attorney-General and the Parliamentary Secretary to the Prime Minister on 27 February 2015.

The substantive parts of this report are Chapters 3 to 10. Chapter 3 comments on how the Act has been received over its first 3 years of operation, and on the extent to which it has achieved its objectives. Much of the content of Chapter 3 has been drawn from the Interim Report. Chapters 4 to 9 then examine the Act and the Register in detail, and make a range of recommendations for reform. Chapter 10 discusses implementation issues, including the need for a comprehensive awareness-raising and education campaign, and again makes a number of recommendations.

The discussion of each topic in Chapters 4 to 9 begins with an explanation of the issue, and how it was presented in the Consultation Papers. It then sets out the views expressed by stakeholders in their responses, and discusses the issue further where this is needed. The discussion then finishes with my recommendations.

I have endeavoured where relevant to identify the submissions that raised the issues discussed in this report. To keep the content of this report more manageable, though, I have only identified individual responses to the Consultation Papers where they raised a particularly interesting perspective on an issue, or where they presented a view that was deserving of separate discussion.

It will be seen that there were a number of issues in relation to which I was not in a position to make a specific recommendation. Where that was the case, I have instead recommended steps that Government could take in order to come to a decision on the matter.

Finally, the footnotes to this report use abbreviations to identify the authors of the submissions and responses, as well as the stage of the review at which the submission or response was provided. The abbreviations are explained in Part B of Annexure D.

Chapter 3

Impact of the Act over its first three years – the case for reform

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3.1 Levels of awareness and understanding of the Act

3.1.1 Levels of awareness of the Act

It was clear from submissions to the review that many businesses, particularly small businesses, were not prepared for the Act when it commenced practical operation in January 2012. Despite the education efforts that had been undertaken by Government in the lead-up to the commencement of the Act, many small businesses remained quite unaware of the Act, and of the impact that it could have on their operations. Some unfortunate business-owners first learnt of the Act when they discovered that they had lost ownership of their property to an insolvent customer, because they had not perfected their interest in their property under the rules set out in the Act.

The Government was aware, when planning the introduction of the Act, that it would need to undertake a broad-based education campaign to inform the business and wider community of the reforms. Over an extended period beginning in 2006, the Government conducted a range of education and awareness–raising activities, including:

- a multi-facetted media campaign;
- mail-outs;
- presentations at industry conferences, seminars and stakeholder forums;
- information brochures, fact sheets and videos; and
- a personal property securities (PPS) road show.

The PPS road show was specifically targeted at small businesses, and at the accounting and other advisers that service them. Unfortunately, it seems that the seminars were generally not well attended.

The apparent lack of awareness or interest among the small business community regarding the need to come to grips with the new regime appears to have been a harbinger of things to come. Almost all of the first-round submissions made the point that much of small business was still either entirely unaware of the existence of the Act, or did not understand the extent to which the Act can impact on their business activities. The New South Wales Small Business Commissioner noted, for example, that:

> …there is a very low level of awareness amongst small businesses of the [Act] and the Personal Property Securities Register.[1]

The Australian Finance Conference and the Debtor and Invoice Finance Association both made the same point. They referred to:

> …a lack [of] awareness of the Act by the broader business community and many of its advisors.[2]

1 NSWBC, S1 page 1.

2 AFC, S1 page 2; DIFA, S1 page 2.

The Commercial Asset Finance Brokers Association of Australia emphasised the lack of awareness in these terms:

> One of the key failings of the [Act] is the education of small business on its importance and small business obligations under it. Not many in small business know about it – "how can you comply if you don't know about it".[3]

A number of small businesses provided their own separate submissions to the review. One of those submissions came from Elphinstone Engineering, a small business in Tasmania. They said that they:

> …have spoken to a broad range of people and are simply staggered at the lack of knowledge in the community of the existence of [the] Act.[4]

3.1.2 Levels of understanding

3.1.2.1 Understanding of the Act

It was also clear from submissions to the review that even businesses that are aware of the Act have found it challenging, and often do not appreciate the impact that the legislation can have on them.

The Australian Bankers' Association noted for example that:

> Overall … small businesses have an insufficient understanding of the Act and its provisions.[5]

The Combined Small Business Alliance of WA similarly observed that:

> …generally speaking small businesses are at [a] loss in understanding how to interpret [the Act] or use it properly.[6]

This lack of understanding does not appear to be limited to specific industry sectors. It was identified as an issue not only in submissions from organisations that span the economy generally, but also from organisations from a wide range of specific industries or sectors, such as:

- the rural sector;[7]
- the building and construction industry;[8]
- the retail sector;[9] and
- importing/wholesale businesses.[10]

An insufficient appreciation of the Act has had particularly severe impacts on the equipment hiring industry. While the general level of awareness of the Act may be no lower in that industry than across the small business community generally, the hiring industry appears to have been more severely impacted by the reforms than most others. The level of concern in the hiring industry is reflected in the large number of submissions that were made by hiring businesses themselves.

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3 CAFBA, S1 page 2.
4 Elphinstone, S1 page 3.
5 ABA, S1 page 1.
6 CoSBA, S1 page 1.
7 NFF, S1; ALPA, S1.
8 CCF, S1; MBA, S1.
9 RCIA, S1.
10 Electaserv, S1.

That concern was also echoed in a number of submissions from other organisations or bodies. BusinessSA, for example, observed that:

> …the average small hire business is thoroughly confused as to their exposure under the Act.[11]

EDX, a PPS advisory and registration business, similarly observed that:

> …the degree of confusion amongst businesses on the application of and compliance with the Act is high, [and] this is particularly true of businesses in the equipment hire sector.[12]

The Australian Bankers' Association suggested that part of the difficulty stems from the fact that small businesses have not been able to accept that they are no longer sufficiently protected by being the owner of their assets:

> One factor that seems to be prevalent is small businesses not coming to grips with the notion that title to personal property has become subordinated to the notion of a security interest. This has led to a consequential lack of knowledge by a business on how the Act is able to protect the business' interests where personal property moves beyond the control of the business.[13]

The Commercial Asset Finance Brokers Association of Australia suggested that the very name of the Act contributes to the confusion:

> Confusion begins for a small business with the common name for the … Act, ie the **Personal Property** Security Register. Most small business would not identify that the … Act applies to assets or equipment used in their business, by the very nature of the name. Most equate "Personal" to apply to personal assets, not those associated to their business.[14]

These have not just been theoretical concerns. Two submissions from individual small businesses (one of which was submitted on a confidential basis) explained how they had lost assets in a customer's administration because they had not appreciated that their ownership of the assets was no longer sufficient to protect them under the new rules. Both submissions expressed surprise and dismay at the fact that this could be possible.

These are not just isolated examples. Insolvency practitioners have been astute in their conduct of insolvency proceedings to test whether businesses that have hired goods to an insolvent company have satisfied the requirements of the Act. The same applies in relation to other secured parties, particularly suppliers who have sold goods to an insolvent company on a retention of title basis. This is not intended by any means to be a criticism of those insolvency practitioners – indeed, it is their responsibility in their role to test the claims of secured parties in this way. Anecdotal evidence does suggest, however, that the issue for hirers and suppliers is widespread. The same conclusion can be drawn from some of the early case law in relation to the operation of the Act.[15]

So it is clear in my view, both from the submissions and from other evidence, that many businesses, particularly small businesses, are not sufficiently aware of the Act and its implications for them, whether positive or adverse. The potential

11 BusSA, S1 page 3.

12 EDX, S1 page 3.

13 ABA, S1 page 1.

14 CAFBA, S1 page 2.

15 See, for example, *Re Maiden Civil (P&E) Pty Ltd; Albarran v Queensland Excavation Services Pty Ltd* [2013] NSWSC 852.

for adverse outcomes for small businesses, in particular, is magnified by the very fact that they are small – a small hiring business, for example, may only have a relatively small pool of assets, and the loss of any of those assets in the insolvency of a customer can have a disproportionately severe impact on the viability of the business as a whole.

3.1.2.2 Understanding of the Register

It was clear from submissions to the review that the Register, also, is far too complex. Businesses find the Register daunting – full of jargon, and unfamiliar concepts. When registering a financing statement, the Register asks them to answer questions that they cannot readily understand. Often they cannot even understand why the question is being asked. This leaves a registrant in the very unsatisfactory position of not knowing whether they have answered the questions accurately, or whether (despite their efforts) their registration is incorrect, leaving them unperfected and exposed.

Many submissions described the Register as being unnecessarily complex. This is a "real life" concern for all businesses, as a registration that does not satisfy the requirements of the Act and the Regulations is likely to be ineffective. This would leave the secured party with only an unperfected security interest, and so at risk of losing its asset to a third party, or on an insolvency of its customer.

One submission made the point in this way:

> The PPSR has many welcome attributes, but at the moment there are too many traps for the unwary and it is self-defeating in terms of one of the key objectives of the PPSA project: simplicity and ease of use. This is particularly acute for small businesses when they are faced with the necessity of registering security interests granted to them, and paying the costs of secured parties in relation to security interests given by them. In particular there are choices and limitations which often mean that it is difficult to complete properly a registration without professional help, errors are easy to make (many of which can be fatal to a registration) and multiple registrations can be required for a single transaction.[16]

Two submissions from small business owners observed that "the process is complicated and difficult to properly understand". They both went on to say:

> We have found that the PPSR is not simple to use, it is confusing as to precisely what type of registration guarantees title protection and has increased rather than reduced our compliance costs.[17]

The Commercial Asset Finance Brokers Association of Australia echoed this view, maintaining that the registration process "is not intuitive and is very difficult to navigate", and is "complex and full of jargon".[18] BusinessSA observed that small businesses find the register "very cumbersome", and that small hiring businesses have suffered "overwhelming frustration" with it.[19]

This complexity and uncertainty also affects users who want to conduct a search on the Register.

16 JLF, S1 page 4.

17 Chalkwest, S1; Payne, S1. I should note for completeness that the register does not in fact guarantee title protection. The authors of these submissions appear to have made this observation from the perspective of a lessor, for which registration can assist to preserve their title by perfecting their security interest.

18 CAFBA, S1 page 2.

19 BusSA, S1 page 2.

In my view, the Register should be a particular focus area for simplification. While much of the content of the Act itself does not directly impact the daily activities of businesses, the same cannot be said for the Register, or for those parts of the Act that shape the operation of the Register. Businesses interact with the Register on a daily basis, and the design of the Register and the rules that underpin it need to be as simple and certain as possible, so that they can use the Register effectively and with confidence.

3.1.2.3 The need for a fresh education campaign

Many of the recommendations in this report are targeted at making the Act simpler to understand. The Act deals with a complex area of commercial activity, however, and will never be an easy read. If the Act is to achieve its potential, Government will need to coordinate an effective education campaign in support of the re-launch of the Act that will hopefully follow on from this report. I return to this topic in Chapter 10.

3.2 Incidence and causes of non-compliance with the Act

3.2.1 The meaning of "non-compliance"

The Act, for the most part, is not a regulatory statute, in that it does not oblige secured parties, grantors or others to conform to specified behavioural standards. Instead, the Act sets out "rules of the game" for participants in secured transactions that affect personal property, and for third parties who wish to take an interest in personal property that may be subject to a security interest. While the Act does contain some mandatory provisions, for the most part an act or omission that is not consistent with the provisions of the Act will not trigger a breach of the Act. Instead, a person who fails to follow the rules set out in the Act may suffer financial consequences, because they may lose (or discover that they never had) the interest in personal property that they were expecting.

For the purposes of this report, I am taking the reference in paragraph (c) of the Terms of Reference to "non-compliance" with the Act in this broader sense – that is, that I have been asked to comment on incidence and causes of failures by a secured party, grantor or third party to follow the rules set out in the Act in a way that has led or could lead to their suffering loss.

3.2.2 Incidence of non-compliance with the Act

The review has been provided with very little data on the level of non-compliance with the Act. Even though the Act has only been in operation for 3 years, however, it is noteworthy that the volume of case law in relation to the Act is growing quickly, and that a number of cases have been decided in which the court has held that a party has failed to follow the rules set out in the Act or the related provisions in the Corporations Act.[20]

Reported court decisions are almost always just the tip of the iceberg, and in my view that is also the case in relation to the Act. The authors of two first-round submissions explained, for example, how they had lost assets in the insolvency of a customer because they had not perfected their security interest by registering

20 See, for example, *Pozzebon (Trustee) v Australian Gaming and Entertainment Ltd (in liq)* [2014] FCA 1034; *Relux Commercial Pty Ltd (in liq) v Doka Formwork Pty Ltd* [2014] VSC 570; *Central Cleaning Supplies (Aust) Pty Ltd v Swan Services Pty Ltd (in liq)* [2014] VSC 61; *White v Spiers Earthworks Pty Ltd* [2014] WASC 139.

a financing statement against the customer.[21] The national PPS advisory and registration business EDX said in its submission that their experience is that the incidence of non-compliance with the Act is high, and in particular that the incidence of errors in registrations is extremely high among businesses that have not taken expert advice. I am also aware from discussions with insolvency practitioners that a significant proportion of registrations against insolvent companies may not have been made correctly.[22]

These are admittedly anecdotal observations, not hard data. They are however reflective of my own observations, and are consistent with the observations made in many submissions about the lack of awareness and understanding of the Act among businesses. My view is that the incidence of non-compliance with the Act has been and continues to be significant, and that this is detrimental to the achievement by the Act of its objectives.

3.2.3 Causes of non-compliance with the Act

The lack of awareness and understanding of the Act among users is also the primary reason why businesses are failing to comply with it. A person who is not aware of the existence of the Act, or of the fact that it could apply to them, is most unlikely to be operating in a manner that is consistent with the rules set out in the Act, particularly as those rules are very different in some critical respects to the laws that preceded them. Similarly, even people who are aware of the Act and of the fact that it affects them are often failing to comply with its rules because they do not understand those rules properly. One submission from the rural sector observed, for example, that the Act:

> has not achieved a clear and appropriate outcome for small business; rather it has created a raft of uncertainty, misrepresentation and total confusion for all small business operators in Rural Australia.[23]

The extracts from submissions that are set out above in Section 3.1.2 all make the same point: that the Act and the Register are far too complex. This was a consistent theme across the submissions as a whole.

The Act deals with a complex area of the law – one that traverses our entire economy, and that manifests itself in different sectors of the economy in very many different ways. The area does not lend itself to one simple set of rules, and the Act will always be complex. The submissions demonstrated, however, that the Act is more complex than it needs to be. In my view, a number of factors have contributed to this outcome.

First, as noted earlier, many of the concepts and much of the terminology in the Act have been adopted from overseas models. Those models were not created in a legal vacuum, but were founded in and based on the substance of the legal systems for which they were developed. In particular, while Article 9 of the Uniform Commercial Code in the United States was regarded as revolutionary in the way that it created a standard set of rules for all types of security interests, it was also very much a creature of the state of law and commercial practice in the United States at the time it was developed. Clearly, the economic structures and legal systems in Australia in the early 21st century are very different to those that prevailed in the United States in the middle of the previous century. As a result,

21 Elphinstone, S1. The other submission was made on a confidential basis.

22 One practitioner put the proportion at between 10 and 20 per cent of registrations.

23 ALPA, S1 page 3.

terminology and concepts that made sense and were relevant for Article 9 as part of United States law will not necessarily make the same sense, or have the same relevance, in the Act as a component of current Australian law.

Secondly, it appears that the architects of the Act may have tried too hard to be helpful. The Act is far longer than its Canadian and New Zealand counterparts, even allowing for the additional provisions that were included to accommodate constitutional and other machinery requirements. The developers of the Act appear to have endeavoured to produce a "best of breed" piece of personal property securities legislation, by picking out the best elements of the offshore models and then adding additional detail in an effort to explain more clearly exactly what is required. Rather than helping Australian businesses, however, this had the effect of creating very specific and detailed operational requirements. It limited flexibility and required changes to operating practices in order to align them with the structures required by the new rules.

The third main factor that has led to this situation, in my view, is that the development of the Act appears to have been approached as a design process, too divorced from the realities of the marketplace that it was designed for. While Government did provide the business and legal community with opportunities to comment on drafts of the legislation, the sense of many of those who were involved in the consultation process was that input from the business and legal community was not sufficiently incorporated into the policy design and the detailed drafting. As a result, there is a misalignment in some areas between the policy and drafting of the Act on the one hand, and the operating realities of the Australian business environment on the other. This has created confusion and uncertainty, rather than clarity and certainty.

This is not intended to reflect adversely on the individuals involved in the actual drafting of the Act, or those who instructed them. Rather, it is a reflection of the magnitude and complexity of the task.

Whatever the reasons for the confusions and complexities in the Act, they have made the Act very hard to understand and to work with, not just for businesses but even for legal specialists as well. This is exacerbated by the fact that the complexities compound each other – unfamiliar terms and uncertain concepts are used in complex provisions, in a way that can make it even more difficult to determine how those complex provisions inter-relate with each other. The cumulative effect is that the Act can be very difficult to understand and to work with.

It is clear that much can and should be done to streamline the Act, and to align it more closely with the realities of the marketplace that it applies to. That is the subject of Chapters 4 to 9 of this report.

3.3 The effect of the reforms introduced by the Act

3.3.1 Consistency

It is clear that the Act has significantly improved the consistency of Australian secured transactions law. It has replaced a complex and disorganised patchwork of Commonwealth, State and Territory statutes and general law with a single set of rules that apply consistently across Australia to all types of personal property and all types of grantor. The replacement of the previous fragmented array of registration systems with the single Register under the Act has also eliminated

what had been a source of considerable confusion and complexity. In 2013, Australia climbed to tenth place in the World Bank's rating for 'ease of doing business' (*'Doing Business 2013 – Smarter Regulations for Small and Medium-Size Enterprises'*) and the commencement of the Act is said to have been instrumental to this.

As some submissions observed, however, more can still be done to improve consistency across Australia's secured transactions laws. A number of types of personal property or transaction are excluded from the operation of the Act, with the result that businesses and their advisers still need to be aware of the laws outside the Act that will apply where the Act does not, and to apply those laws where the Act has been excluded. This re-introduces (or perhaps retains) some of the form-based distinctions that the Act had sought to eliminate.

3.3.2 Certainty and complexity

The Act has been successful in sweeping away the uncertainties and complexities that plagued the fragmented sets of rules that it replaced. Many submissions argued, however, that the Act has replaced those old uncertainties and complexities with new uncertainties and complexities, because of the unfamiliar terminology, and the complex and difficult drafting, that I referred to earlier in this report.

It is inevitable with any legislative transformation of this scale that there will be some confusion and uncertainty at the outset, as users of the legislation come to terms with the new rules. However, the levels of frustration and anxiety revealed in the submissions go beyond mere "teething" problems. The message from the submissions is that much more can and should be done to help the Act to realise its full potential.

3.3.3 Cost and availability of finance

It was anticipated that the Act would reduce the cost of finance in a number of ways. The cost to financiers of providing finance would be reduced, as financiers would benefit from the removal of the need to maintain multiple sets of documents and procedures for different types of financing product in different States and Territories. Financiers would be able to pass the benefit of these efficiency gains on to their customers. Financiers would also be able to reduce their funding charges to customers, because the elimination of the old uncertainties would reduce the related risk premium that financiers incorporated into the pricing that they offered their customers. Borrowers would also be able to use a wider range of assets as security.

Comments in the submissions and anecdotal evidence both suggest that these benefits are yet to be fully realised. While larger financiers are likely to have generated some cost savings through the standardisation of documents and procedures, they all incurred significant costs in preparing for the introduction of the Act. Financiers also continue to incur legal costs as they come to grips with its complexity. And while I have no evidence on this point, I expect that there has not been as yet any reduction in overall risk premiums charged to borrowers, as the complexities and uncertainties in the Act can still leave financiers unsure of the strength of their legal position.

Indeed, the Master Builders Association argued in its submission that the Act has had the reverse effect: of increasing the costs of obtaining finance for participants in the building and construction industry, and for small businesses generally.[24] The Airconditioning and Mechanical Contractors' Association Ltd of Australia made the same point.[25] The Australian Bankers' Association also pointed out in its submission that the complexity of the Act, and in particular the volume and content of information on the register, can delay transactions, and so have the effect of increasing their cost – additional cost which financiers will inevitably want to pass on to their borrowers as part of the cost of completing the transaction.[26]

Almost all of the submissions from small businesses, or the organisations representing them, identified cost as an issue. Unlike a financial institution, which can usually pass its transaction costs on to its customer, a business that is a secured party under the Act is likely to need to fund the associated costs itself. Those costs include professional advice such as legal fees, the costs of registering financing statements, and the internal administrative costs of dealing with the registrations. To some extent at least, these costs substitute for other costs that secured parties would have incurred under the previous regimes. But for suppliers with a large customer base, or for hiring businesses with a large customer base or that hire out serial-numbered goods, these costs can be significant. And the relative cost for a small business of getting a registration wrong can also be significant, as it could lead to the loss of what might be a substantial part of its asset pool, if a customer becomes insolvent.

Amending the Act will not reverse the fact that costs have already been incurred in adjusting to the new regime. It is clear though that businesses, both small and large, would benefit from any steps that can be taken to reduce the costs that parties need to incur going forward.

There is no doubt that the replacement of the previous confusion of overlapping and fragmented regimes for different types of secured transactions with a single consistent set of rules for all types of security interests over all types of personal property has the potential to unlock value for Australian businesses and consumers, by making it easier for them to use their assets as security and to access cost-effective finance. The submissions indicated, however, that the Act has yet to realise this potential.

3.3.4 The effects of the reforms for consumers

The Act is likely to affect a consumer in two ways:

- as a borrower who grants a security interest; or
- as a person who searches the Register for encumbrances over an item of personal property (in most cases, a motor vehicle).

Consumers as borrowers

The review has not been provided with any data about the impact that the Act may have had on a consumer's ability to use their assets as security, or to raise cost-effective finance. My expectation, however, is that the Act is yet to make an appreciable positive impact on either of these goals, for the same reasons as I

24 MBA, S1 page 5.
25 AMCA, S1 page 2.
26 ABA, S1 page 3.

have discussed above in relation to small businesses. While the Act has produced greater consistency across Australia's secured transactions laws, the complexity of the Act, and the uncertainty that results from that complexity, have not reduced cost or risk for financiers, and so have not yet made it possible for financiers to pass the benefit of any reduced cost or risk on to their business customers. It is likely that this holds true for consumers as well.

Consumers as searchers of the Register

Helpfully, some data is available in relation to the way that users of the Register are searching for encumbrances over motor vehicles.

The Register replaced the State and Territory REVS registers that operated prior to the commencement of the Act. The Register allows consumers to use a simplified "Quick Motor Vehicle Search" (QMVS) interface for these searches. Consumers also benefit from the fact that the Register applies nationally, as this means that a consumer no longer needs to work with different registers, interfaces and fees for each jurisdiction in which they need to conduct the search.

AFSA reports that on average 26,738 individual QMVS searches were conducted each month in 2014, and that call volumes to its National Service Centre (NSC) dropped markedly after the introduction of the QMVS. It is also noteworthy that in 2014, over 95% of searches for registrations which list the collateral type as consumer property were for motor vehicles and were conducted using the QMVS.

This usage pattern suggests that significant numbers of consumers are taking advantage of the Register and feeling confident in doing so, given the drop-off in the number of calls to the NSC. However, the Consumer Action Law Centre (CALC) has indicated that low levels of awareness of the Act and the Register persist amongst consumers, and continue to prevent some potential users from accessing the benefits of the Act. CALC has also stated that many consumers who do use the Act find it confusing, and have difficulty achieving more than a search for a motor vehicle. This means that a consumer who is faced with a more complex task may need to incur the cost of legal advice to clarify their position, or put their assets at risk.

CALC also noted that the confusing layout of search certificates provided by the Register can mean that the results of searches are not easily understood by consumers.

The reforms implemented by the Act offer significantly enhanced functionality to users searching for encumbrances over motor vehicles. Apart from that, however, the consumer experience of the Register appears to be hampered by the same factors as those that hamper small business users. They include low levels of awareness of the Act and the Register, and a level of complexity in Register products and the website that make them difficult to understand and work with.

3.4 Opportunities for minimising regulatory and administrative burdens, including cost, and for further efficiencies

It is clear that much can and needs to be done to improve the Act, to make it less burdensome for users and to enhance its capacity to achieve its objectives.

A small number of submissions suggested that the problems associated with the Act are so intractable that the Act should simply be repealed.[27] I discuss this suggestion in Section 4.1.4 below. If the Act is retained (as in my view it should be), then many opportunities are available to minimise the burdens that it currently imposes on users, without detracting from the Act's ability to achieve its objectives. Indeed, minimising those burdens will enhance the ability of the Act to achieve its objectives, as it will reduce the cost to business of working with the regime.

The steps that can best help to unlock the Act's potential, in my view, are these:

- **Simplify the content of the Act and the Regulations, by using more streamlined language and removing provisions that are of marginal benefit.** This will make it easier for users to navigate their way around the Act and the Regulations, and to understand what the Act is trying to do.
- **Simplify the Register, by reducing the number of decision points for users and making the remaining decision points clearer and easier to answer.** This will make it easier for both registrants and searchers to use the Register with confidence.
- **Revisit the exclusions.** The Act excludes a number of types of property and security interest from its reach, for a range of reasons. The Act will best be able to achieve its objectives if it can apply as broadly as possible.
- **Use more customary and intuitive terminology.** The Act uses a number of terms that are unfamiliar to Australian readers, or uses familiar terms in unfamiliar ways. The Act would be much easier to understand if it used more familiar terminology, and in more intuitive ways.
- **Explain the concepts.** The Act does not explain a number of key underlying concepts, in particular concepts that help to explain when a security interest can attach to collateral, and what that "collateral" is. Those concepts are however critical to understanding how the Act works. The Act would be much easier for all to use, if those concepts could be clarified and explained.
- **Better reflect Australian conditions.** Because the Act is based on models from other jurisdictions, it has inherited a range of policy outcomes that were appropriate in those jurisdictions at the time they enacted their legislation, but may not be appropriate for Australia today. The Act will be a much better piece of legislation if those inherited policy outcomes can be re-assessed, and then adjusted to reflect current Australian expectations where appropriate.

There is no "magic bullet" in this endeavour. Rather, improvement will come from a large number of mostly small changes. Individually those changes may seem minor, but in aggregate they can have the capacity to dramatically improve the Act. That, in turn, will enhance the ability of businesses and consumers to use their assets as security, and to access cost-effective finance in Australia.

Those changes are the subject of Chapters 4 to 9 of this report.

27 CCF, S1 page 4; MBA, S2 page 3.

While it is not within the scope of this review to conduct a formal cost benefit analysis of the proposed reforms, I acknowledge that Government will subject any legislative or regulatory reform proposals to the requirements of the regulatory impact assessment process. This process assesses the regulatory impact of proposed legislation against the objects and purpose of the proposed reform, and requires exploration of alternative options for achieving those objects. It is designed to ensure that the cost to the community of complying with regulation is not increased unnecessarily.

Chapter 4
The reach of the Act

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4.1 What types of transactions should be covered by the Act, and why?

4.1.1 The Act's main organising principle

The Act at its heart is a law about secured finance. This is clear from the Government's stated goals for the Act, which were to increase the consistency and certainty of secured finance in Australia, and to reduce its complexity and cost.[1]

The Act did not attempt to achieve its goals by simply standardising the rules that previously applied across Australia's States and Territories for each type of secured transaction. Instead, the Act took a much more comprehensive approach, and standardised the rules across the different types of secured transactions as well. As a result, the Act applies a largely uniform set of rules to all transactions that in substance secure payment or performance of an obligation, regardless of the form of transaction or of who technically has title to the collateral. The Act accomplished this by following a legislative model that was first developed and implemented in North America (by Article 9 of the Uniform Commercial Code in the United States, and the Canadian PPSAs), and that had been adopted more recently by New Zealand in the NZ PPSA.[2]

This standardisation of the rules for transactions that function in substance as security did come at some cost to secured parties and their customers, as it reduced the flexibility that they had previously enjoyed to structure their transaction and its legal effect as they saw fit. The trade-off for this loss of flexibility was anticipated to be the benefits that would flow from the increased consistency and certainty and reduced complexity and cost of secured finance, and the improved ability of borrowers to use collateral as their security.

4.1.2 The "ostensible ownership" or "publicity" concern

Consultation Paper 1 suggested that the drafting of the models on which the Act is based were also founded on a second important principle. This was the perceived need to deal with what has been called the "ostensible ownership" problem – the concern that a person could take a security interest in another person's property but leave that person in possession of the property, and in so doing mislead outsiders into believing that the person in possession had a better title to the property than was in fact the case.[3]

The solution adopted for this concern in the overseas models, commencing with Article 9, was the concept of "perfection" – a concept that requires a secured party to take some step to publicise the existence of its security interest, or run the risk that the security interest may not be fully effective.

This concern about what are sometimes called "fraudulent conveyances" or "secret liens" is not unique to United States law. Under early English law, the only way in which a person could take an effective security interest in the property of another person was by means of a possessory pledge. A security transaction under which the grantor remained in possession of the collateral despite having granted security over it was regarded as a fraud on third parties, and void.[4]

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1 See Section 2.1.2 above.

2 See Section 2.3 above.

3 Gilmore, § 14.1.

4 See *Twynes's Case* 76 Eng Rep 809 (Star Chambers, 1601).

While the general law in England and Australia slowly relented on its concern about secret liens and eventually permitted a range of non-possessory security interests, the invisibility of non-possessory security interests continued to be of concern, and prompted occasional legislative responses that required certain types of security arrangements to be publicised by registration, such as the now-repealed bills of sale legislation,[5] and the charges registration provisions in the Corporations Act.[6]

Publicity is also said to be the primary function of perfection under the Canadian PPSAs[7] and the NZ PPSA.[8] The same point has been made in relation to the Act, as well.[9]

Consultation Paper 1 noted that it might be asked whether ostensible ownership is as significant a concern in modern Australia as it clearly has been in the United States, Canada and New Zealand and, if ostensible ownership is not a material concern in Australia, whether the Act should respond to it. If ostensible ownership is not important, then this could call into question whether the Act needs a concept of perfection. It could even lead to the conclusion that the Register itself might no longer be required.

Consultation Paper 1 went on to express the view that the concept of perfection and the existence of the Register are integral components of the Act, and that the publicity function that they are designed to serve, by providing outsiders with an opportunity to determine whether an item of personal property might be subject to an encumbrance, is a central function of the regime established by the Act and should be preserved.

The great majority of respondents agreed with these views, at least as they relate to in-substance security interests under s 12(1). Two thoughtful responses queried, however, whether concerns regarding ostensible ownership really are (or should be) a driver in the design of the Act.[10] One of those responses made the point that there are many circumstances outside the reach of the Act under which possession of property can be separated from ownership of it, and suggested that there is little point in trying to deal through the Act with only some circumstances that allow for invisible interests in property.

I accept that the Act does not deal with all circumstances under which a person may have an interest in property that is not apparent to outsiders. I also acknowledge that the publicity that is provided through the mechanism of perfection is incomplete. It is clear from the great majority of responses, however, that the concept of perfection, including through the registration of financing statements on the Register, is seen to be performing an important publicity function, by making it easier for a person who wants to take an interest in an item of personal property to determine whether another person might already have a security interest in it.

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5 For example *Bills of Sale Act 1886* (SA), *Instruments Act 1933* (ACT), *Registration of Interests in Goods Act 1986* (NSW), *Instruments Act 1935* (NT), *Bills of Sale and Other Instruments Act 1955* (Qld), *Chattel Securities Act 1987* (Vic), *Bills of Sale Act 1899* (WA), and *Bills of Sale Act 1900* (Tas).

6 Previously Chapter 2K of the Corporations Act.

7 For example Cuming Walsh & Wood, page 301.

8 For example B Allan, *Personal Property Securities Act 1999 – Act and Analysis* (Brookers, 2010), page 103. See also the NZ Law Commission Report, page 7.

9 Duggan & Brown, para 5.4.

10 JLF, CP1 page 2; SP, CP1 page 2.

It may be that part of the problem lies in the use in this context of the term "ostensible ownership" itself, as the breadth of the term may suggest that the Act is promising to achieve a more comprehensive outcome than it is in fact intended to deliver. For this reason, I will endeavour in the balance of this report to refer instead to perfection, including through the registration of financing statements on the Register, as having a "publicity" function. Hopefully, this is an expression that better captures just what it is that perfection is intended to achieve.

The responses that queried the relevance of ostensible ownership suggested in the alternative that the principal purpose of perfection, including through the registration of financing statements on the Register, is to provide a mechanism for resolving priority disputes between competing interests in collateral, and that the publicity afforded by perfection is really just a consequence of the way in which priority contests are resolved. In my view, however, the causal chain is the other way around – if a secured party wants its security interest to be able to prevail over competing interests in the collateral, then it must advertise the existence of its security interest by taking an appropriate perfecting step, and a secured party's priority is determined in part by how quickly it publicises the existence of its security interest through perfection.

This is not just an academic question. The Act contains a number of rules dealing with the different ways in which a secured party can perfect its security interest, and it is not possible to comment meaningfully on the adequacy of those rules without first understanding their purpose. The reason for having a concept of perfection can also influence decisions regarding the types of transactions that the Act should apply to, as discussed later in this Chapter.

4.1.3 Deemed security interests

Some additional policy considerations also influence the extent to which the Act should apply to transactions that are not in-substance security interests, but are nonetheless deemed by s 12(3) to be security interests even though they do not secure anything. They will be discussed further below in the context of each of the deemed security interests.

4.1.4 Should the Act be repealed?

4.1.4.1 ***The issue***

Many submissions drew attention to the difficulties that many users have experienced in trying to work with the Act and the Register. There was a strong consistent theme throughout those submissions that both the Act and the Register are too complex.

A small number of submissions suggested that the problems associated with the Act are so great that it would be preferable to repeal the Act altogether.[11] Repealing the Act would also respond to many of the concerns expressed in other submissions about the complexity of the Act or the (in the view of the submitters) inappropriate way in which the Act affects them or their business activities.

It is not clear that it is within the Terms of Reference for me to recommend that the Act be repealed rather than amended. Even if it were within the remit of this review to do so, however, I would not be minded to recommend this. While much can be done to improve the workings of the Act, to remove complexity and to better

11 CCF, S1 page 4; HB, S2; MBA, S2 page 3.

accommodate the operating practices of the Australian marketplace, in my view it would be a retrograde step to repeal the Act, and so to revert to the confused and fragmented system of laws and registration systems that preceded it. In any event, it is highly unlikely that it would even be possible to revert to the laws that applied before the Act took effect, at least in their entirety, so simply repealing the Act would be likely to create considerably more cost, confusion and uncertainty, in the short term if not in the longer term as well. And because it is not possible to speculate just what the shape of any replacement rules might be, it is not possible to predict with any confidence that the outcomes under those replacement rules would be superior to those that we can achieve by retaining the Act, and reshaping it in a way that better allows it to achieve its potential.

4.1.4.2 ***Discussion of stakeholder feedback***

Consultation Paper 1 indicated that I expected for these reasons to recommend that the Act not be repealed, but rather that it be amended to enable it to better achieve its potential. Every response on this question was in support of this approach.

4.1.4.3 ***Recommendation***

> **Recommendation 1:** *That the Act not be repealed, but rather that it be amended to enable it to better achieve its potential.*

4.2 In-substance security interests

4.2.1 Introduction

The concept of a "security interest" lies at the very heart of the Act. The term is defined in s 12(1) in this way:

> (1) A ***security interest*** means an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property).

That definition is supplemented by s 12(2), which says this:

> (2) For example, a ***security interest*** includes an interest in personal property provided by any of the following transactions, if the transaction, in substance, secures payment or performance of an obligation:
>
> (a) a fixed charge;
>
> (b) a floating charge;
>
> (c) a chattel mortgage;
>
> (d) a conditional sale agreement (including an agreement to sell subject to retention of title);
>
> (e) a hire purchase agreement;
>
> (f) a pledge;
>
> (g) a trust receipt;
>
> (h) a consignment (whether or not a commercial consignment);

(i) a lease of goods (whether or not a PPS lease);

(j) an assignment;

(k) a transfer of title;

(l) a flawed asset arrangement.

It is not entirely clear whether the list of transactions in s 12(2) merely provides examples of transactions that can be security interests if they fall within the primary definition of the term in s 12(1), or whether the nature of some of the listed examples is such that they actually expand on it. I return to this question in Section 4.2.3.1.

Sections 12(1) and (2) are also informed by the definition of "interest" in s 10:

> ***interest***, in personal property, includes a right in the personal property.

4.2.2 Does a security interest need to be a proprietary interest?

4.2.2.1 *The issue*

Under the general law, a security interest is a proprietary right (what lawyers would call a right *in rem*), not a mere contractual right (a right *in personam*). This means that a security interest was a right that was capable of being asserted against the world at large, rather than just against the owner of the collateral.

The same view is taken of the meaning of "security interest" under the Canadian PPSAs[12] and the NZ PPSA.[13] It is less clear that the meaning of "security interest" in the Act is limited in the same way, however, because of the fact that the Act defines "interest" as **including** a right in property. The Canadian PPSAs and the NZ PPSAs do not do this.

This is not just a theoretical concern. As a number of submissions pointed out,[14] the question is causing genuine uncertainty, as it is not clear whether the holder of a purely contractual right needs to perfect by registration, or run the risk that the right could be ineffective.

The concern that a security interest could include purely contractual rights was more acute under the Act as originally enacted, as the original definition of "security interest" referred to an interest "in relation to" personal property, rather than an interest "in" personal property.[15] The words "relation to" suggested that the concept of a security interest could capture more than just interests "in" personal property, particularly when contrasted with the corresponding definitions in Canada and New Zealand. Government responded to this concern in 2011 by amending the Act to remove the words "relation to" from both the definition of "security interest" and the definition of "interest".[16] However, the fact that the Act retains the current definition of "interest" still leaves it unclear whether or not purely contractual interests could be captured.

12 See Cuming Walsh & Wood, page 12.

13 See Widdup, para 2.14.

14 For example: AICM, S1 page 6; LCA, S1 page 4; QLS, S1 page 1; CW, S1 page 1; HW, S2 page 3.

15 *Personal Property Securities Act 2009*, s 12 before it was amended by the *Personal Property Securities (Consequential Amendments) Act 2009*.

16 See the *Personal Property Securities (Corporations and Other Amendments) Act 2011*, sch 2 items 6 and 7.

In my view, a "security interest" should only capture interests that are proprietary in character. One of the key objectives of the Act is to provide mechanisms that can alert third parties to the fact that a person's property may be encumbered by an interest that makes the true net value of that property less than might appear to be the case. A purely contractual right relating to property does not do this (as a breach of the obligation would entitle the holder to sue for damages, not to assert an enforceable claim over the property), so including purely contractual rights within the framework of the Act is unlikely to assist in the pursuit of this objective. Also, if contractual rights were treated as a security interest, this could have the arguably paradoxical effect of elevating them in some respects into the equivalent of proprietary rights – for example, because the priority rules could enable a contractual right that is a security interest to take priority over a security interest that is based on a proprietary interest, or because the holder of the right would be able to enforce against the collateral under Chapter 4 of the Act.

It is also difficult to see how it would be appropriate for the "vesting on insolvency" rule in s 267 to apply to a purely contractual right. The intent behind s 267, as I understand it, is to provide that an unperfected security interest vests on insolvency in the insolvent grantor, but that the secured party remains free to pursue its (now unsecured) claim through the insolvency process. If the security interest was only contractual to start with, then the effect of s 267 would appear to be that the secured party loses its claim entirely, and has nothing left to pursue.[17]

For these reasons, my view is that a security interest should only arise under a transaction for the purposes of the Act if the transaction provides for an interest that is a proprietary right (ie a right *in rem*), not a purely contractual right. I agree however with the submissions that suggested that the current definition of "interest" in s 10 makes it less clear that the current drafting of the Act reflects this principle. I also cannot see how that definition otherwise provides any assistance in the interpretation of the Act.

For these reasons, Consultation Paper 1 suggested that the definition of "interest" in s 10 should be removed.

4.2.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that a secured party's interest needed to be a proprietary right, and not merely contractual. One response suggested that the definition of "interest" should be retained, and amended to state this expressly. My preference, however, and the view that was supported by other respondents, is to delete the definition altogether, and to allow the meaning of the term to be informed by this report and by the approach taken to the meaning of the term in other PPS jurisdictions.

As another response noted, deleting the definition of "interest" will not of itself resolve all controversies over whether particular types of rights are "interests" in personal property of the kind contemplated in s 12(1).[18] It is however unlikely that any attempt to define the term in a statute could ever achieve such an outcome, and I agree with the observation made in that response that it is preferable to leave it to the courts to resolve any residual uncertainties as they arise.

17 Section 267 is discussed later in this report – see Section 8.7.

18 SP, CP1 page 3.

4.2.2.3 ***Recommendation***

> **Recommendation 2:** *That the definition of "interest" in s 10 of the Act be deleted.*

4.2.3 Section 12(2) – examples of in-substance security interests

4.2.3.1 What is the effect of the examples?

4.2.3.1.1 ***The issue***

Section 12(2) of the Act lists examples of transactions that can give rise to a security interest if they "in substance, secure[…] payment or performance of an obligation". Read in this way, it appears that the list is not intended to expand the meaning of "security interest", but just to provide examples of transactions that can be security interests if they otherwise fall within the primary definition of the term. This conclusion is clouded, however, by the fact that two of the listed examples refer to transactions that are of a type that would not normally be regarded as giving rise to an interest in personal property at all, if you take the view (as I have done above) that an interest should only be able to be a security interest if it is proprietary in character. Those two examples are:

- the "conditional sale agreements" referred to in s 12(2)(d), and
- the "flawed asset arrangements" referred to in s 12(2)(l).

Consultation Paper 1 expressed the view that the correct approach to the interpretation of s 12(2) is that the list of transactions does not expand the meaning of the term security interest, but only provides examples of transactions that can give rise to a security interest if they otherwise fall within the definition of the term.[19]

4.2.3.1.2 ***Discussion of stakeholder feedback***

All respondents agreed that this was the correct interpretation of s 12(2).

A number of responses suggested that s 12(2) could perhaps even be deleted entirely, presumably because the section does not add to the substantive effect of s 12(1). If it were deleted, then it would also not be necessary to consider the clarifying amendments discussed in the balance of this Section 4.2.3.

While I can see some merit in this suggestion, in my view s 12(2) serves a useful function, by providing examples of the types of transactions that can be captured by the concept of a security interest under s 12(1). My view is that s 12(2) should be retained, and be amended as described below.

4.2.3.1.3 ***Recommendation***

> **Recommendation 3:** *That s 12(2) be retained.*

19 Section 15AD of the *Acts Interpretation Act 1901* appears to suggest a contrary conclusion, as it states in paragraph (b) that an example of the operation of a provision may extend the provision. However, the version of s 15AD that was in force at the time the Act was passed provided for the opposite outcome – that is, if an example is inconsistent with the provision, that the provision prevails. See the *Acts Interpretation Act 1901* (Cth), s 15AD as amended by the *Statute Law (Miscellaneous Provisions) Act 1987* (Cth), and s 11 of the Act. The potential effect of the current language of s 15AD will need to be taken into account when enacting legislation to implement changes recommended in this report.

4.2.3.2 Section 12(2)(d) – conditional sale agreements

4.2.3.2.1 *The issue*

Section 12(2)(d) of the Act says that one example of a transaction that can give rise to a security interest is:

> (d) a conditional sale agreement (including an agreement to sell subject to retention of title);

This language has been adopted without change from the NZ PPSA.[20] That language appears in turn to have been based in part on the Canadian PPSAs, which refer in this context to a "conditional sale".[21] The concept of a "conditional sale" in prior Canadian law reflected what we would describe as a "retention of title" or "Romalpa" clause,[22] and it may be that the NZ PPSA sought to clarify this, without discarding the Canadian language entirely, by referring to retention of title arrangements as an example of a conditional sale agreement.

Our general law also once understood the term "conditional sale" to be a reference to an agreement to sell on condition that title remains with the seller until the buyer has completed payment for the goods.[23] In Australia, the term has largely lost that meaning, at least in common business language, and the term "conditional sale agreement" would now generally be thought of as a reference to a sale agreement that was subject to conditions that needed to be satisfied before the transaction could be completed. The more specific meaning that once attached to the term "conditional sale" is now more commonly covered by the term "retention of title" or a "Romalpa" clause.

In any event, the current formulation of s 12(2)(d) can create confusion and uncertainty, as it appears to suggest that any sale agreement subject to conditions could potentially give rise to a security interest, or at least that "conditional sale agreement" has a broader meaning than just "an agreement to sell subject to retention of title". While it is possible that a sale agreement structured in a particular way could give rise to a security agreement even without a retention of title clause, in my view it creates unnecessary confusion to single out conditional sale agreements (as opposed to retention of title arrangements) in this way.

For these reasons, Consultation Paper 1 suggested that s 12(2)(d) be amended by removing the reference in the section to "conditional sale agreements".

4.2.3.2.2 *Discussion of stakeholder feedback*

One response questioned whether the amendment would in fact make the provision easier to understand. All other responses, however, were in favour of this change.

The reference to conditional sale agreements in s 12(2)(d) does not contribute to the ease of understanding of the Act, and on the contrary has the potential to cause confusion. In my view, it would make the Act easier to understand and use if the reference were deleted.

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20 NZ PPSA, s 17(3).

21 See, for example, Sask PPSA, s 3(1).

22 See Cuming Walsh & Wood, page 123.

23 See, for example, J Parris, *Effective Retention of Title Clauses* (Collins, 1986), Ch 5.

4.2.3.2.3 ***Recommendation***

Recommendation 4: *That s 12(2)(d) be amended to read:*

"(d) an agreement to sell subject to retention of title;".

4.2.3.3 **Section 12(2)(g) – trust receipts**

4.2.3.3.1 ***The issue***

Section 12(2)(g) says that a further example of a transaction that can give rise to a security interest is:

(g) a trust receipt;

The Act derives the reference to a "trust receipt" from the Canadian PPSAs,[24] and the NZ PPSA.[25] A trust receipt is a document that a person may issue in relation to an asset, where the person has raised finance to purchase an asset. A trust receipt in that context is a document that states that the person agrees to hold the asset on trust for the financier until the finance has been repaid.

The concept of a trust receipt is said to have originated in the United States in the late 1800s, as a tool to facilitate import/export transactions that were supported by a trade letter of credit.[26] A bank that provided a trade letter of credit to support the purchase of goods by a customer would receive the bill of lading for the goods from the seller and (if the documents were in order) would pay the agreed purchase price to the seller. The bank would usually want to retain control of the goods represented by the bill of lading until it had been paid, but the buyer might only be able to pay out the bank by taking possession of the goods and selling them. To accommodate this, the bank would give possession of the goods to the buyer, and the buyer in return would issue a trust receipt to the bank declaring that it held the goods on trust for the bank.

It has been said that trust receipts continue to be used extensively in letter of credit financings.[27] To my knowledge, though, it is not a well-recognised term in mainstream Australian finance practice. The principle itself is not unfamiliar, as it is not uncommon, when a bank issues a letter of credit in support of a customer's import transaction, for the bank to allow its customer to take early possession of the goods as long as the customer agrees to hold them on trust for the bank. I believe, however, that local practice is for this trust arrangement to be set out in the bank's general trading terms with the customer, and not in a separate document.

It seems quite clear that a trust arrangement of the type just described would be a security interest under the Act, on general principles. While it might be said that the inclusion of the express reference to a trust receipt in s 12(2) does no harm, it is also not clear that it adds any particular value.

For these reasons, Consultation Paper 1 expressed the preliminary view that the provision could be removed.

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24 For example Sask PPSA, s 3(1)(b).

25 NZ PPSA, s 17(3).

26 See Gilmore, Chapter 4.

27 See O'Donovan at 10.510, note 4.

4.2.3.3.2 ***Discussion of stakeholder feedback***

This proposal received mixed responses. A number of respondents agreed, and a number of others did not feel strongly either way. Some respondents said however that they do encounter trust receipts in their business dealings, and so thought that it would be useful to retain a reference to the term in the section.

Section 12(2) is not intended to list all the types of transactions that could give rise to a security interest. As I explained earlier,[28] however, my approach to potential amendments to the Act is generally to recommend an amendment only if there is a clear net benefit to making it. If commercial parties still make use of trust receipts in their dealings, then part of the rationale for deleting s 12(2)(g) no longer applies. For this reason, I do not propose to recommend that s 12(2)(g) be deleted.

A trust receipt is also an example of a broader point, which is that certain trusts can give rise to security interests for the purposes of the Act. There has been a school of thought to the effect that trusts generally (or at least fixed trusts) could give rise to a security interest, with the beneficiary as the secured party and the trustee as the grantor, on the basis that the beneficiary has an interest in personal property (ie its beneficial interest in the trust assets), and that its interest secures performance by the trustee of its obligations as trustee. While there may be some superficial attraction to this argument, however, my view is that this analysis misconstrues the nature of the relationship between the interest and the obligation. Under a typical trust, the trustee's obligations are not secured by the beneficiary's beneficial interest – rather, those obligations are part of what identifies and gives substance to the beneficial interest. They are part of what makes up the beneficial interest, rather than being secured by it.[29]

It is of course possible for a trust to function as a security device. For that to be the case, though, there would need to be an obligation outside the immediate trust relationship that is in turn secured by it. The trust receipt, as described above, is one example of this.

Rather than refer in s 12(2)(g) only to a trust receipt, it could be thought to be helpful for it to refer instead to "trusts" generally.[30] Because the overwhelming majority of trusts will not be security interests and because of the potential for this to cause confusion rather than assist in the understanding of the Act, however, Consultation Paper 1 expressed the view this would be unwise.

This view was supported by all of the responses that commented on it.

4.2.3.3.3 ***Recommendation***

Recommendation 5: *That s 12(2)(g) be retained.*

28 See Section 2.1.3.

29 For a similar view, see Duggan and Brown, paras 3.11 to 3.13.

30 The Sask PPSA does this – see Sask PPSA, s 3(1)(b).

4.2.3.4 Sections 12(2)(h), (i) and (j) – interests that might also be deemed security interests

4.2.3.4.1 *The issue*

Sections 12(2)(h), (i) and (j) of the Act say that a transaction may be capable of giving rise to a security interest if it is:

> (h) a consignment (whether or not a commercial consignment);
>
> (i) a lease of goods (whether or not a PPS lease);
>
> (j) an assignment;

Sections 12(2)(h) and (i) appear to have been included to avoid any implication that the transactions that they refer to could not be security interests on general principles under s 12(1). This implication might otherwise arise because commercial consignments and PPS leases are also deemed to be security interests under s 12(3).

The Canadian PPSAs[31] and the NZ PPSA[32] contain provisions corresponding to ss 12(2)(h), (i) and (j). It is curious, however, that s 12(2) does not make a similar specific clarifying statement in relation to transfers of accounts or chattel paper, as they are also deemed to be a security interest under s 12(3).

Consultation Paper 1 expressed the view that it may have been intended that this gap be covered by the reference in s 12(2)(j) to "assignments", but suggested that this should be made clearer.

4.2.3.4.2 *Discussion of stakeholder feedback*

The great majority of respondents agreed with this proposal.

One respondent pointed out in support of this that there was a drafting defect in the corresponding provision in the Sask PPSA, in that it referred to an "assignment" where it should have referred to a "transfer of an account or chattel paper".[33] It might be thought, however, that s 12(2)(j) would be structurally more consistent with ss 12(2)(h) and (i) if it were to state that a security interest could arise under a "transfer of a monetary obligation (whether or not a transfer of an account of chattel paper)". This is the language that Consultation Paper 1 suggested could be inserted into s 12(2) in place of the current s 12(2)(j). As one other response pointed out, though, ss 12(2)(h) and (i) also serve the purpose of confirming that a lease or a consignment can be an in-substance security interest, whether or not they are also a commercial consignment or a PPS lease and so deemed to be a security interest under s 12(3).[34] That response suggested that it is useful for the sections to confirm this because this would not have been the case under prior law. That concern is not present in the case of a transfer of an account or chattel paper, however, because a transfer was already capable of being a security interest under prior law (as a mortgage), if it was made by way of security.

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31 For example Sask PPSA, s 3(1)(b). Interestingly, s 3(1)(b) of the Sask PPSA also mentions transfers of chattel paper, but not transfers of an account, in this context.

32 NZ PPSA, s 17(3).

33 AD, CP1 page 4.

34 JLF, CP1 page 7.

So ss 12(2)(h) and (i) can be said to serve two purposes – first, to confirm that a consignment or a lease can be an in-substance security interest on general principles, and secondly to confirm that a commercial consignment or a PPS lease can be an in-substance security interest under s 12(1) even if it is also deemed to be a security interest under s 12(3). For transfers of monetary obligations, there is not the same need to clarify that they can be an in-substance security interest on general principles, because that was already an accepted principle of general law. In the case of a transfer of an account or chattel paper, though, it can still be helpful to confirm that the transfer can be an in-substance security interest under s 12(1), even if it is also deemed to be a security interest under s 12(3).

Against this, it might be argued that there is no need to clarify the situation in relation to a transfer of an account because the position is already sufficiently clear, for example by implication from other provisions in the Act such as s 109(1)(a) or s 268(1)(a)(i). In my view, though, it would be beneficial to do so.

If my recommendation in Section 4.3.3 is adopted, however, then s 12(2) would only need to refer to a transfer of an account, and would not need to refer to a transfer of chattel paper.

4.2.3.4.3 *Recommendation*

Recommendation 6: *That section 12(2)(j) be amended to read:*

"(j) a transfer of an account;".

4.2.3.5 Section 12(2)(k) – transfers of title

4.2.3.5.1 *The issue*

Section 12(2)(k) of the Act states that a transaction may be capable of giving rise to a security interest if it is:

(k) a transfer of title;

None of the Canadian PPSAs or the NZ PPSA contains a corresponding provision.

The reference to "transfer of title" in s 12(2)(k) was not in the first public draft of the *Personal Property Securities Bill 2008* that was released in early 2008.[35] It only appeared later, in the draft that was released in November that year.[36] Its inclusion may have been prompted by the widely–publicised decision of Finkelstein J in the Federal Court of Australia in *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited* that had been handed down in May that year.[37]

The expressions "assignment" (in s 12(2)(j)) and "transfer" (in s 12(2)(k)) cover very similar territory. They are one example of a theme that I return to later,[38] which is that it would improve the readability and facilitate comprehension of the Act if it could use more consistent terminology, or if it could at least use different terms, if it needs to, in ways that make it clear what the differences in meaning are intended to be.

35 *Personal Property Securities Bill 2008* (Cth), May 2008 Consultation Draft.

36 *Personal Property Securities Bill 2008* (Cth), November 2008 Exposure Draft.

37 [2008] FCA 974.

38 See Section 7.1 below.

As noted above, it may be that s 12(2)(k), referring as it does to a "transfer of title", was inserted in response to the decision of the Federal Court of Australia in *Beconwood*. In that case, Beconwood entered into a securities lending agreement with a financier, Opes Prime. Under the terms of the agreement (which was in an industry-standard form), Beconwood transferred outright title to securities to the financier, in return for a payment. At the end of the arrangement, the financier was then required to transfer equivalent securities back to Beconwood (not the specific securities that were originally transferred by Beconwood to it), in return for a payment by Beconwood that was calculated as if the arrangement had been a loan. The court held that this arrangement did not give rise to a mortgage under the law as it stood before commencement of the Act.

The insertion of s 12(2)(k) may have been intended to respond to this, and to ensure that the Act does in fact apply to arrangements of the type considered in that case. If that was the purpose behind the inclusion of s 12(2)(k), then it is not clear that it has achieved its objective.[39] Even if it does achieve this objective, though, it needs to be asked whether that is an appropriate policy outcome.

Consultation Paper 1 suggested that s 12(2)(k) should be deleted, and that it should be made clear that a transaction is not a security interest for the purposes of s 12(1) of the Act if it is an outright transfer of title that does not leave the transferor with any indicia of ownership that could enable it to deceive outsiders into believing that it had clear title to the asset.

4.2.3.5.2 ***Discussion of stakeholder feedback***

The great majority of respondents on this question agreed that s 12(2)(k) should be deleted, or did not object to this being done.

Views were more mixed on whether it should be made clear that a transaction is not a security interest for the purposes of s 12(1) of the Act if it is an outright transfer of title that does not leave the transferor with any indicia of ownership that could enable it to deceive outsiders into believing that it had clear title to the asset. Some respondents suggested that such a provision was not necessary, and that the general language of s 12(1) would already have this effect (on the basis that an outright transfer of that type is unlikely to be a transaction that is in substance security for payment or performance of an obligation).[40] I can also see that an exclusion along these lines would bring its own interpretative difficulties – for example, regarding what is an "outright" transfer, or what might or might not constitute "indicia of ownership". There could also be situations where it is not appropriate to exclude an outright transfer from the operation of the Act – for example, if it is not a stand-alone transfer, but is part of a larger transaction that contained additional features that could cause it to be a security interest in general principles, were it not for the exclusion.

Consultation Paper 1 expressed the view that the purpose of regulating and requiring disclosure of transactions that function in substance as security interests is to enable outsiders to become aware of the existence of interests in an asset that a person could otherwise misrepresent as being their unencumbered property. In a situation where a person has transferred outright title in property to a third party, and has only a contractual right to the return of equivalent securities (or

39 See for example the discussion in Duggan and Brown, para 3.18 (in relation to a similar financial product repurchase agreements).

40 CW, CP1 page 4; LCA, CP1 page 4; QLS, CP1 page 4.

their value in cash) at some future point in time, however, it is hard to see how the transferor could credibly represent to outsiders that it continued to own the property that it had transferred. Consultation Paper 1 went on to suggest that there may be no point in regulating a transaction as a security interest just because it has characteristics similar to security interests, if it is of a type that does not engage the rationale for regulating security interests in the first place.

It can be seen from the discussion in Section 4.1, however, that the publicity objective is only one of the Act's organising principles. An even more central purpose of the Act is to bring consistency of treatment into secured transactions law in Australia, by applying a consistent set of rules to all transactions that allow a person to raise finance that is backed by an interest in personal property, regardless of the form of the transaction or the location of title to the asset. Seen in that light, it becomes less clear that it would be appropriate to provide as a blanket statement that the Act does not apply to an outright transfer of title to property that does not leave the transferor with any residual indicia of ownership. I believe that this is the reason why a number of responses did not agree with the proposal that the Act be amended in this way.

I have concluded for these reasons that s 12(2)(k) should be deleted, but that it is not appropriate to amend the Act to state as a general proposition that a transaction is not a security interest under s 12(1) if it is an outright transfer of title that does not leave the transferor with any indicia of ownership that could enable it to deceive outsiders into believing that it had clear title to the asset.

This leaves open the question of the extent to which the Act does or should apply to securities lending arrangements of the type considered in *Beconwood*. I return to this question in Section 4.5.16 below.

4.2.3.5.3 ***Recommendation***

Recommendation 7: *That s 12(2)(k) be deleted.*

4.2.3.6 **Section 12(2)(l) – flawed asset arrangements**

4.2.3.6.1 ***The issue***

Section 12(2)(l) of the Act states that an interest provided for by a transaction may be capable of being a security interest if the transaction is:

(l) a flawed asset arrangement.

The NZ PPSA contains similar language.[41] There does not appear to be corresponding language in the Canadian PPSAs.

The inclusion of s 12(2)(l) has generated both controversy and uncertainty in a number of ways.

First, it is not clear just what the term "flawed asset arrangement" captures. It is not a legal term of art (in contrast to most of the other types of transactions listed in s 12(2)), so it is difficult to say precisely what types of transaction s 12(2)(l) is intended to confirm is within the reach of the Act.

41 NZ PPSA, s 17(3).

Among finance lawyers, the expression "flawed asset" is understood to refer to a right to receive a payment of money that is subject to a condition (or "flaw") that must be satisfied before the payment needs to be made. Perhaps the most common example is that of a bank account which has as one of its terms that the depositor is required to perform an obligation owed to the bank (often an obligation that is not directly related to the account itself) before the bank is required to repay the deposit. That other obligation of the depositor could be to repay some other loan that the depositor owes to the bank. In this case, the condition on the bank's obligation to repay the deposit is the "flaw" on the asset (ie on the deposit), and it serves to protect the bank against the risk of non-performance of the depositor's other obligation by virtue of the fact that the bank is not required to repay the deposit until the depositor's other obligation has been performed.

Flawed asset provisions are also a standard feature of most derivative transactions.[42]

While the deposit arrangement described above may be the most recognised example of the term "flawed asset arrangement", other arrangements could fall within its reach as well. Almost all executory contracts contain conditions to performance. For example, almost every contract for the sale and purchase of property will contain conditions to completion. Could they also be seen to be flawed asset arrangements, and so need to be perfected under the Act (presumably by registration) in order to be enforceable? Of course, even if an arrangement is a flawed asset arrangement, it will only give rise to a security interest for the purposes of the Act if the arrangement provides the putative secured party with an interest in personal property that in substance secures payment or performance of an obligation. Most routine contracts for the sale and purchase of property will not do this, so the Act is unlikely to be engaged in relation to those contracts even if it could be said that the conditionality within the contract causes it to be a flawed asset arrangement. The question does however demonstrate the uncertainty that s 12(2)(l) can create.[43]

The second source of uncertainty created by s 12(2)(l) relates to the fact that a flawed asset arrangement with respect to a deposit does not obviously give the putative secured party any proprietary right in the affected asset. The fact that the bank's obligation to repay the deposit is subject to a condition (or flaw) does not give the bank a proprietary interest in the deposit. Rather, the condition on the bank's obligation to repay is an inherent term of the deposit itself. The situation can be contrasted with one where a customer holds a deposit with the bank, and then offers the deposit up to the bank as collateral for a loan. If the bank takes a security interest over the deposit to secure repayment of the loan, then the bank is clearly taking a security interest on general principles, because it is acquiring a proprietary interest in the deposit (through the security agreement) to secure repayment of the loan. In the case of a flawed deposit, however, the inclusion of the flaw as a term of the deposit agreement does not give the bank a proprietary right in the benefit of the deposit. It simply limits the circumstances in which the deposit must be repaid.

It is of course correct to say that the two structures described in the previous paragraph are functionally very similar, and it could be argued that it would be inappropriate for one to be covered by the Act but not the other. One case in

42 See, for example, the standard-form ISDA master agreement discussed in Section 4.5.3.

43 As another example of its potential reach, the term "flawed asset" has been used in a number of English decisions to refer to property that is subject to removal on the insolvency of the holder: see for example *Money Markets International Stockholders Ltd v London Stock Exchange Limited* [2002] 1 WLR 1150, page 1174.

Canada has held that a flawed asset arrangement, at least in combination with set-off rights, can be a security interest for the purposes of legislative provisions in Canada that are similar to the definition of "security interest" in the Act.[44] That decision has however received a very mixed reception, both in Canada and here in Australia,[45] and it is not at all clear that Australian courts would agree with it.

In any event, the purpose of this discussion is to consider not what the Act might currently cover, but rather what it should cover. It may be possible to construct examples of arrangements that could enable a flawed asset arrangement to provide a secured party with an interest in the flawed asset that is proprietary in character. If that is so, however, then the arrangements will be a security interest on general principles whether or not s 12(2)(l) is retained.

Consultation Paper 1 expressed the view that it is preferable not to clutter the Act with examples of possible security interests that have the potential to cloud the Act's meaning, in this case by suggesting that a security interest could be merely contractual in nature. It also expressed concern at the fact that the expression "flawed asset arrangement" is imprecise, and without a generally-accepted meaning. For these reasons, Consultation Paper 1 proposed that s 12(2)(l) be removed.

4.2.3.6.2 ***Discussion of stakeholder feedback***

This proposal was supported by almost all respondents.

One response suggested that there may be benefit in replacing the reference to a "flawed asset arrangement" in s 12(2)(l) with a reference to a so-called "triple cocktail".[46] A triple cocktail is a security arrangement that has been used in the past to take security over bank accounts. The arrangement was designed to overcome uncertainties in the law regarding the effectiveness of set-off rights and whether a bank was able to take security over a deposit with it, by providing the bank with a combination of set-off rights, a charge over the deposit and a condition on the deposit to the effect that the bank was not required to repay the deposit until the secured obligation had been performed. In my view, however, it is not necessary to refer to triple cocktails in s 12(2). Section 12(4)(b) of the Act has eliminated previous uncertainty in the law by making it clear that a bank can take security over a deposit with it, so triple cocktail arrangements may now become less common, at least here in Australia. In any event, it is clear that the "security" component of the triple cocktail is likely to be a security interest under s 12(1), and in my view it is not necessary to have additional language in s 12(2) that spells that out.

It may not be correct to say, of course, that a flawed asset arrangement (on any meaning of the term) could never be a security interest. If a flawed arrangement manages to satisfy the elements of the definition of a security interest in s 12(1), then it should be subject to the Act, under s 12(1). This will continue to be the case even if s 12(2)(l) is deleted.

4.2.3.6.3 ***Recommendation***

Recommendation 8: *That s 12(2)(l) be deleted.*

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44 *Caisse populaire Desjardin de l'Est v Drummond* [2009] 2 SCR 94.

45 See for example D Loxton, *One Flaw Over the Cuckoo's Nest: Making Sense of the 'Flawed Asset Arrangement' Example, Security Interest Definition and Set-Off Exclusion in the PPSA* (2011) 34(2) UNSWLJ 472.

46 AFC, CP1 page 5.

4.3 Deemed security interests

4.3.1 Policy arguments for extending the Act to deemed security interests

4.3.1.1 The provisions

As I noted above in Section 4.1.1, the Act is at its heart a law about secured finance. Despite this, s 12(3) of the Act deems three types of interest in personal property to be security interests, whether or not they secure payment or performance of an obligation. They are:

(a) the interest of a transferee under a transfer of an account or chattel paper;

(b) the interest of a consignor who delivers goods to a consignee under a commercial consignment;

(c) the interest of a lessor or bailor of goods under a PPS lease.

Article 9, the Canadian PPSAs and the NZ PPSA also apply to some types of transactions that do not have a security function. The types of transactions vary from jurisdiction to jurisdiction, but are largely consistent with the types of transactions listed in s 12(3).

4.3.1.2 The policy arguments

The approach taken in s 12(3) is not easy to reconcile with the approach taken by the Act to the primary definition of "security interest" in s 12(1), as s 12(3) focuses on the form of a transaction, rather than its substance, to determine whether or not the Act should apply to it. A number of different justifications have been given for this.

Publicising hidden interests in property

One justification is founded in the fact that the existence of an in-substance security interest over property is just one circumstance in which a person with apparent ownership of property may not have clear title. A person might have temporary possession of the property of another, for example, or could be storing it for the owner as bailee or custodian. Like security interests, these types of arrangements all have the capacity to enable a person who appears to be the owner of the property to misrepresent the extent of their rights in the property to third parties.

This is the explanation that was given by the Saskatchewan Law Reform Commission for its recommendation that the Sask PPSA apply to certain transactions that do not have a security function.[47] That Commission noted, however, that it would not be practicable to attempt to deal comprehensively with all circumstances in which apparent ownership of property is divorced from its true ownership. For that reason, the Sask PPSA was extended to include transactions that separated apparent ownership from true ownership if they were of such significance that it would produce "significant disruption" if they were not captured.[48] One of the leading Canadian commentaries in relation to the Canadian PPSAs also expresses the view that the clear policy reason in the Canadian

47 Sask Law Commission Report, page 8.

48 See the previous footnote.

PPSAs for deeming some transactions to give rise to a security interest is the fact that "[e]ndemic to each type of transaction is the potential for third party deception and the consequent commercial disruptions that this entails".[49]

Characterisation difficulties

A second justification is a more pragmatic one, and is based on the fact that sometimes it can be difficult to determine whether or not a transaction does in substance secure payment or performance of an obligation. This argument has been advanced in particular in relation to the overseas equivalents of s 12(3)(c), relating to longer-term leases. A long line of case law in Canada has wrestled with the distinction between security leases and "true" leases, with mixed results.[50] Ontario extended the reach of the Ontario PPSA in 2006 to include leases with a term of more than one year, whether or not they were in substance a security interest, in order to reduce the need for litigation over the distinction.[51]

Similar financing arrangements

A third possible reason for extending the reach of the Act to some transactions that do not have a security function is that those transactions are simply other ways in which a person uses property to fund their activities. This could be said to be an extension of the "consistency" principle – even though the additional transactions do not involve a person using property to secure finance, they do involve a person using property to raise finance. It could be argued that such transactions should be regulated in the same way as in-substance security transactions because it is consistent to do so.

Better rules

A final justification, advanced particularly in relation to the extension of the Act to transfers of accounts, is that the Act provides a simpler and clearer set of legal rules than the laws that would otherwise apply.

The general law rules regarding the effectiveness of a transfer of an account depend in part on whether the transfer is legal or equitable, and on whether an effective notice of the transfer has been given to the obligor. If there are competing interests in an account, priority between them is determined under the general law by the order in which notice of the interest was given to the obligor, under the rule in *Dearle v Hall*.[52] A person who is considering whether to take an interest in an account will only be able to establish whether there is a competing interest in the account by making inquiries of the obligor, and there is no guarantee that the obligor will be prepared to respond to a request for information of that type.

These general law rules can be difficult to work with.[53] In contrast, according to this explanation, the Act provides rules that deal with these matters clearly, simply and effectively.

49 Cuming Walsh & Wood, page 155.

50 See, for example, Ziegel & Denomme, § 2.2.3; Cuming Walsh & Wood, pages 128 to 133.

51 Duggan & Brown, para 3.31.

52 (1828) 38 ER 475.

53 For a more detailed discussion of the deficiencies of the general law rules and in particular the limitations of the rule in *Dearle v Hall*, see F Oditah, Legal Aspects of Receivables Financing (Sweet & Maxwell, 1991), para 6.6.

4.3.1.3 Preliminary observations

It appears that no single policy argument would justify the extension of the Act to all the types of transactions listed in s 12(3). Rather, different justifications (or different combinations of justification) will apply, and the relative importance of the different possible justifications for extending the reach of the Act will vary for each of them.

The strength of the policy arguments for extending the Act to the transactions listed in s 12(3) is discussed below for each of them separately. One theme that should however be common across all the analysis is the "disruption" point identified by the Saskatchewan Law Reform Commission.[54] Even if a particular type of transaction appears to fit the criteria for inclusion in the Act on the basis of one or more of the policy explanations summarised above, it would only be appropriate to include it in the Act (and so to accept the further complexity that this would bring to the Act) if "significant disruption" would result if it were left out.

As a number of responses to Consultation Paper 1 pointed out, it is also important, in determining whether a particular type of transaction should be captured by the Act, to take into account the potential disruption to secured parties and others if the transaction is included. [55]

4.3.2 Section 12(3)(a) – transfers of an account

4.3.2.1 Should the Act apply to a transfer of an account, if it is not an in-substance security interest?

4.3.2.1.1 *The issue*

Section 10 of the Act defines "account" in these terms:

> ***account*** means a monetary obligation (whether or not earned by performance, and, if payable in Australia, whether or not the person who owes the money is located in Australia) that arises from:
>
> (a) disposing of property (whether by sale, transfer, assignment, lease, licence or in any other way); or
>
> (b) granting a right, or providing services, in the ordinary course of a business of granting rights or providing services of that kind (whether or not the account debtor is the person to whom the right is granted or the services are provided);
>
> but does not include any of the following:
>
> (c) an ADI account;
>
> (d) chattel paper;
>
> (e) an intermediated security;
>
> (f) an investment instrument;
>
> (g) a negotiable instrument.
>
> Example: An account that is a credit card receivable is covered by paragraph (b).

54 See note 48.

55 For example: ABA, CP1 page 5; AFC, CP1 page 5.

The NZ PPSA defines its corresponding term, "account receivable", much more simply:[56]

> **Account receivable** means a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance.

The definition in the Canadian PPSAs is similar to the definition in the NZ PPSA.[57]

The inclusion of transfers of accounts and chattel paper within the Act is consistent with the Canadian PPSAs,[58] and the NZ PPSA.[59]

Is there a publicity concern?

An account is intangible, and a transfer of an account is by necessity an invisible transaction. Unlike tangible property, a potential buyer cannot physically inspect an account to see whether the seller appears to be the owner. It could be argued for this reason that the Act should apply to transfers of accounts, in order to provide third parties with a mechanism that assists them to determine whether the owner of an account might have already transferred it.

Against this, however, it could be argued that a registration system that discloses the existence of a transfer of an account cannot give a searcher of the register a complete picture. This is because a potential purchaser of the account cannot use the register to determine whether the account exists in the first place. And as the account is an intangible, the potential purchaser is unable to verify its existence by means of a physical inspection. The only way in which a potential purchaser of an account can determine whether or not the account exists, other than by relying on the transferor's word, is by making relevant enquiries of the putative obligor – as would be the case if the Act did not apply. And if the purchaser needs to rely on the transferor's word as comfort that the account exists, why should they not also rely on the transferor's word that the account is unencumbered? This suggests that a potential purchaser of an account does not gain as much comfort from a search of the Register as might initially be thought to be the case, and this might be thought to call into question the extent to which the Register really assists them.

Even though a search of the Register will not indicate whether an account that is the subject of a proposed transfer in fact exists, it does help a prospective purchaser to narrow the risk in its transaction, by enabling it to determine whether the transferor might have already transferred it, or have given security over it, to another person. So while the Register will not assist a searcher to determine whether a particular account does exist, I can see that perfection by registration on the Register can provide third parties with some potentially useful information.

Are there characterisation difficulties?

A transfer of an account can take many forms. At one end of the spectrum, a transferor may transfer the benefit of an account to a transferee on the basis that the transferee takes on all the risks associated with the account, including whether and when the obligor on the account will pay. At the other end of the spectrum, a transferor could agree with the transferee that the transferee can sell the account back to the transferor, or that the transferor will otherwise indemnify the transferee,

56 NZ PPSA, s 16(1).

57 For example Sask PPSA, s 2(1)(b).

58 For example Sask PPSA, s 3(2).

59 NZ PPSA, s 17(1)(b).

if the account is not paid on time and in full. There are also many variations in between, under which a transferor may agree that the transferee can have recourse back to the transferor for certain types of risks, but not others.

A transfer of an account with no recourse is unlikely to be a security interest on general principles, whereas a sale with full recourse almost certainly would be. It may be very difficult, however, to decide whether a transaction that falls between these extremes will or will not give rise to an in-substance security interest. Parties are relieved of the need to make potentially difficult decisions as to the proper characterisation of their transaction if all transfers of an account are captured by the Act, whether or not they have a security function.

Is it a similar financing arrangement to an in-substance security interest?

Businesses often sell their trade receivables or book debts as a tool to finance their working capital, whether the sale is structured as a security transaction or as a non-recourse sale. If it is appropriate to extend the reach of the Act to transactions that serve a similar purpose to a security transaction, then it may be appropriate to include transfers of accounts in the Act, at least to the extent that the accounts are of this type.

Does the Act provide better rules?

Finally, it can be argued that the Act provides a simpler and clearer set of rules to govern transfers of accounts than the general law rules that would otherwise apply, and that non-security transfers of accounts should be in the Act for this reason.

Preliminary conclusion

In my view, it is clear from the above discussion that there are good policy reasons for extending the reach of the Act to include transfers of accounts even if they do not secure payment or performance of an obligation. I am also satisfied that receivables financings are an important feature of our financial system,[60] so that it may cause "significant disruption" if transfers of accounts were not covered by the Act. And even if it could be argued that insufficient evidence is available to support that assertion, it must also be said that that the case has not been made for amending the Act to take transfers of an account out.

One submission did take the opposite view,[61] and proposed that the Act be amended so that it only applies to a transfer of an account if it is an in-substance security interest under s 12(1). Despite that submission, Consultation Paper 1 proposed that s 12(3)(a) should be retained.

4.3.2.1.2 ***Discussion of stakeholder feedback***

The great majority of respondents agreed that s 12(3)(a) should be retained.

Some respondents were of the view that the policy reasons for applying the Act to non-security transfers were not compelling. It is clear in my view, however, that the arguments against applying the Act to non-security transfers of an account are not sufficiently compelling to justify a recommendation that they be removed from the Act, even if I were otherwise minded to propose that.

60 According to the Debtor & Invoice Finance Association, total turnover of debtor financing in Australia in the 12 months to 30 September 2014 was $62.2 billion. See http://difa.asn.au/statistical-profile/.

61 JLF, S2 page 7.

One response suggested, if s 12(3)(a) were retained, that some amendments would need to be made to the Act to reconcile the interaction between the rules in the Act and the general law rules regarding the obligations of an obligor who has received notice of an assignment.[62] It may be, however, that the rules in s 80 (particularly ss 80(7) and (8)) are sufficient to deal with this. I discuss those rules later in this report.[63]

In my view, there are good reasons for retaining s 12(3)(a) in the Act, and there is no clear case for deleting it.

4.3.2.1.3 ***Recommendation***

> **Recommendation 9:** *That s 12(3)(a), which provides that a transfer of an account can be a security interest whether or not it in substance secures payment or performance of an obligation, be retained.*

4.3.2.2 **What should be an "account" for this purpose?**

4.3.2.2.1 ***The issue***

A number of submissions made the point that the parameters of the definition of "account" in the Act are quite unclear.[64] Comments were directed in particular at the fact that paragraph (b) of the definition extends the term to include a monetary obligation that arises from "granting a right" or "providing a service", in each case in the ordinary course of a business of granting rights or providing services of that kind. While the overall flavour of the definition of "account" is one of capturing what might loosely be described as trade receivables or book debts, those submissions pointed out that the language of paragraph (b) could be read as capturing other types of monetary obligations as well, including monetary obligations that arise under a loan agreement. This is because the monetary obligations under a loan agreement could be said to arise from the fact that the lender granted to the borrower the right to draw the loan.[65] This line of analysis is bolstered by the example given immediately below the definition, which cites a "credit card receivable" as an example of a monetary obligation that is covered by paragraph (b).

Paragraph (b) could be said to capture transfers of insurance policies for the same reason, although many of them, subject to the discussion in Section 4.5.7 below, would then be excluded from the Act by s 8(1)(f)(v).

My understanding of the corresponding provisions in the NZ PPSA and the Canadian PPSAs is that the concept of an account in those jurisdictions is intended to cast a broad net. This has recently been confirmed by case law in New Zealand.[66] The question that needs to be asked for the purposes of this review however, is: what is the desirable breadth of the definition for the purposes of the Act, in the Australian business environment?

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62 ASF, CP1 page 6.

63 See Section 8.2.3.

64 JLF, S2 page 8; ABA, S2 page 9; LCA, S2 page 7.

65 It could also be argued that the loan is an account under paragraph (a), on the basis that the obligation to repay the loan arises because the lender disposed of property (cash) to the borrower when it made the loan.

66 *Strategic Finance Limited v Bridgman* [2013] NZCA 357.

The answer to this question will turn in part on the relative importance of the different reasons that are given for bringing transfers of accounts under the Act.

The "publicity" argument would suggest that the definition of "account" should be cast broadly, as this would allow more information regarding dealings in intangible property to be available for search on the Register. If the main reason for capturing transfers of accounts that do not have a security function is that this avoids the need to determine whether or not a particular transaction is in substance a security interest (the "characterisation difficulties" argument), however, then it could be argued that the definition of "account" only needs to capture accounts of the type that are commonly the subject of transactions that produce these sorts of difficulties – which in my experience would be accounts that a business typically sells to finance its working capital, such as trade receivables or book debts.

If the purpose of extending the Act to transfers of accounts is to capture transactions that are outside s 12(1) but nonetheless involve a person using property to raise finance (the "similar financing arrangements" argument), then this would also suggest that the term "account" does not need to extend beyond accounts of the type that businesses typically sell to finance their working capital, such as trade receivables or book debts. Finally, however, if the purpose is to enable transfers of accounts to be governed by a simpler and clearer set of rules than those that would otherwise apply (the "better rules" argument), then it would be appropriate to give "account" a broad meaning, in order to maximise the benefit of this.

All of these arguments have some force. Consultation Paper 1 proposed, however, that the better approach for the purposes of this review is to limit the meaning of the term "account", and so the scope of operation of s 12(3)(a), to accounts of the type that businesses regularly sell in order to finance their activities, such as trade receivables or book debts. There were a number of reasons for this.

- First, it reflects what I believe was the intention behind the current drafting of the definition of "account" in s 10, based both on the overall flavour of the language of the definition, and on its drafting history. The definition of "account" in the May 2008 Consultation Draft of the Bill was substantially the same as the broad definition in the NZ PPSA.[67] By the time the Bill was presented to Parliament, however, the definition contained the qualifications now in paragraphs (a) and (b). The clear intent behind paragraphs (a) and (b) was to narrow the reach of the definition, and the tenor of the language of those paragraphs suggests that they were intended to limit its reach to obligations that are akin to a business's trade receivables or book debts.
- Secondly, if the Act were to apply to transfers of monetary obligations generally, then this would affect transfers of monetary obligations that had no financing element – that is, transfers undertaken in a non-financing context, potentially involving parties who are not involved in the finance industry and who may not be aware that this review is under way. In my view, it would not be appropriate to consider expanding the reach of s 12(3)(a) unless we were satisfied that those other stakeholders had been given an opportunity to express a view on the desirability of bringing their transactions into the Act, and that their views had been taken into consideration.

67 NZ PPSA, s 16 (definition of "account receivable").

In contrast, trade receivables and book debts are purchased for the most part by businesses that specialise in doing so, and which for that reason are able to be aware of the Act and to work with it. If the operation of s 12(3)(a) were to be expanded by broadening the definition of an account, however, many other purchasers of a monetary obligation, including potentially unsophisticated or occasional purchasers, would now need to be aware of the need to register under the Act in order to perfect their purchase.

If the definition of an account is limited in this way, then this might also provide a solution to the concern expressed by a number of submissions that s 12(3)(a) should not apply to a transfer of a participation in a syndicated loan facility.[68] That will depend on whether the definition is reworked in a way that makes it clear that a corporate loan cannot be a book debt of a bank.

Should s 12(3)(a) apply to *ad hoc* transfers of accounts?

Consultation Paper 1 noted that the definition of "PPS lease" resolves the policy competition between potentially unsophisticated or occasional lessors on the one hand, and searchers of the Register on the other, by only bringing a lease within the ambit of the Act (if it is not an in-substance security interest under s 12(1)) if the lessor is "regularly engaged in the business of leasing goods" – in other words, if it is leasing goods as a business and so should be aware that the Act may apply.[69] *Ad hoc* lessors, in contrast, are not captured by the definition. Consultation Paper 1 then asked whether a similar distinction should be drawn for the purposes of transfers of accounts – in other words, whether a transfer of an account (if it is not an in-substance security interest under s 12(1)) should only be within the ambit of the Act if the transferee is regularly engaged in the business of purchasing accounts.

Respondents had mixed views on this suggestion, and I do not propose to pursue it. That is partly because there is less need to protect unwitting purchasers of an account, if the definition of an account is limited in the way I am proposing, because accounts of that type are typically purchased by experienced businesses.

4.3.2.2.2 ***Discussion of stakeholder feedback***

Respondents expressed a range of views on what should be an account for the purposes of the Act.

Some respondents agreed that the definition of account should be clarified in the way described in Consultation Paper 1. Other respondents were of the view that the benefits of legal certainty were such that it was desirable to make the definition a broad one. As noted above, however, I am not satisfied that it would be appropriate to recommend this without affording other stakeholders an opportunity to comment on the desirability of doing so. Rather, my view is that the appropriate course of action for the purposes of this review is to recommend that the definition of an account be amended to clarify that it only applies to monetary obligations of the types that the commercial world would describe as being the transferor's trade receivables or book debts, and that Government consider separately whether it might be appropriate to extend the definition beyond this.

68 APLMA, S2 page 1; JLF, S2 page 8.

69 Section 13(2)(a).

4.3.2.2.3 ***Recommendations***

Recommendation 10: *That the definition of "account" in s 10 of the Act be amended to clarify:*

- *that it is limited to monetary obligations of the types that commercially would be described as being the transferor's "trade receivables" or "book debts"; and*
- *that it does not capture corporate loans.*

Recommendation 11: *That Government separately consider, in consultation with the States and Territories, whether the concept of an "account" under the Act should be expanded to include monetary obligations generally.*

4.3.2.3 **The meaning of "transfer" – introduction**

The term "transfer" is not defined in the Act. At general law, it has a very broad meaning, and has been said to be:

> a word of the widest import, and [to] include… every means by which… property may be passed from one person to another. [70]

Consultation Paper 1 explored whether 3 particular types of dealings with an account should be a "transfer" of the account for the purposes of the Act:

- outright legal transfers;
- novations; or
- declarations of trust.

They are discussed in the next few Sections of this report.

4.3.2.4 **Should the Act apply to an outright legal transfer of an account?**

4.3.2.4.1 ***The issue***

The rules of the common law, as they developed through the Middle Ages, did not permit an account (referred to in legal terminology as a "chose in action") to be assigned. The rules of equity sought to soften the effect of this rigidity, however, by allowing the holder of a chose in action to assign the benefit of the chose in equity. Under an equitable assignment, the assignor remains the legal owner of the chose in action, but is required to hold it for the benefit of the assignee, who is regarded as the owner of the account in equity. The assignee can give notice of the assignment to the obligor and require the obligor to make payments directly to it. Alternatively, the assignee can allow the assignor to continue to collect payments, and to pass them on to the assignee. In either case, if the equitable assignee wants to bring proceedings to enforce the payment obligation, it must do so through the assignor (or must join the assignor as a party to the proceedings), because the assignor is still the legal owner of the obligation.

70 Re *Hardman; Ex parte Official Receiver* (1932) 4 ABC 207, at page 210.

Legislation in all States and Territories now facilitates a legal assignment of payment obligations as well.[71] A legal assignment needs to be in writing and to be absolute, and written notice of the assignment needs to be given to the obligor. If the legislative requirements are satisfied, the assignee is able to recover payments directly from the obligor, and does not need to involve the assignor in the enforcement proceedings. The assignor is no longer able to enforce the debt, and as a practical matter is no longer able to credibly claim to have an interest in it.

Given this practical effect of a legal assignment of an account, Consultation Paper 1 queried whether it is appropriate for legal assignments of accounts to be deemed to be security interests by s 12(3)(a) and so brought within the Act. If a legal assignment is by way of security, of course, it will be captured by s 12(1), despite its apparent outright nature. That accords with established legal principle, as the transferor would be regarded under the general law as holding a residual property interest in the account (a so-called equity of redemption). If an outright legal transfer is captured under s 12(3), however, the effect is that the transferor continues for the purposes of the Act to have an interest in the account, or at least continues to be able to grant interests in the account to third parties, even though the transferor has severed all connection with the account. While it is clearly possible for the Act to have this effect, it is not a very intuitive outcome.

For these reasons, Consultation Paper 1 suggested that the Act might be amended so that s 12(3)(a) does not apply to a transfer of an account that is an outright legal transfer.

4.3.2.4.2 ***Discussion of stakeholder feedback***

Some respondents agreed with this suggestion. The majority of respondents, however, did not. While not all respondents provided reasons for their view, the respondents who disagreed with the proposition appear to have been persuaded by the benefits that flow from having a clear and consistent set of rules apply to all types of transfers of an account. And as one response explained,[72] difficult priority questions would arise if an account was the subject of competing transfers, with one of the transfers subject to the Act and the other not. The Act does not provide any guidance on priority competitions such as this, so the answer would need to be found in the general law. It is not readily apparent how the general law would respond.

I accept for these reasons that it would not be appropriate to amend the Act to exclude outright legal transfers of an account from the operation of s 12(3)(a).

4.3.2.4.3 ***Recommendation***

Recommendation 12: *That the Act not be amended to provide that s 12(3)(a) does not apply to an outright legal transfer of an account.*

71 *Civil Law (Property) Act 2006* (ACT) s 205; *Law of Property Act 2000* (NT) s 182; *Conveyancing Act 1919* (NSW) s 12; *Property Law Act 1974* (Qld) s 199; *Law of Property Act 1936* (SA) s 15; *Conveyancing and Law of Property Act 1884* (Tas) s 86; *Property Law Act 1958* (Vic) s 134; *Property Law Act 1969* (WA) s 20.

72 KWM, CP1 page 2.

4.3.2.5 Should a novation of an account be treated as a transfer?

4.3.2.5.1 *The issue*

It is not uncommon in corporate finance transactions for a debt to be "transferred" by way of a novation. Under this type of arrangement, a lender "transfers" the benefit of a loan to another financier by means of a three-way agreement between the lender, the new financier and the borrower. Under that agreement, the borrower and the outgoing lender agree to cancel their loan, in return for the borrower agreeing to owe identical obligations to the new lender instead. In other words, the existing loan is not transferred, but is cancelled and replaced by a new loan obligation between the borrower and the new lender.

This would not be regarded as a "transfer" of the existing loan on the traditional understanding of the term "transfer". It might be thought, however, particularly given the "substance over form" approach that the Act takes to determining whether a transaction gives rise to a security interest under s 12(1), that a novation of this nature could be a "transfer" for the purposes of s 12(3)(a).

The issue will be less relevant if the definition of "account" is clarified in a way that makes it clear that it does not include corporate debt obligations. See Section 4.3.2.2. It would then be very unlikely to be an issue in practice, as it would be highly unusual in my experience for a trade receivable or book debt to be dealt with by way of novation.

For these reasons, Consultation Paper 1 proposed that the Act did not need to be amended to clarify whether a novation of an account could be a transfer for the purposes of s 12(3)(a).

4.3.2.5.2 *Discussion of stakeholder feedback*

The majority of respondents agreed that the Act should not be amended to confirm that a novation of an account was not a transfer of the account for the purposes of s 12(3)(a). It was not always clear from the responses, however, whether the respondents agreed that a novation was not a transfer, or whether they were simply of the view that the Act did not need to be amended to confirm the position one way or the other.

A number of respondents thought that the question was sufficiently important that it should be addressed in the Act. I expect however that this view was based on the prospect that corporate loan obligations could be regarded as accounts for the purposes of the Act, and I have separately recommended (see Section 4.3.2.2) that the definition of "account" be clarified in a way that would make it clear that this is not the case. If that recommendation is adopted, then the need to clarify the nature of a novation for the purposes of s 12(3)(a) is diminished.

One response expressed the view that it could be possible for a novation to be a transfer for the purposes of the section.[73] The response went on to suggest that much of the sting could be taken out of breadth of the concept of a transfer of an account, however, if the Act were to adopt the approach taken by Article 9 to transfers of accounts, and deem a transfer of an account to be automatically perfected unless the transfer was part of a transfer of a "significant part" of the transferor's outstanding accounts.[74]

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73 AD, CP1 page 7.

74 Article 9, §9-309(2).

The effect of the Article 9 approach described in the previous paragraph would be to make some transfers of an account undiscoverable, as they would be perfected automatically, without registration. That approach could also raise difficult questions about whether any particular transfer of an account was part of a transaction that involved a transfer of a "significant part" of the transferor's accounts at the time of the transfer. In any event, the approach taken by Article 9 to transfers of accounts is different to the approach taken in the Act (and in the Canadian PPSAs and the NZ PPSA) in a number of ways, and I would be loath to recommend that we adopt the Article 9 approach without a full examination of the impact of doing so, particularly if that were to be done in isolation from the balance of the Article 9 provisions.

The question of whether a novation of an account can be a transfer for the purposes of s 12(3)(a) will be of diminished importance, if the meaning of the term "account" is amended to make it clear that it does not include corporate loans. If that change is not made, however, then I believe that the Act should be amended to make it clear that a novation of a loan obligation will not be a transfer for the purposes of s 12(3)(a).

4.3.2.5.3 *Recommendation*

Recommendation 13: *That the Act be amended to confirm that a novation of an account is not a "transfer" for the purposes of s 12(3)(a) of the Act, unless it is clear that a corporate loan obligation is not an "account".*

4.3.2.6 Should a declaration of trust be treated as a transfer?

4.3.2.6.1 *The issue*

At general law, an equitable assignment (or transfer) of an account is conceptually different to a declaration of a trust over it.[75] As a practical matter, though, they achieve very similar outcomes, as the result in each case is that the assignor/trustee has just the legal title to the asset, and equitable title to the asset is vested in the assignee/beneficiary. Similar to the discussion above in relation to outright legal transfers and novations, it should be asked whether it is appropriate as a policy matter for the Act to apply to one but not the other.

I can see that it would not be desirable to allow a receivables financing arrangement to escape the operation of the Act by being structured as a declaration of trust rather than an assignment. It is highly likely, however, that such an arrangement would be in substance a security interest and so captured by s 12(1), whether or not the declaration of trust was also a transfer and so within s 12(3)(a). And while a declaration of trust over an asset can produce an outcome that is similar to an equitable assignment of the asset, declarations of trust operate in many ways, and are often in favour of multiple beneficiaries, and it would be quite impractical, in my view, for s 12(3)(a) to apply to all of them. It would be impractical for the Act to apply, for example, where a trustee declares that it holds an account on trust under a trust that has multiple beneficiaries, as it would otherwise be necessary for each beneficiary to then perfect (presumably by registration) against the trustee, in order to protect its beneficial interest in the account.

75 See *Barbados Trust Co v Bank of Zambia* [2007] All ER (D) 350.

It could also become very difficult to know where to draw the line between a declaration of trust that was a transfer and one that was not. This could raise just the type of characterisation difficulty that s 12(3)(a) was intended to avoid.

Consultation Paper 1 expressed the view that a declaration of trust over an account should not be regarded as a transfer of the account for the purposes of s 12(3)(a). Similar to the approach taken above in relation to novations, however, it did not propose to recommend that the Act be amended to clarify this.

4.3.2.6.2 ***Discussion of stakeholder feedback***

Responses on this question were mixed.

The majority of responses thought that it was not necessary to clarify whether a declaration of trust over an account could be a transfer of the account for the purposes of s 12(3)(a). Again, however, it was not always clear whether this was because the respondent agreed that a declaration of trust would not be a transfer, or whether it was because they did not feel that it was necessary to clarify the question one way or the other.

Some responses suggested that a declaration of trust over an account could be a transfer of the account for the purposes of s 12(3)(a), on the basis that the in-substance effect of the declaration of trust is the same as an assignment in equity. Not all responses agreed with that proposition, however.

My view on balance is that a declaration of trust over an account should generally not constitute a transfer of the account for the purposes of s 12(3)(a). As noted above, a receivables financing that is structured using a declaration of trust structure is likely to give rise to an in-substance security interest under s 12(1), making it unnecessary to decide whether the transaction is captured by s 12(3) as well. A receivables financier is unlikely in any event to consciously structure its transaction in a way that takes it outside the Act, as it would then be unable to make use of the priority mechanism provided for accounts financiers in s 64. And any net value that might be gained by treating declarations of trust as transfers would be outweighed by the difficulties that would then be encountered in deciding what declarations of trust were captured, and which ones were not.

In any event, I agree with the majority of respondents that it is not necessary to amend the Act to clarify this further.

4.3.2.6.3 ***Recommendation***

> **Recommendation 14:** *That the Act not be amended to clarify whether a declaration of trust can be a "transfer" for the purposes of the Act.*

4.3.3 Section 12(3)(a) – transfers of chattel paper

4.3.3.1 ***The issue***

The term "chattel paper" is defined in s 10 of the Act in this way:

> ***chattel paper*** means one or more writings that evidence a monetary obligation and either or both of the following:
>
> (a) a security interest in, or lease of, specific goods, or specific goods and accessions to the specific goods (even if the description of the goods (and accessions) is taken to include a description of intellectual property, or an intellectual property licence, under section 105);

(b) a security interest in specific intellectual property or a specific intellectual property licence;

but does not include any of the following:

(c) a document of title;

(d) an intermediated security;

(e) an investment instrument;

(f) a negotiable instrument.

A similar (but simpler) definition can be found in the Canadian PPSAs,[76] and the NZ PPSA.[77]

At the risk of over-simplifying the concept, chattel paper can be said to be rather like a secured account. This suggests that the reasons for including transfers of accounts in the Act should justify extending the Act to transfers of chattel paper as well. There is, however, an important difference between an account and chattel paper, and that is that the concept of "chattel paper" is not recognised by Australian law outside the Act.

The term "chattel paper" is an expression that was first coined in Article 9, to enable Article 9 to facilitate a particular method of financing motor vehicles (and some other consumer goods) that was prevalent in the United States at that time.[78] Under that financing method, if a customer wanted to finance the purchase of a motor vehicle (for example), the dealer that sold the motor vehicle to the customer would provide the initial finance itself, and would take security over the motor vehicle to secure repayment of the loan. At appropriate intervals, the dealer would then bundle up the secured loan contracts that it had made to its customers, and transfer them as a package to a financier. It appears that this type of transfer of the secured loan contracts to the financier had acquired a semi-negotiable status under United States law even before Article 9 was introduced, and Article 9 sought to preserve that status.[79] It did this in part through the inclusion of Article 9 of a provision that is equivalent to s 71 of the Act.[80]

Chattel paper financing also is also said to have been a "key feature" of Canadian secured financing since the early 1900s.[81]

It has been pointed out with some force, however, that the Australian motor vehicle and consumer finance industry does not work in this way.[82] This makes it appropriate to ask whether the concept of "chattel paper" and the related provisions in the Act, including in particular s 71, should be retained.

It was put to me, in discussions around the time the Act was introduced, that it did not matter that chattel paper was not a current term of art, or that the Australian finance industry did not currently rely on chattel paper as a financing tool, because it was hoped that including chattel paper and the associated machinery in the Act would foster the development of a market in chattel paper in the same way as in the overseas jurisdictions. Two submissions suggested

76 For example Sask PPSA, s 2(1)(f).

77 NZ PPSA, s 16.

78 See Duggan, *Chattel Paper* (2013) 41 ABLR 214.

79 See Gilmore, § 25.5.

80 Article 9, §9-330.

81 Sask Law Commission Report, pages xvii to xviii.

82 Duggan, *Chattel Paper* (2013) 41 ABLR 214.

that this may indeed be starting to be the case.[83] The message from most submissions however was that the inclusion of the concept of chattel paper in the Act is much more of a hindrance in commercial transactions than a benefit.[84] As one example, because s 71 provides priority to a purchaser of chattel paper that takes possession of the physical instrument, a financier to a leasing company now has to consider whether it needs to take physical possession of all the leasing company's lease contracts as they are entered into, in order to avoid the risk that the leasing company could give a superior interest in its portfolio to another financier by transferring possession of the contracts to that other financier. Leasing companies understandably resist being required to provide their financiers with physical possession of all their leasing contracts, as this would significantly disrupt their business operations. Because this leaves the financier exposed to the risk that the value of its security package could be eroded, however, it may make the financier more reluctant to extend credit to the leasing company, or may cause the financier to provide credit on less favourable terms. This outcome is contrary to one of the over-arching objectives of the Act, which is to improve the ability of businesses to use their assets as collateral, and to access finance more cost-effectively.

The concept itself is also a source of considerable uncertainty. Uncertainty arises, for example, where the chattel paper consists of a financing arrangement under which the secured party is the owner of the asset and leases it to the grantor. It is not too difficult to conceptualise the effect of a transfer of chattel paper where the chattel paper consists of a secured loan, as the secured party, by transferring the chattel paper, is transferring to the transferee the benefit of the loan and the security. In the case of chattel paper that represents a leasing arrangement, however, what happens to the secured party's ownership of the goods themselves when the secured party deals with the chattel paper – for example, by transferring possession of the chattel paper under s 71? Does the original secured party retain ownership of the goods, or does ownership of the goods transfer to the transferee as part of the transfer of the chattel paper? If the original secured party does retain ownership, what happens to its ownership when the transferee secured party enforces the chattel paper rights against the lessee?

It may be that this uncertainty was not such an issue under Article 9, because prior United States law had already taken the step of re-characterising transactions such as finance leases into secured loans and treating the putative owner/lessor of the goods as only having security over them.[85] It is however a source of confusion and uncertainty under the Act, as the particular aspects of United States law that helped to make sense of the concept of chattel paper under Article 9 are not all part of our legal system.

A number of submissions expressed similar concerns about the inclusion of the concept of chattel paper in the Act, and proposed that it be deleted.[86] Consultation Paper 1 also expressed the view that the concept should be removed from the Act.

83 ABA, S2 page 5; AICM, S2 page 6. The ABA indicated in a later meeting however that the member that had made this observation had not followed up on a request to substantiate the statement, so the strength of the proposition remains untested.

84 For example: JLF, S1 page 25; AFC, S2 att B page 2.

85 Gilmore, § 3.6.

86 For example: AFC, S2 att B page 2; DIFA, S2 att A page 4.

4.3.3.2 ***Discussion of stakeholder feedback***

Almost all responses were in favour of removing the concept of chattel paper from the Act. Two responses expressed support for retaining the concept, on the basis that a niche market in chattel paper was developing or might develop.[87] I have not been provided with any information that might substantiate this, however, so the strength of that proposition remains untested.[88] In any event, the clear majority view (and my view) is that the concept of chattel paper is generating more difficulties than the potential benefits would justify. In my view, it should be removed from the Act.

4.3.3.3 ***Recommendation***

Recommendation 15: *That the definition of "chattel paper" in section 10, and all references in the Act to chattel paper (including s 71), be deleted.*

4.3.4 Section 12(3)(b) – commercial consignments

4.3.4.1 Should the Act apply to a commercial assignment, if it is not an in-substance security interest?

4.3.4.1.1 ***The issue***

Section 10 of the Act defines a "commercial consignment" in this way:

> ***commercial consignment*** means a consignment if:
>
> (a) the consignor retains an interest in goods that the consignor delivers to the consignee; and
>
> (b) the consignor delivers the goods to the consignee for the purpose of sale, lease or other disposal; and
>
> (c) the consignor and the consignee both deal in goods of that kind in the ordinary course of business;
>
> but does not include an agreement under which goods are delivered to:
>
> (d) an auctioneer for the purpose of sale; or
>
> (e) a consignee for sale, lease or other disposal if the consignee is generally known to the creditors of the consignee to be selling or leasing goods of others.

The NZ PPSA defines the concept in somewhat simpler terms:

> **Commercial consignment** –
>
> (a) Means a consignment where –
>
> (i) A consignor has reserved an interest in the goods that the consignor has delivered to the consignee for the purpose of sale, lease, or other disposition; and
>
> (ii) Both the consignor and the consignee deal in the ordinary course of business in goods of that description; and
>
> (b) Does not include an agreement under which goods are delivered to an auctioneer for the purpose of sale;[89]

87 ABA, CP1 page 8; AICM, CP1 page 8.

88 See note 83.

89 NZ PPSA, s 16.

Section 4.3.1.2 set out four arguments that have been put forward to support the extension of the Act to some transactions that do not necessarily have a security function:

- the "publicity argument" – that extending the Act to the transaction allows third parties an opportunity to become aware of what would otherwise be an invisible interest in property.
- the "characterisation difficulties" argument – that extending the Act removes the need to decide whether or not a particular transaction is within the "in-substance" test for a security interest in s 12(1).
- the "similar arrangements" argument – that the Act should apply, for consistency reasons, to transactions that do not use property to secure finance, but instead use property to raise finance.
- the "better rules" argument – that the Act should be extended to cover a transaction because the Act provides a simpler and clearer set of rules for the transaction than the laws that would otherwise apply to it.

It is not clear that the "characterisation difficulties" or "better rules" arguments are particularly compelling in relation to consignments. However, I can see that the "publicity" and "similar arrangements" arguments could provide good reasons for extending the Act to commercial consignments, whether or not they operate in substance as security.

It must still be asked, however, whether commercial consignments are a sufficiently important feature of the Australian economy that it could cause "significant disruption" if they were left out of the Act, as that will help to determine whether it is appropriate that the Act go to the effort of including provisions that deal expressly with them.

It has been suggested that consignment sales became a feature of Canadian financing practice because they enabled parties to avoid the "difficulties and technicalities" that were associated with some other types of chattel financing.[90] It appears, for example, that sales on consignment were an important element of the financing landscape in Saskatchewan at the time it enacted the Sask PPSA.[91] The NZ Law Commission Report also suggests that commercial consignments may have been an important feature of the New Zealand financial marketplace at the time that New Zealand was exploring the prospect of introducing the NZ PPSA. It states, for example, that a "common" example of this type of transaction is the bailment or "floor plan" financing arrangement that motor vehicle manufacturers or finance companies commonly provide to motor vehicle dealers.[92]

Bailment or floor plan financings are also a common financing tool in Australia. As they are typically structured here (as I understand it), though, they are unlikely to be "commercial consignments", as the motor vehicle dealer does not usually have the authority to sell vehicles as the manufacturer's or financier's agent. Under this type of arrangement as it commonly operates in Australia, the manufacturer or financier makes the vehicles available to the vehicle dealer by way of a bailment. The manufacturer or financier remains the owner of the vehicles, and the dealer is given possession of them. That enables the dealer to make the vehicles available

90 B Colburn, *Consignment Sales and the Personal Property Security Act* (1981-82) I Can. Bus. L.J. 40, at page 42.

91 Sask Law Commission Report, Comment 3 to s 3 of the proposed draft legislation.

92 NZ Law Commission Report, page 82.

for inspection by prospective purchasers on the dealer's showroom floor. While the dealer has possession of the vehicles, though, it does not typically have a right to purchase them, or to sell them as the manufacturer's or financier's agent. Rather, when the dealer enters into a contract to sell the vehicle to a customer, it asks the manufacturer or financier to sell the vehicle to it, so that it can complete the on-sale. It is the fact that the dealer does not sell the vehicle as the manufacturer's or financier's agent that means that the typical bailment or floor plan financing in Australia would not be a consignment transaction on the common understanding of the term.

Bailment or floor plan arrangements of this type are highly likely to be in-substance security interests under s 12(1), so in my view it is not necessary to ensure that they are captured by the Act by also deeming them to be commercial consignments.

For these reasons, Consultation Paper 1 queried whether commercial consignments were a sufficiently important feature of the Australian commercial environment to warrant specific treatment in the Act.

4.3.4.1.2 ***Discussion of stakeholder feedback***

In contrast to the preliminary view expressed in Consultation Paper 1, a number of respondents indicated that they do regularly encounter commercial consignments in their business activities. It is perhaps also instructive that consignment sales have featured in a recent reported case on the Act.[93] The majority of respondents also expressed the view that the Act should continue to apply to commercial consignments.

For these reasons, I accept there may be benefit in retaining s 12(3)(b), and that there is no clear case for deleting it.

4.3.4.1.3 ***Recommendation***

Recommendation 16: *That s 12(3)(b) be retained.*

4.3.4.2 **What should be a "commercial consignment" for this purpose?**

4.3.4.2.1 ***The issue***

The expression "commercial consignment" as used in the Act is a rather narrow one. In particular, a consignment is only a "commercial consignment" if both the consignor and the consignee deal with goods of the relevant kind in the ordinary course of business, and if the consignee's creditors are not generally aware that the consignee is selling or leasing goods belonging to others.

Consultation Paper 1 queried whether consideration should be given to adjusting the parameters of the term in 2 ways:

- First, to amend paragraph (c) of the definition so that it is only necessary for the consignor (and not also the consignee) to be in the business of dealing in goods of that kind (eg that the consignor be "regularly engaged in the business of disposing of goods"). This would make it more consistent with the current risk allocation principles that sit behind the definition of a PPS lease.

93 Re *Arcabi Pty Ltd* [2014] WASC 310.

- Secondly, to amend paragraph (e) of the definition by deleting the words "to the creditors of the consignee" – so that a transaction will not be a commercial consignment if the consignee is "generally known to be selling or leasing goods of others". This suggestion was made because it is not clear why the test should focus on what is generally known to the consignee's creditors, as they are by no means the only class of people who may be interacting in a relevant way with the consignee.

4.3.4.2.2 ***Discussion of stakeholder feedback***

Most responses on this question were in favour of the proposed changes.

The visual arts industry

One submission on behalf of the visual arts industry highlighted in particular the difficulties that artists face in dealing with the regime established by the Act.[94] Many artists sell their work through galleries on a consignment basis, and for an artist that loses one of their works as a result of the application of the Act, the loss is not just a financial one, but a personal one as well. The submission suggested that the Act should be amended to provide that a sale of artwork on consignment to a gallery or agent should be presumed to be exempt from the Act.

For reasons I have discussed elsewhere,[95] I am loath to deal with specific practices, or issues that affect specific industries, by means of *ad hoc* exemptions, as they add to the complexity of the Act and are contrary to the objective of achieving consistency across Australia's secured transactions laws. I believe however that the concerns expressed in the submission can be dealt with in a different way.

One difficulty faced by artists selling through galleries is that the artist's position is dependent on what is actually known by third parties about the circumstances of the individual galleries that the artist sells through. It might be generally known throughout the art world, for example, that galleries sell goods on consignment, but whether a consignment to a particular gallery is within or outside the Act will depend in part on whether third parties actually know that to be the case for that particular gallery. I believe there is merit in adjusting paragraph (e) of the definition of "commercial consignment" so that the limitation turns on whether third parties either actually know or **should** know that the consignee sells or leases goods of others, rather than focus solely on what is in fact known about the individual consignee. Through my (somewhat limited) dealings with the art world, I expect that people either do know, or should know, that art galleries commonly sell art works on a consignment basis. If that is correct, then a sale of an artwork on consignment through an art gallery is unlikely to give rise to a commercial consignment for the purposes of the Act, and the artist should not need to register a financing statement or take other steps to protect their interest.

As for the proposed change to paragraph (c) of the definition, it might be thought that deleting the reference to "the consignee" could increase the risk for a consignor that the Act could apply to their consignment arrangement. Against that, it could be argued that consignors are likely to be sufficiently protected by the fact that a consignment will only be a "commercial consignment" if the consignee is or should be generally known to be selling or leasing goods of others (under

94 NAVA, S2 page 2.

95 See Annexure C.

paragraph (e) of the definition). Having said that, though, I can see that there is no particularly compelling case for deleting the reference to the consignee from paragraph (c) as well.

For these reasons, my conclusion is that paragraph (c) of the definition of "commercial consignment" should remain unchanged, but that paragraph (e) should be amended as just discussed.

4.3.4.2.3 ***Recommendation***

Recommendation 17: *That paragraph (e) of the definition of "commercial consignment" in s 10 of the Act be amended to read:*

(e) a consignee for sale, lease or other disposal if the consignee is or should reasonably be generally known to be selling or leasing goods of others.

4.3.5 Section 12(3)(c) – PPS leases

4.3.5.1 Should the Act apply to a PPS lease, if it is not an in-substance security interest?

4.3.5.1.1 ***The issue***

Section 13 of the Act defines the term "PPS lease" in this way:

Meaning of PPS lease

(1) A ***PPS lease*** means a lease or bailment of goods:

(a) for a term of more than one year; or

(b) for an indefinite term (even if the lease or bailment is determinable by any party within a year of entering into the lease or bailment); or

(c) for a term of up to one year that is automatically renewable, or that is renewable at the option of one of the parties, for one or more terms if the total of all the terms might exceed one year; or

(d) for a term of up to one year, in a case in which the lessee or bailee, with the consent of the lessor or bailor, retains uninterrupted (or substantially uninterrupted) possession of the leased or bailed property for a period of more than one year after the day the lessee or bailee first acquired possession of the property (but not until the lessee's or bailee's possession extends for more than one year); or

(e) for goods that may or must be described by serial number in accordance with the regulations, if the lease or bailment is:

(i) for a term of 90 days or more; or

(ii) for a term of less than 90 days, but is automatically renewable, or is renewable at the option of one of the parties, for one or more terms if the total of all the terms might be 90 days or more; or

(iii) for a term of less than 90 days, in a case in which the lessee or bailee, with the consent of the lessor or bailor, retains uninterrupted (or substantially uninterrupted) possession of the leased or bailed property for a period of 90 days or more after the day the lessee or bailee first acquired possession of the property, (but not until the lessee's or bailee's possession extends for 90 days or more).

(2) However, a ***PPS lease*** does not include:

(a) a lease by a lessor who is not regularly engaged in the business of leasing goods; or

(b) a bailment by a bailor who is not regularly engaged in the business of bailing goods; or

(c) a lease of consumer property as part of a lease of land where the use of the property is incidental to the use and enjoyment of the land; or

(d) a lease or bailment of personal property prescribed by the regulations for the purposes of this definition, regardless of the length of the term of the lease or bailment.

Bailments for value only

(3) This section only applies to a bailment for which the bailee provides value.

The NZ PPSA defines its corresponding concept in these terms:

Lease for a term of more than 1 year –

(a) Means a lease or bailment of goods for a term of more than 1 year; and

(b) Includes –

(i) A lease for an indefinite term, including a lease for an indefinite term that is determinable by 1 or both of the parties not later than 1 year after the date of its execution; and

(ii) A lease for a term of 1 year or less that is automatically renewable or that is renewable at the option of 1 of the parties for 1 or more terms, where the total of the terms, including the original term, may exceed 1 year; and

(iii) A lease for a term of 1 year or less where the lessee, with the consent of the lessor, retains uninterrupted or substantially uninterrupted possession of the leased goods for a period of more than 1 year after the day on which the lessee first acquired possession of them, but the lease does not become a lease for a term of more than 1 year until the lessee's possession extends for more than 1 year; but

(c) Does not include –

(i) A lease by a lessor who is not regularly engaged in the business of leasing goods; or

(ii) A lease of household furnishings or appliances as part of a lease of land where the use of the goods is incidental to the use and enjoyment of the land; or

(iii) A lease of prescribed goods, regardless of the length of the lease term.[96]

The concept of a PPS lease, and the consequences for an owner of goods if they enter into a PPS lease with those goods, was the subject of far more comments (and criticisms) in the submissions than was the case for any other topic. Submissions from the short–term hiring industry were especially vehement in their

96 NZ PPSA, s 16.

criticism of the fact that their hiring activities are subject to the Act.[97] They objected in particular to the fact that they are at risk of losing ownership of their goods in the insolvency of a customer, if they have hired the goods to the customer for an indefinite period and the customer becomes insolvent during the term of the hire. This was said to be an intolerable outcome, in particular for small hiring businesses that may struggle to understand how the Act could apply to them and what they need to do in order to protect themselves.

Leasing plays a major role in the Australian economy.[98] Lease finance is very commonly used by companies and individuals to finance the acquisition of an asset (as the very name lease "finance" suggests). A good deal of leasing activity also relates to what might broadly be described as operating leasing – where a company wants to acquire the use of a particular asset for a period of time, but on the basis that the company will return the asset to the lessor at the end of that period, for the lessor to then re-deploy elsewhere (eg by re-leasing it to another lessee).[99]

It is clear that leasing raises the "publicity" problem. A lessee of goods, by being in possession of the goods, is put in the position of being able to represent to outsiders that it has a better title to the goods than is in fact the case, as the lessor's ownership interest may not be visible to outsiders. The lessee's ability to do this is enhanced if it has been in possession of the goods for an extended period – that is, the longer the term of the lease, the greater the lessee's capacity to mislead.

Leasing also clearly raises the "characterisation" challenge. It can be seen from a long line of case law in Canada that it may be extremely difficult in some cases to determine whether the terms of a particular lease cause it to be an in-substance security interest.[100] This difficulty is said to be the reason why Ontario amended its PPSA in 2006 to apply its PPSA to leases for more than one year, to reflect the position that already applied under the other Canadian PPSAs.[101]

The "similar arrangements" argument could also support the extension of the Act to leases that do not operate as security, as some companies and financiers use operating leases as a structured alternative to finance leases.

So leasing is clearly a type of transaction that is appropriate for inclusion in the Act as a deemed security interest, based on these arguments.[102] It is also clear that leasing (including operating leasing) is a very important feature of our commercial environment,[103] so that it could cause "significant disruption" if leasing were left out of the Act. Seen in this way, there is a strong case for including leases (or at least longer-term leases) within the Act, even if they do not operate in substance as security.

97 For example: AITA, S2 page 2; HRIA, S1 page 8; Kerr, S1 page 2.

98 According to the Australian Bureau of Statistics, the total value of lease financing transactions for motor vehicles, plant and equipment in 2013/14 was in excess of $4.923 billion.

99 According to the Australian Bureau of Statistics, operating lease transactions in 2013/14 were valued at $2.437 billion.

100 See note 50.

101 Duggan & Brown, para 3.31.

102 The "better rules" argument is less persuasive for leases, as the prior law regarding the operation of leases was reasonably clear.

103 See notes 98 and 99.

There is of course an important practical distinction between a finance lease on the one hand, and an operating lease, or "true" lease, on the other. In the case of a finance lease, the lessor is providing the lessee primarily with finance – the lessor's title to the leased goods operates as security for that finance, and the lessor does not expect or want the goods to be returned to it, even at the end of the lease term. Under an operating lease, in contrast, the lessor is providing the lessee primarily with the use of an asset (and not with finance), and the lessor expects to have the asset returned to it in due course. In the case of an operating lease, the lessor still regards the asset as its property, in a commercial and business sense, even though the asset is in the lessee's possession. Such a lessor might ask, not unfairly, why its commercial arrangements should be caught up in legislation that deals with secured finance, when it is not providing finance at all.

It is clear from submissions and from anecdotal evidence that many lessors have been surprised and dismayed to discover that their business activities are subject to the Act.[104] Treating lease arrangements as security interests (when they do not operate in fact as security) also significantly increases the conceptual complexity of the Act, for example in relation to the common practice of subleasing – a topic to which I return in Section 7.3.3 below. Despite these justified concerns, however, it seems to me that leasing is such a widespread and significant commercial activity, and so clearly engages the rationales for extending the Act to some non-security transactions, that it is appropriate for the Act to apply to at least some leases, even though they do not operate in substance as security. This is consistent with the approach taken in the NZ PPSA,[105] and the Canadian PPSAs.[106]

Consultation Paper 1 invited stakeholders to comment on this.

4.3.5.1.2 ***Discussion of stakeholder feedback***

A small number of respondents took the view that there was insufficient justification for extending the reach of the Act to non-security leases. The overwhelming majority of respondents agreed however that it is appropriate for the Act to apply to some non-security leases, principally because of the "publicity" and "characterisation" concerns. I am also satisfied that it is appropriate for the Act to continue to do so.

This is not to say, of course, that the Act should apply to all leases. This is discussed below.

4.3.5.1.3 ***Recommendation***

Recommendation 18: *That s 12(3)(c) be retained, so that the Act will continue to apply to some types of longer–term leases, whether or not they operate in substance as security for payment or performance of an obligation.*

104 See for example: Manlift, S1; Chalkwest, S1; Payne, S1; Kerr, S1.

105 NZ PPSA, s 16.

106 For example Sask PPSA, s 3(2). Article 9, in contrast, applies only to leases that are in-substance security interests, and not to "true" leases.

4.3.5.2 The *Personal Property Securities Amendment (Deregulatory Measures) Bill 2014*

4.3.5.2.1 *The issue*

The *Personal Property Securities Amendment (Deregulatory Measures) Bill 2014* is currently before Parliament. If passed, it will remove paragraph (1)(e) from the definition of PPS lease in s 13, and make consequential amendments to other provisions in the Act.

Consultation Paper 1 supported the proposed deletion of paragraph (1)(e) from the definition of PPS lease, and consequential amendments, as contemplated by the Bill.

4.3.5.2.2 *Discussion of stakeholder feedback*

A small number of respondents expressed some reservations about the practical effects of deleting paragraph (1)(e) from the definition of PPS lease. All other respondents approved of the amendments contemplated by the Bill.

Some respondents suggested that it might then be appropriate to replace the term "PPS lease" throughout the Act with the expression "lease for more than one year". The responses suggested that this could increase transparency. It would also bring the terminology into line with the language used in the Canadian PPSAs and the NZ PPSA. On balance, however, I am not in favour of recommending this change. Users of the Act have become quite accustomed to working with the term "PPS lease", and while the term is arguably unhelpful, in that it does not give the reader any immediate sense of what the term captures, it is also helpful, in that it forces the reader to look at the definition of the term in s 13. While the expression "lease for more than one year" does capture the essence of the concept of a PPS lease, it risks masking the fact that some leases can be PPS leases even if they do not run for more than one year (for example, if a lease agreement has an initial term of less than one year, but includes renewal options that do not get exercised). Using a more content-neutral expression such as PPS lease eliminates the risk that a reader might take the expression "lease for more than one year" at face value, and end up being misled.

4.3.5.2.3 *Recommendation*

Recommendation 19: *That paragraph (1)(e) of the definition of "PPS lease" in s 13 of the Act be deleted.*

4.3.5.3 Should the Act apply to a bailment, if it is not an in-substance security interest?

4.3.5.3.1 *The issue*

The Act is unique among the major PPSA jurisdictions in the comprehensive way in which it extends the application of the regime to bailments.[107] The Canadian PPSAs do not refer to bailments at all in this context, and the corresponding definition in the NZ PPSA uses the term only once (although New Zealand case

107 Technically, a lease is also a form of bailment. The discussion in this Section of the report uses the term "bailment" as a convenient shorthand for "bailment other than a lease".

law has stated in effect that the term should also be implied into the balance of the definition of "Lease for a term of more than 1 year" in s 16 of the NZ PPSA, as if each subsequent reference to "lease" were a reference to "lease or bailment").[108]

A number of submissions argued that the Act should not apply to a bailment unless it is an in-substance security interest under s 12(1).[109] One submission expressed particular concern at the potential impact of the Act on bailment arrangements that are common in the horse racing industry.[110]

Section 13 of the Act does not capture all bailments. It only applies to bailments by a bailor who is regularly engaged in the business of bailing goods (similar to the limitation that applies in relation to leases). Section 13(3) then limits this further, so that it only applies to a bailment "for which the bailee provides value".

As a number of submissions pointed out, though, the inclusion of bailments in the definition of PPS lease has generated considerable uncertainty. [111] Owners of goods who give possession of the goods to others in the course of their business activities have not been confident that they fall within one of the exclusions, and have elected on occasion to register a financing statement against a bailee in order to ensure that they are protected. Depending on an owner's view of the level of risk involved and the scope of the limitations within the definition, this might cause the owner to register financing statements against bailees in a very wide range of circumstances, such as:

- a farmer who stores wheat in a grain silo operated by a bulk-handling company, or agists cattle with a neighbour;
- an artist who store works with a professional storage company; or
- arguably (perhaps at the extreme), any business that hands possession of a letter or parcel to a courier company, or even to Australia Post, for the purposes of delivery.

It is true that all these arrangements involve a passing of possession of goods to a bailee, and so might be said to raise the same publicity concern as leases. They are also very common arrangements, and so might be said to be a sufficiently important feature of the Australian commercial environment that it would do "significant disruption" if they were not covered by the Act.

On the other hand, it seems to me that it is inherently more likely in a bailment arrangement that outsiders will be alive to the fact that the bailee does not necessarily own the goods, even though they are in its possession. It is common knowledge, for example, that bulk handling companies generally do not own all the grain in their silos, and it is general knowledge that Australia Post does not normally own the parcels that it delivers. This will not be true for all bailments, of course, but will be true often enough to lead me to the view that bailments should not be treated by the Act in the same way as leases.

It would also be fair to say that bailments are less likely to engage the "characterisation difficulties" and "similar arrangements" reasons for extending the reach of the Act to non-security leases. It could also be argued that the "significant

108 *Rabobank v McAnulty* [2011] NZCA 212.

109 For example: ABA, S2 page 3; AFC, S2 att A page 1; LCA, S2 page 2; MBA, S2 page 9. Not all submissions agreed with this: AICM, S2 page 7.

110 ARB, S2.

111 For example: JLF, S1 page 26; LCA, S1 page 4; QLS, S1 page 1; CW, S1 page 1; HW, S2 page 3.

disruption" concern argues in favour of excluding bailments, on the basis that "significant disruption" is being caused by the fact that they are currently included in the Act.

In any event, the limitations on the types of bailments that are captured by the definition of PPS lease come close to restricting many of those bailments to ones that are in effect leases as well. At general law, a lease of goods is a bailment for reward, in that the owner of goods provides possession of them to another person, and the other person provides value (usually back to the owner) as consideration for having the possession and use of the goods for the agreed term. The combined effect of the limitations on the types of bailments that are captured (particularly the requirement that the bailment be one for which the bailee provides value) is arguably to reduce many of the types of bailments that are within the definition to ones that are likely to be leases as well.

For these reasons, Consultation Paper 1 expressed the view that the definition of PPS lease in s 13 should not apply to bailments, unless they are otherwise captured by that definition as leases.

4.3.5.3.2 ***Discussion of stakeholder feedback***

A small number of respondents were not confident that the references to "bailments" in s 13 should be deleted. The overwhelming majority of respondents agreed however that the definition of "PPS lease" in s 13 should be amended so that it does not apply to a bailment that is not otherwise captured by the definition as a lease.

One response expressed concern that this change might have the result that typical motor vehicle "bailment" or floor plan financing arrangements could fall outside the Act.[112] As I discussed in Section 4.3.4.1, however, I am satisfied that those arrangements, as I understand them, would be highly likely to give rise to an in-substance security interest under s 12(1) of the Act, and that the Act would apply to them for that reason even if the definition of "PPS lease" is amended as discussed in this Section.

The references to bailments in s 13 of the Act generate uncertainty and produce undesirable outcomes. I am satisfied that the references should be deleted.

4.3.5.3.3 ***Recommendation***

Recommendation 20: *That the definition of PPS lease in s 13 be amended to remove all references to "bailments".*

4.3.5.4 **Should the Act apply to a lease with an indefinite term of less than one year, if it is not an in-substance security interest?**

4.3.5.4.1 ***The issue***

A number of submissions,[113] particularly submissions from members or representatives of the short-term hiring industry, were of the view that the Act should not apply to a lease with a term of less than one year, whether or not it has a definite term.

112 AFC, CP1 page 8.

113 For example: AFC, S1 att B, page 6; HRIA, S1 page 6.

I am told that it is common in the short-term hiring industry for businesses to lease goods out on short-term arrangements to a large number of customers, and that the cost and administrative burden associated with managing proper PPSA registration practices can be overwhelming for this business sector, particularly for the many small operators. Leases may be agreed at very short notice, and on occasions may involve serial-numbered property and/or equipment that will be inventory in the hands of the lessee. In these situations, the hirer would want to register a specific financing statement against its customer before handing over possession – something that may be quite impracticable in a fast-moving business environment.

Business owners often have no option but to complete their registrations in the evening, rather than in real-time during the business day. This exposes them to both intra-day risk, and to the risk of losing their PMSI super-priority. And some small operators have limited legal knowledge, which means that they struggle to understand how to register correctly. For these reasons, the short-term hiring industry maintained that the Act should not apply to them.

I am satisfied that there is a concern here that needs to be addressed.

One of the solutions put forward in some submissions was that the short-term hiring industry should simply be excluded from the operation of the Act altogether.[114] As I have observed elsewhere in this report, however, I am not in favour of addressing specific concerns such as this by way of *ad hoc* exclusions or carve-outs from the Act (unless there is no alternative), as they add to the complexity of the Act and increase the difficulty of working with the Act for those that remain subject to it. They can also raise difficult definitional issues in the formulation of the carve-out, and risk compromising the Act's broader objectives.

Consultation Paper 1 expressed the view that it might be appropriate to amend the definition of "PPS lease" so that a lease for an indefinite term that in fact ends within one year is not captured by the definition. This was based in part on the fact that there is no obvious reason why a lease that is of an indefinite term but happens to run for two months should be captured as a PPS lease, when a lease that is for a fixed term of two months is not. A lessee in possession of goods under the first type of lease is no more able to deceive others as to the nature of its interest in the goods, and the first type of lease is no more susceptible to characterisation difficulties than the other.

If a lease for an indefinite term was still on foot after one year, of course, then it should become a PPS lease (assuming it satisfied the other requirements in s 13) at that time.

The effect of this change would be that the definition of PPS lease would capture a lease of goods:

- for an agreed term of more than one year (taking into account renewal options); or
- for a period of initially less than one year, once the lease has in fact continued for more than one year.

114 For example: AITA, S1 page 3; HRIA, S1 page 8.

4.3.5.4.2 ***Discussion of stakeholder feedback***

Not all responses were in favour of this proposal. Some felt that the concerns expressed by the hiring industry did not justify making the change, while others were concerned that the change might open the definition of PPS lease to abuse through contrived structuring of lease arrangements. The respondents who raised this latter point may have done so, however, because the detail of the proposal may not have been sufficiently clear in Consultation Paper 1 (as the proposal was intended to be that a lease for an indefinite term would become a PPS lease for the purposes of the Act once its term actually exceeded one year).

The majority of responses were in favour of the proposal that a lease for an indefinite term should only be a PPS lease once it in fact runs for more than one year.

I am satisfied that the application of the Act to hiring arrangements of an indefinite term of less than one year is producing considerable hardship for an important business sector, and that those hardships outweigh the benefits that flow from including leases of an indefinite term in the Act. It is also difficult to see the logic behind capturing leases with an indefinite term of less than one year, but excluding leases with a definite term of less than one year. I propose for these reasons to recommend that a lease with an indefinite term of less than one year should not be captured by the Act as a PPS lease. If such a lease were an in-substance security interest, of course, it would still be subject to the Act, but under s 12(1).

It was suggested in some responses that a change along these lines might be problematic for lessors as an operational matter, because of s 151 of the Act or s 588FL of the Corporations Act, or because of the need to register a financing statement within the timeframe contemplated by s 62(2) in order to get the benefit of the PMSI priority. I believe that these concerns are all manageable, however, and return to them later in this report.[115]

4.3.5.4.3 ***Recommendation***

Recommendation 21: *That:*

- *s 13(1)(b) of the Act be deleted; and*
- *the words "for an indefinite term or" be inserted at the start of s 13(1)(d).*

4.3.5.5 **Should the "one year" test be changed?**

4.3.5.5.1 ***The issue***

Some submissions suggested that consideration be given to extending the "bright line" test of one year in the definition of PPS lease in s 13, to 2 or 3 years.[116] This was suggested as a further method of excluding simple hiring and rental arrangements from the Act.

As discussed earlier, 3 principal reasons are given for extending the reach of the Act to include some leases that do not operate in substance as security – that is, that are not security interests under s 12(1).

115 See Sections 6.10.4.3, 7.7.8.9 and 9.2.1.1 below.

116 For example: HRIA, S1 page 9; LCA, S2 page 2. Not all submissions agreed: AICM, S2 page 9.

The first reason is that it helps to address the "publicity" concern – the concern that a lessee in possession of goods for an extended period is able to mislead outsiders into believing that the lessee has better title to the leased goods than is in fact the case, because the lessor's ownership interest is not visible. According to this reason, those outsiders should be given the opportunity to determine whether the lessee is in fact the owner of the goods, by searching the Register. If this is the primary reason for extending the Act to longer-term leases, then it would compromise the objectives of the Act if the threshold time period were to be extended beyond one year, as that would increase the period of time during which a lessee would be able to mislead outsiders as to the true nature of its interest in the goods.

The second principal reason for extending the Act to leases that are not security transactions is the "characterisation difficulties" argument – the concern that it is often very difficult to say whether a particular lease is in fact a security interest under s 12(1). Under this argument, the bright line test of one year in s 13 adds clarity, and enables the Act to avoid the uncertainty that appears to have bedevilled the Canadian PPSAs before they introduced the same bright line test.[117] If this is the primary reason for applying the Act to longer-term leases, then there may well be a good case for extending the bright line test from one year, to 2 or perhaps 3 years. That is because it would be unusual in my experience for a finance lease to have a scheduled term of less than 2 or 3 years.

The third principal reason for extending the Act to leases that are not security transactions is the "similar arrangements" argument – the argument that operating leases can achieve commercially similar outcomes to leases that are in-substance security interests. That line of analysis, however, does not obviously help to determine what the threshold time period in the definition of PPS lease should be.

I believe that the changes to the definition of PPS lease that I have already recommended, and in particular the removal of s 13(1)(b) (the "indefinite term" provision), will resolve most of the concerns expressed by the short-term hiring industry. I am told that the short-term hiring industry may occasionally hire goods out for a period of more than one year, in particular in relation to major construction projects, but it could be argued that a lease for that term is such a significant transaction that the lessor could rightly be expected to take some additional steps to protect itself. And while not decisive of itself, it is instructive to observe that all other major PPSA jurisdictions with a similar provision continue to use one year as their bright line test as well.

For these reasons, Consultation Paper 1 expressed the view that the "one year" yardstick should remain as is.

4.3.5.5.2 ***Discussion of stakeholder feedback***

A small number of respondents also argued that the time period of one year in the definition of PPS lease should be extended, to 2 or 3 years. The great majority of respondents agreed, however, that the time period should stay as it currently is.

I am satisfied that the amendment of the definition of PPS lease to delete s 13(1)(b) will alleviate the bulk of the hardship that the Act has imposed on the hiring industry, and that there is no compelling case for changing the current one-year yardstick.

117 See Cuming Walsh & Wood, pages 125 to 133.

4.3.5.5.3 ***Recommendation***

Recommendation 22: *That references in s 13 of the Act to "one year" not be changed.*

4.3.5.6 **Leases that can be terminated early by agreement**

4.3.5.6.1 ***The issue***

One submission appeared to suggest that it should be made clear that a lease is not captured by s 13, even if it has a term of greater than one year, if it can be terminated earlier by agreement between the parties.[118] If that is a correct description of the proposal, I am not inclined to agree with it. Many leases allow the lessee to terminate the lease early, and it is always open to the lessor and the lessee to terminate a lease early by agreement. It seems to me for this reason that a change of this type would deprive the concept of a PPS lease of most of its content. It would also be inconsistent with the objective of responding to the "publicity" and "characterisation difficulties" concerns, as it would allow those longer-term leases to escape the operation of the Act even if they did in fact run on for more than one year.

The intent behind the proposal may however have been that such a lease would only be outside s 13 of the Act if it in fact terminated within the first year, and that the Act would apply to it, from the end of that first year, if it continued beyond that time. If this were the case, then the lessor under such a lease would have the option of waiting until near the end of the first year before deciding whether it needed to register, if the lessor was confident that the lease was not also an in-substance security interest under s 12(1).

Operationally, this may not be an attractive alternative for many lessors, as it is likely that they will want to address any registration needs up-front when the lease is entered into, rather than wait, and run the risk of forgetting to register on time near the end of the first year. Such an approach could also be at risk of falling foul of s 588FL of the Corporations Act, if that section remains in its current form.[119] There is however a pleasing symmetry between this proposal and the recommendation that I have made in Section 4.3.5.4 that a lease for an indefinite term should only become a PPS lease if it in fact runs for more than one year. Consultation Paper 1 indicated for that reason that I was tempted to agree with it.

4.3.5.6.2 ***Discussion of stakeholder feedback***

One response appeared to support the proposal that a lease should only become a PPS lease if it had in fact run for more than one year (whether or not the term of the lease was indefinite). All other respondents, however, were in favour of not making this change. So while there is some logic to the proposed change, I accept that there is little support for it. I also accept that there is no clear case for it to be made.

118 LCA, S2 page 2.

119 I recommend separately that s 588FL of the Corporations Act be deleted. See Section 9.2.2.1.

4.3.5.6.3 ***Recommendation***

> **Recommendation 23:** *That the Act not be amended to provide that a lease is not a PPS lease if it ends within one year.*

4.3.5.7 **The "regularly engaged in the business of leasing" requirement**

4.3.5.7.1 ***The issue***

Even if a lease satisfies the term requirements discussed above, it will only be a PPS lease if the lessor is "regularly engaged in the business of leasing goods" (see s 13(2)(a)). One submission queried whether this should be aligned with the language of s 46, and refer to a lessor who is regularly engaged in the business of leasing goods "of that kind".[120]

As I see it, however, different policy considerations are at work in the two sections. Section 46 determines when a buyer or lessee of property can take the property free of a security interest. The section only allows a buyer or lessee to take free if the sale or lease is in the ordinary course of the seller/lessor's business of selling or leasing of property of that kind. This reflects the commercial expectation that a buyer would expect to get clear title without investigation if it purchases a television from a retailer (for example), but not necessarily if it were to buy the retailer's office furnishings. The "of that kind" language in s 46 gives voice to that distinction.

Section 13 is limited to lessors who regularly engage in the business of leasing goods for a different reason. Any lease that satisfies the term requirements in s 13 has the capacity to mislead outsiders. It could also be unclear for such a lease whether it is also an in-substance security interest under s 12(1). The thinking behind s 13 accepts however that it would not be fair to impose the implications of s 13 and the Act on *ad hoc* lessors, and that it should only apply to lessors that are in the business of leasing and so should be expected to have investigated the content of the laws that affect their business, including the Act. There is no need in this context to limit the application of the section to leases of goods of the particular type that the lessor regularly leases out.

For these reasons, Consultation Paper 1 expressed the view that it would not be appropriate to make this change.

4.3.5.7.2 ***Discussion of stakeholder feedback***

One respondent was of the view that it was appropriate to limit the application of s 13 to a lease of goods by a lessor who is regularly engaged in the business of leasing goods of the particular kind. All other respondents agreed, however, that this change should not be made.

4.3.5.7.3 ***Recommendation***

> **Recommendation 24:** *That s 13(2)(a) not be amended to insert "of that kind" after the phrase "regularly engaged in leasing goods".*

120 LCA, S1 page 4.

4.4 The meaning of "personal property" in the Act

4.4.1 The definition

One of the over-arching objectives of the Act is to increase consistency across Australia's secured transactions laws. The Act will be best-placed to achieve this objective if it applies as broadly as possible.

To that end, the Act defines "personal property" in section 10 in wide terms:

> ***personal property*** means property (including a licence) other than:
>
> (a) land; or
>
> (b) a right, entitlement or authority that is:
>
> (i) granted by or under a law of the Commonwealth, a State or a Territory; and
>
> (ii) declared by that law not to be personal property for the purposes of this Act.

4.4.2 The meaning of "property"

4.4.2.1 ***The issue***

The Act does not separately define "property", but leaves its meaning to the general law. Consultation Paper 1 expressed the view that this is appropriate – the concept of property will continue to evolve over time, and it is desirable that the Act be able to move in tandem with that evolution, rather than set a pre-determined meaning in stone.

4.4.2.2 ***Discussion of stakeholder feedback***

All respondents agreed with this view.

4.4.2.3 ***Recommendation***

Recommendation 25: *That the Act not be amended to include a definition of "property".*

4.4.3 Licences

4.4.3.1 ***The issue***

The term "personal property" is defined to include a "licence". That term is also defined in s 10, in this way:

> ***licence*** means either of the following, if it is transferable by the licensee (whether or not the right, entitlement, authority or licence is exclusive, and whether or not a transfer is restricted or requires consent):
>
> (a) a right, entitlement or authority to do one or more of the following:
>
> (i) to manufacture, produce, sell, transport or otherwise deal with personal property;
>
> (ii) to provide services;
>
> (iii) to explore for, exploit or use a resource;
>
> (b) an intellectual property licence;

but does not include a right, entitlement or authority that is:

(c) granted by or under a law of the Commonwealth, a State or a Territory; and

(d) declared by that law not to be personal property for the purposes of this Act.

The express reference to licences in the definition of "personal property" appears to be in response to a series of Canadian cases that have wrestled with the question of whether a statutory licence is property for the purposes of the Canadian PPSAs.[121] To my knowledge, however, that question was not the subject of significant controversy in Australia before commencement of the Act, and I do not see that the introduction of the Act has made this a more pressing question than was previously the case. In other words, it is not clear why the definition of personal property needs to state expressly that it includes a "licence".

I am also troubled by the fact that the definition of "licence" is limited to rights, entitlements, authorities or licences that are "transferable", as this could make the concept of "personal property" a narrower one than would otherwise be the case. One of the common hallmarks of property under our law is indeed that it is transferable, and something is less likely to be regarded by the law as property if it is not able to be transferred to a third party. Transferability, however, is not an immutable criterion of the concept of property, and our High Court has held in the past that a statutory right can be property even if it is not assignable.[122] This means that the reference to licences in the definition of personal property could have the effect of excluding some licences from the Act – that is, if they are property in the eyes of the law, but are not transferable.

The Act can deliver better outcomes if property rights are within the scope of the Act, whether or not they are transferable. If a financier holds a general security interest over all the property of a corporate grantor, for example, the financier is likely to enforce its security interest (if it needs to) by appointing a receiver. That receiver would want to take possession of all the grantor's property, whether or not it is transferable. If some of the property such as a licence cannot be transferred, then that would limit the tools that are available to the receiver to realise value from the grantor's assets, as it would not be able to dispose of the licence. However, the receiver could use the non-transferable licence in other ways, for example by continuing to operate a business under the terms of the licence. So in my view it makes sense to allow the Act to govern the taking of security over property (as understood by the general law), including licences, even if the property is not transferable.[123]

The term "licence" is also used elsewhere in the Act, in a range of differing contexts. Consultation Paper 1 noted that it does not appear, based on the manner in which the term is used in those other contexts, that the defined term needs to be limited to licences that are transferable. For this reason, Consultation Paper 1 expressed a preference not just to amend the definition of "personal property" to remove the reference to licences, but also to amend the definition of "licence" to make it clear that the definition applies whether or not the right, entitlement, authority or licence is transferable.

121 See Cuming Walsh & Wood, pages 151 to 154.

122 *National Trustees Executors & Agency Co of Australasia Ltd v FCT* (1954) 91 CLR 540.

123 Currently, of course the enforcement rules in Chapter 4 do not apply to property in the hands of a corporate receiver. See Section 8.1.10 below. The secured party would however still want to be able to take security over the licence.

4.4.3.2 *Discussion of stakeholder feedback*

Almost all respondents approved the proposed amendment to the definition of "licence".[124]

One response did not agree with this proposal, on the basis that a non-transferable licence is unlikely to be property in the eyes of the general law. That may well be the case, but is not necessarily so, and the purpose of the proposed change is to close the potential gap. One other response noted that it needs to be clear that allowing a non-transferable licence to be property for the purposes of the Act (if it is also property in the eyes of the general law) should not mean as a consequence that a secured party could transfer the licence on enforcement, despite a prohibition on transfers in the terms of the licence itself.[125] That concern is already covered by the Act, in ss 112(3) and 128(6). Other responses also properly pointed out that care would need to be taken with the drafting, to ensure that the result was not to deem all non-transferable licences to be property for the purposes of the Act, whether or not they were property in the eyes of the general law.

These concerns, however, do not detract from the general proposition, which is that the drafting should not pre-empt the question by providing that a non-transferable licence is incapable of being personal property under the Act. All other responses agreed that the Act should be amended to clarify the point.

4.4.3.3 *Recommendations*

Recommendation 26: *That the definition of "personal property" in s 10 be amended by deleting the language "(including a licence)".*

Recommendation 27: *That the first 4 lines of the definition of "licence" in s 10 be amended to read:*

> *"**Licence** means either of the following (whether or not the right, entitlement, authority or licence is exclusive), if it is personal property:".*

4.4.4 Land

4.4.4.1 *The issue*

The definition of "personal property" in s 10 excludes land. The word "land" is defined in s 10 in this way:

> ***land*** includes all estates and interests in land, whether freehold, leasehold or chattel, but does not include fixtures.

The introduction of the Act was a joint State, Territory and Commonwealth initiative, under the auspices of the Council of Australian Governments. Consistent with the Canadian PPSAs,[126] and the NZ PPSA,[127] it does not appear to have been contemplated at any stage that the Act might apply to land.

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124 Respondents did not comment on the proposed amendment to that definition of "personal property".

125 AD, CP1 page 12.

126 For example Sask PPSA, s 4(e).

127 NZ PPSA, s 23(e)(i).

It must be asked why it is necessary for the Act to define "land", rather than leave it to the general law meaning. Having a separate definition, rather the relying on the general law understanding of the word, produces the risk that the Act might not be able to interact sufficiently seamlessly with other legislation or general law principles. This can cause undesirable uncertainty, particularly through the fact that the definition excludes fixtures.

For this reason, Consultation Paper 1 suggested that the definition of "land" in s 10 be deleted.

4.4.4.2 ***Discussion of stakeholder feedback***

A small number of responses were of the view that the definition was a helpful clarification. The great majority of responses agreed, however, that the definition should be deleted.

4.4.4.3 ***Recommendation***

Recommendation 28: *That the definition of "land" in s 10 be deleted.*

4.4.5 Trees

4.4.5.1 ***The issue***

The definition of "crops" in s 10 includes trees before they have been harvested, "but only if they are personal property". This seems to leave it to the general law to determine whether unharvested trees are crops.

One submission suggested that the Act be amended to clarify whether unharvested trees are crops, rather than leave it to the general law.[128] This would be consistent with the approach taken in other jurisdictions, such as the Sask PPSA[129] and the NZ PPSA.[130]

This would certainly clarify the position under the Act. If there is a risk that the general law could then be different to the position under the Act, however, it could produce uncertainty on other fronts. In particular, it could have the effect that both real property laws and the Act could apply to a security interest over the trees (if the unharvested trees are both part of the land at general law, and personal property under the Act).

For this reason, Consultation Paper 1 proposed that this amendment not be made.

4.4.5.2 ***Discussion of stakeholder feedback***

A small number of responses took the view that it was preferable to clarify the point. Several of them suggested that Government might engage with the States and Territories to see whether relevant State and Territory laws could be amended to address this, in a consistent way.

All other responses agreed, however, that it was not necessary to make any change in the Act.

128 JLF, S2 page 6.

129 Sask PPSA, s 2(1)(l).

130 NZ PPSA, s 16.

4.4.5.3 ***Recommendations***

Recommendation 29: *That the definition of "crops" in s 10 not be amended to clarify when it may include trees.*

Recommendation 30: *That Government ask the States and Territories to consider enacting legislation that clarifies the circumstances in which "trees" can be "crops".*

4.4.6 Statutory licences

4.4.6.1 ***The issue***

The definition of "personal property" in s 10 of the Act states that it does not include a statutory right that is declared, by the law that grants the right, not to be personal property for the purposes of the Act. This exclusion is then repeated in the definition of "licence" (also in s 10), and again as a general exclusion from the operation of the Act in s 8(1)(k).

It was a condition to the willingness of States and Territories to support the Act that they retain the ability to remove some or all of their statutory licensing regimes from the ambit of the Act.[131] This appears to have been driven by a concern that subjecting a State's or Territory's licensing regime to the Act might limit the ability of that State or Territory to control who holds the licence, or the circumstances in which it could be transferred.

States and Territories have made liberal use of the opportunity afforded by these exclusions, and have removed a wide range of statutory licences from the scope of the Act. In some cases, they have done this by providing that a licence is not "personal property" for the purposes of the Act. In other cases, they have provided that a licence is "not transferable", presumably in order to ensure that they are not "licences" as defined in s 10 and so not "personal property". It is not readily apparent why States and Territories have chosen in some cases to use one method of excluding licences over the other. The answer may be that the State or Territory in question wanted to prevent the licence from being used as collateral at all, whether within or outside the Act, and that they sought to achieve this outcome by declaring that the licence is not transferable.

Either way, it is disappointing in my view that so many statutory licences have been removed from the ambit of the Act. It reduces the ability of the Act to achieve the objective of making it easier for grantors to use their assets as collateral, if these potentially valuable assets are excised from the regime. Removing them from the Act also increases uncertainty – while some of the licensing statutes include their own rules for resolving priority disputes between competing claims to the licence, most do not. This probably means that most disputes regarding excluded licences need to be resolved by the general law rules that the Act sought to render redundant. This has also added to complexity, as it means that secured parties now need to understand and be able to manage their exposures under two sets of rules – the Act where it does apply, and the general law rules where it does not.

131 PPS Intergovernmental Agreement, clause 3.2(3).

For these reasons, a number of submissions proposed that statutory licences be brought into the Act.[132] They made the point that the Act would still allow the government that issued the statutory licence to control who holds the licence and how it is disposed of, as s 112(3) of the Act states clearly that a secured party may only seize, purchase or dispose of a licence subject to the terms and conditions of the licence, and to any applicable law. Also, the "taking free" rules in Part 2.5 of the Act only regulate the circumstances in which an acquirer of personal property will take the property free of an existing security interest over the property – they do not affect the extent to which the holder of the property can dispose of it in the first place.

Consultation Paper 1 agreed that it would be desirable for statutory licences to be brought within the Act.

4.4.6.2 ***Discussion of stakeholder feedback***

One response did not agree with this proposal, and argued that bringing statutory licences within the Act would add to confusion and complexity, rather than reduce it.[133] One other response agreed in principle that statutory licences should be within the Act, but argued that this should not apply to mining licences or water rights, on the basis that they have their own well-developed registration systems.[134]

All other responses agreed, however, that it was desirable for statutory licences to be covered by the Act. As one response noted, licences are often a business's most valuable asset, and a business's ability to raise credit may be compromised if it is not able confidently to offer up its licences as collateral.[135] And as a secured party can only deal with a licence in a manner that is consistent with its terms of issue, the interests of the authority that issued the licence are not at risk. One other response also drew attention to the fact that much of the complexity that is regularly encountered in security agreements is generated by the fact that the agreements need to cover both property that is covered by the Act, and property that has been excluded from it.[136] The more personal property that can be brought under the Act, the greater the prospects that security documents can be simplified as well.

I acknowledge that the issue of regulating security interests in statutory licences is of considerable political sensitivity for the States and Territories. I am confident, however, that the Act contains safeguards that enable the issuer of a statutory licence to continue to control who holds its licences, and how they might be disposed of. I am also confident that it would make a significant contribution to the ability of the Act to achieve its potential if the Act applied to statutory licences, and not the general law. For these reasons, my view is that Government should earnestly explore with the States and Territories whether the Act could be amended to allow this.

4.4.6.3 ***Recommendation***

Recommendation 31: *That Government ask the States and Territories to agree that the Act be amended to delete the provisions that allow statutory rights to be removed from the reach of the Act.*

132 For example: ABA, S2 page 4; AFC, S2 att A page 5; LCA, S2 page 6.
133 HW, CP1 page 9.
134 JLF, CP1 page 15.
135 AD, CP1 page 13.
136 SP, CP1 page 11.

4.5 Exclusions from the Act

4.5.1 Introductory comments

As I have noted earlier, the Act will best be able to achieve its objectives of improving consistency and certainty across Australia's secured transactions laws, and of minimising the complexity of those laws, if it applies comprehensively, with as few exclusions as possible.

This is not to say, of course, that there should be no exclusions at all. An exclusion may be appropriate if it is desirable for other policy reasons that a particular type of interest or class of property be regulated by a separate regime. A good example of this is land, as noted earlier in this report. Other exclusions may be desirable in order to make it completely clear that a particular type of arrangement is not intended to give rise to a security interest at all. And some exclusions may be appropriate where other policy considerations, such as market efficiency, are thought to be more important.

A range of exclusions from the Act are set out in s 8. This Section 4.5 looks at a number of those exclusions, and discusses whether they are appropriate.

4.5.2 General structure of s 8

4.5.2.1 *The issue*

Section 8(1) says that the Act "does not apply" to the interests listed in the section. It is not clear in all cases whether this means that those interests are not "security interests", or whether they are not "personal property". While s 8 follows the drafting approach used in other jurisdictions, such as in the NZ PPSA,[137] it would reduce uncertainty if this were clarified.

For these reasons, Consultation Paper 1 expressed the view that s 8(1) should be split into two separate provisions. One provision would provide that the interests listed in that provision are not "security interests" for the purposes of the Act, and the other would state that the interests listed in it are not "personal property" for the purposes of the Act.

4.5.2.2 *Discussion of stakeholder feedback*

One response was not confident that the section could be restructured effectively in this way. All other responses that expressed a view on the question, however, were in favour of this proposal.

In my view, it would help to make the Act easier to understand and apply if s 8 were amended in this way.

4.5.2.3 *Recommendation*

Recommendation 32: *That s 8(1) be split into two provisions: one listing interests that are not "security interests" for the purposes of the Act, and the other listing interests that are not "personal property" for the purposes of the Act.*

137 NZ PPSA, s 23.

4.5.3 Section 8(1)(e) – close-out netting contracts

4.5.3.1 ***The issue***

Section 8(1)(e) states that the Act does not apply to:

> (e) any right or interest held by a person, or any interest provided for by any transaction, under any of the following (as defined in section 5 of the *Payment Systems and Netting Act 1998*):
>
> (i) an approved netting arrangement;
>
> (ii) a close-out netting contract;
>
> (iii) a market netting contract;

It is usual practice in Australia (as it is elsewhere in the world) for off-market derivative transactions (often called "over the counter" contracts) to be documented using a standard form of master agreement that has been developed by the International Swaps and Derivatives Association (*ISDA*). The general understanding is that the termination mechanisms in the template ISDA master agreement are a "close-out netting contract" for the purposes of the *Payment Systems and Netting Act 1998*, and that the exclusion in s 8(1)(e) has the effect that the termination mechanisms do not give rise to a security interest for the purposes of the Act.

It is also not uncommon for a party to an ISDA master agreement to require its counterparty to provide credit support for the counterparty's obligations under the agreement. This can take a number of forms, but the most common form for Australian transactions is the so-called "Credit Support Annex". This provides a mechanism under which the party can require its counterparty to transfer to it title to securities with a value that reflects the party's financial exposure to the counterparty under the agreement. The party has only a deferred obligation to pay the purchase price for those securities, and that payment obligation is then taken into account on termination of the contract in calculating the net amount due as between the parties.

The view that appears to be taken by the market is that the introduction of a Credit Support Annex into an ISDA master agreement is also covered by s 8(1)(e), and that the transaction as a whole continues to be excluded from the Act. I am aware, however, that not all commentators are confident that this view is clearly correct.

Consultation Paper 1 invited stakeholders to comment on this.

4.5.3.2 ***Discussion of stakeholder feedback***

A small number of responses were in favour of clarifying whether transactions under an ISDA Credit Support Annex are excluded from the Act by s 8(1)(e). The majority of responses, however, did not feel that a sufficient case had been made for this.

It may be that transactions under an ISDA Credit Support Annex are outside the concept of a security interest for reasons similar to those discussed in Section 4.5.16 below in relation to securities lending arrangements, in that the transaction produces no identifiable collateral that a security interest could be attached to. Either way, I accept that there is no groundswell of support for clarification of the question at this time, and so do not propose to recommend it.

4.5.3.3 ***Recommendation***

Recommendation 33: *That s 8(1)(e) of the Act not be amended.*

4.5.4 Section 8(1)(f)(ii) – interests in or in connection with land

4.5.4.1 ***The issue***

Section 8(1)(f)(ii) states that the Act does not apply to an interest that is provided for by:

> (ii) the creation of an interest in a right to payment, or the creation or transfer (including a successive transfer) of a right to payment, in connection with an interest in land, if the writing evidencing the creation or transfer specifically identifies that land;

The Canadian PPSAs,[138] and the NZ PPSA,[139] contain a similar provision.

There has been much debate regarding the parameters of this exclusion, for example the requirement that the relevant writing "specifically identif[y]" the land. The uncertain scope of that language prompted the inclusion of a provision in the Regulations to clarify the operation of the exclusion as it affects securitisation programs.[140] Even with the clarification, though, this exclusion is not easy to follow.

The edges of the exclusion will also not necessarily intersect neatly with the Torrens system requirements in individual States and Territories. This creates the potential for double registration requirements (ie a possible need to register under both the Torrens system rules and the Act) or, more probably, a risk that some interests may fall between the cracks and not be registrable under either regime. This potential for overlaps or gaps is not desirable.

Consultation Paper 1 suggested that an alternative approach might be to frame the exclusion more expressly by reference to the reach of the relevant State's or Territory's Torrens system legislation. For example, the Act could simply state that it does not apply to any interest that is capable of being registered under applicable State or Territory real property legislation. The Act would then only apply to whatever was left. This would have the advantage of ensuring that the Act interfaced seamlessly with the relevant State or Territory real property legislation, without overriding or affecting it in any way.

4.5.4.2 ***Discussion of stakeholder feedback***

A number of responses supported this proposal. The majority of respondents, however, did not think that the change was necessary, or were uncertain as to how it would work in practice.

I accept that it is not sufficiently clear at this stage how such a proposed recasting of s 8(1)(f)(ii) would work, and that it would not be appropriate at this stage to recommend the change. I do believe however that it is worth exploring further, whether there is an effective and economical way to structure the section so that it eliminates the potential for doubling-up or for gaps as between the Act and real property law.

138 For example Sask PPSA, s 4(f).

139 NZ PPSA, s 23(e)(ii).

140 Reg 1.4(5)(c).

4.5.4.3 ***Recommendation***

> **Recommendation 34:** *That Government consult further with appropriate experts in real property law to determine whether s 8(1)(f)(ii) of the Act can be recast more simply, and so that it neither overlaps with relevant real property law, nor allows for gaps between the Act and that law.*

4.5.5 Section 8(1)(f)(iii) – unperformed contracts

4.5.5.1 ***The issue***

Section 8(1)(f)(iii) states that the Act does not apply to:

> (iii) a transfer (including a successive transfer) of an unearned right to payment under a contract to a person who is to perform the transferor's obligations under the contract;

A similar exclusion can be found in the Canadian PPSAs[141] and the NZ PPSA.[142]

This exclusion is based on the fact that the transferee of the contract will be performing the work that gives rise to the right to payment, so that there is little risk that an outsider might be misled into believing that the transferor was still entitled to receive the payment. I have no difficulty with this. It is not clear, though, why the provision includes the language "(including a successive transfer)" in the first line. While perhaps unproblematic when seen in isolation, the inclusion of this language raises the question as a matter of statutory interpretation as to whether references to "transfers" in other provisions that do not have this additional language are references to a primary transfer alone, and not to a successive transfer of the same asset.

Consultation Paper 1 expressed the view that the additional language in s 8(1)(f)(iii) runs the risk of creating confusion in other contexts, while adding little to the provision itself, and that it should be deleted.

4.5.5.2 ***Discussion of stakeholder feedback***

All respondents agreed with this view.

4.5.5.3 ***Recommendation***

> **Recommendation 35:** *That the language "(including a successive transfer)" be deleted from s 8(1)(f)(iii).*

4.5.6 Section 8(1)(f)(iv) – transfers of remuneration

4.5.6.1 ***The issue***

Section 8(1)(f)(iv) states that the Act does not apply to:

> (iv) a transfer of present or future remuneration (including wages, salary, commission, allowances or bonuses) payable to an individual as an employee or a contractor;

141 For example Sask PPSA, s 4(d).

142 NZ PPSA, s (e)(iii).

This exclusion appears to have been adopted (albeit with some modifications) from the Canadian PPSAs,[143] and the NZ PPSA.[144] It has been suggested that the exclusion was appropriate for the NZ PPSA because other New Zealand legislation regulated assignments of wages.[145] In contrast, there is no comprehensive legislative regulation of assignments of remuneration under Australian law, although securities over an employee's remuneration or employment benefits are restricted by the National Credit Code.[146]

Unlike the Canadian PPSAs and the NZ PPSA, our exclusion extends beyond remuneration payable to employees, as it also excludes remuneration payable to an individual as a contractor. While the Act does not define "contractor", it is likely that the term is only intended to capture individuals who have structured their affairs as a contractor but are otherwise performing a role equivalent to that of an employee. This is not clear from the language of the provision itself, however, and there is a real risk that the exclusion could pick up genuine contracting arrangements by individuals as well.

It is not clear in any event what is achieved by excluding transfers of remuneration from the Act. Excluding a transfer of remuneration from the Act does not make such a transfer impossible as a matter of law (if this was the intention) – rather, it simply means that the transfers are governed by the general law, rather than the Act. It may have been thought that it would be helpful for the Act to restate the restriction from the National Credit Code. However, s 8(1)(f)(iv) is expressed very differently to the restriction in the National Credit Code. Also, there are other restrictions in the National Credit Code that have not been restated in the Act,[147] so a reader of the Act will need to be familiar with the requirements of the National Credit Code in any event.

For these reasons, Consultation Paper 1 expressed the view that transfers of remuneration, to the extent that other laws such as the National Credit Code permit them, should be covered by the Act and not be left to the general law.

4.5.6.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal, but did not explain why. All other respondents agreed, however, that s 8(1)(f)(ii) should be deleted.

Of course, deleting s 8(1)(f)(ii) will not have the result that all transfers of remuneration will be subject to the Act. If the definition of an "account" is limited in the manner discussed in Section 4.3.2.2, then a transfer of remuneration is likely to be subject to the Act only if the transfer is by way of security. If a person does transfer remuneration by way of security (and this is permitted by other laws such as the National Credit Code), though, then it is appropriate that the Act apply.

In my view, this change will enhance the Act's objective of providing consistent rules for all transactions that serve the same security function, and should be made.

143 For example Sask PPSA, s 4(c).

144 NZ PPSA, s 23(e)(iv).

145 Gedye Cuming & Wood, para 23.8.

146 National Credit Code, s 50.

147 Such as the restriction on third-party mortgages in s 49 of the National Credit Code.

4.5.6.3 ***Recommendation***

Recommendation 36: *That s 8(1)(f)(iv) be deleted.*

4.5.7 Section 8(1)(f)(v) – transfers of annuity or insurance policies

4.5.7.1 ***The issue***

Section 8(1)(f)(v) states that the Act does not apply to:

> (v) a transfer of an interest or claim in, or under, a contract of annuity or policy of insurance, except a transfer of a right to an insurance payment or other payment as indemnity or compensation for loss of, or damage to, collateral (or proceeds of collateral);

This exclusion appears to have been adopted (again, with modifications) from the Canadian PPSAs,[148] and the NZ PPSA.[149] The rationale for the exclusion in Canada is said to have been that insurers maintain records of dealings in rights under their policies, so that there was no need to provide for separate registration of those dealings under the Canadian PPSAs.[150] Life insurers maintain similar records in Australia in relation to legal transfers of life insurance policies, and the process for the legal transfer of a life insurance policy is regulated by ss 200 and 201 of the *Life Insurance Act 1995*. The same is not the case, however, for transfers of interests under the other types of policies listed in the provision.

Article 9 contains a similar exclusion.[151] According to Professor Gilmore, the exclusion from Article 9 was "politically inspired", in that it was the result of lobbying efforts by insurers that preferred to remain outside the Article 9 regime.[152]

The impact of this exclusion may be lessened if the definition of "account" in s 10 is limited as discussed above in Section 4.3.2.2, as the Act would then only apply (subject to the exclusion in s 8(1)(f)(v)) to a transfer of an annuity or insurance policy that is made by way of security. Even in that case, however, it is hard to see why insurance policies, and in particular annuity and non-life insurance policies, should be excluded.

It might also be said that even transfers of life policies by way of security should be within the Act rather than excluded from it, on the basis that it is more efficient, and more consistent with the objectives of the Act, to have all security interests dealt with on the one register. Also, if a transfer of a life insurance policy by way of security is outside the Act, it would be quite unclear what priority rules would apply to a competition between the transferee and a secured party that also held security over the policy but not by way of transfer (ie who held a security interest that was subject to the Act).

Consultation Paper 1 invited stakeholders to comment on the desirability of retaining s 8(1)(f)(v).

148 For example Sask PPSA, ss 4(b) and (b.1).

149 NZ PPSA, s 23(e)(vi).

150 Duggan & Brown, para 3.60.

151 Article 9, §9-109(d)(8).

152 Gilmore, page 315.

4.5.7.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of retaining s 8(1)(f)(v), but did not explain why. The majority of respondents however, were in favour of deleting the section – that is, of no longer excluding transfers of annuity or insurance policies from the Act.

My view is that a transfer of an annuity or insurance policy should not be excluded from the Act unless, possibly, it is a policy of life insurance. Even in the case of a life insurance policy, my preference would be for the Act to apply if the transfer is otherwise a security interest, but I can see that further thought would need to be given to the manner in which this would interface with ss 200 and 201 of the *Life Insurance Act 1995*.

4.5.7.3 ***Recommendations***

Recommendation 37: *That s 8(1)(f)(v) be limited in its application to transfers of interests in policies of life insurance that are registrable under ss 200 and 201 of the Life Insurance Act 1995.*

Recommendation 38: *That Government consider further whether transfers by way of security of interests in life insurance policies could also be brought within the Act.*

4.5.8 Sections 8(1)(f)(vi) to (viii) and 8(4) – some transfers of accounts

4.5.8.1 ***The issues***

Sections 8(1)(f)(vi), (vii) and (viii) state that the Act does not apply to:

(vi) a transfer of an account made solely to facilitate the collection of the account on behalf of the person making the transfer;

(vii) without limiting subparagraph (vi), a transfer of an account, if the transferee's sole purpose in acquiring the account is to collect it;

(viii) a transfer of an account or negotiable instrument to satisfy (either wholly or partly) a pre-existing indebtedness;

Section 8(4) then says this:

> To avoid doubt, the interest provided for by a transfer of an interest or right (see paragraph (1)(f)) is the interest that the transferee has to claim against the transferor.

Section 8(1)(f)(vi)

Section 8(1)(f)(vi) is based on an exclusion that can be found in the Canadian PPSAs,[153] and the NZ PPSA.[154] The policy behind the exclusion appears to be that nothing would be achieved by requiring the transferee of an account in this situation to register a financing statement against the transferor – any collections on the account will be paid back to the transferor, so it will not mislead outsiders if the transferor remains able to represent that it is the unencumbered owner of the account.

153 For example Sask PPSA, s 4(h).

154 NZ PPSA, s 23(e)(viii).

Section 8(1)(f)(vii)

The exclusion in s 8(1)(f)(vii) appears to be unique to Australia. In a sense, any person who takes a transfer of an account is likely to be doing so for the purposes of collecting it, and if the section is given its natural meaning it could arguably exclude almost all transfers of accounts from the operation of the Act. It may be that s 8(1)(f)(vii) was intended to exclude a transfer of an account to what might loosely be described as a debt collector. If the debt collector is collecting the debt on behalf of the transferor, though, it is difficult to see what s 8(1)(f)(vii) adds to s 8(1)(f)(vi). If the debt collector is collecting the debt for its own benefit, then it is difficult to see why the transfer should be excluded.

Section 8(1)(f)(viii)

Section 8(1)(f)(viii) is based on a provision in Article 9,[155] and in the NZ PPSA.[156] The exclusion has been justified on the grounds that it is appropriate to exclude a transfer to satisfy a pre-existing indebtedness because the transfer involves the discharge of a liability, rather than the securing of one.[157] However, if it does discharge a liability rather than secure one, then it is unlikely to be an in-substance security interest to start with. And if it is a deemed security interest under s 12(3), then it would appear to engage the reasons for extending the Act to non-security transfers of an account in the same way as any other transfer of an account.

As something of an aside, it is also not clear why s 8(1)(f)(viii) also refers to a transfer of a "negotiable instrument". This language appears in the corresponding NZ provision, but the purpose behind it is not apparent.

Section 8(4)

It has been put to me that the objective of s 8(4) is to clarify that only the immediate interest or right that is referred to in s 8(1)(f) is being excluded, and not any property that might derive from the interest or right. It is not readily apparent that the provision achieves this objective, however, or what its effect might otherwise be. I think it is clear in any event that s 8(1)(f) only excludes the immediate subject matter of the section, and not an interest that might derivatively flow from it. And if it were clear that s 8(4) has the effect described above, then this would cast doubt on the scope of the other exclusions in s 8, as it would suggest (by negative implication) that those other exclusions did extend to subsequent interests, not just the immediate interests referred to in the exclusions.

For these reasons, Consultation Paper 1 expressed the view that ss 8(1)(f)(vii), 8(1)(f)(viii) and 8(4) should be removed.

4.5.8.2 *Discussion of stakeholder feedback*

A small number of respondents did not agree with this proposal. All other respondents agreed, however, that ss 8(1)(f)(vii), 8(1)(f)(viii) and 8(4) should be deleted.

4.5.8.3 *Recommendation*

Recommendation 39: *That ss 8(1)(f)(vii), 8(1)(f)(viii) and 8(4) be deleted.*

155 Article 9, §9-109(d)(7).

156 NZ PPSA, s 23(e)(ix).

157 Gedye Cuming & Wood, para 23.13.

4.5.9 Sections 8(1)(i) and 8(5) – water rights

4.5.9.1 ***The issue***

Section 8(1)(i) states that the Act does not apply to:

> (i) a right entitlement or authority, whether or not exclusive, that is granted by or under the general law or a law of the Commonwealth, a State or a Territory in relation to the control, use or flow of water;

The meaning of s 8(1)(i) is clarified (or perhaps expanded) by s 8(5), which says this:

> (5) In paragraph (1)(i), the reference to a right in relation to the control, use or flow of water includes, but is not limited to, a reference to a right that a person has against another person to receive (or otherwise gain access to) water.

The exclusion of water rights from the Act was a requirement of the PPS Intergovernmental Agreement.[158]

Practitioners have not found it easy to reconcile the language of ss 8(1)(i) and 8(5) with the mechanisms and systems through which water rights are typically held and traded. This has made it difficult for financiers and their customers to know with confidence whether or not the Act applies to their transactions.

One submission recommended that water rights be brought within the Act.[159] The submission argued that this "would help to overcome issues with taking security over water entitlements held through private irrigation companies (such as Murrumbidgee Irrigation), where no register is presently available and [would] replace inconsistent State based registers for water access licences with one nationally consistent register." The submission noted that this would provide greater legal certainty.

Consultation Paper 1 invited stakeholders to express their views on this proposal.

4.5.9.2 ***Discussion of stakeholder feedback***

A number of respondents were not in favour of bringing water rights into the Act. Their views appear to have been based, at least in part, on the proposition that the current systems for the recording of interests in water rights work well, and do not need to be replaced.

The great majority of respondents, however, were in favour of deleting s 8(1)(i), and of bringing water rights under the Act.

As I understand it, water rights are of broadly two types: *water access entitlements*, and *irrigation rights*. *Water access entitlements* are statutory rights, granted through State or Territory legislation, that provide a perpetual right to a share of the water that is available for consumption in a given water system. In 2004, the States and Territories (other than Western Australia and Tasmania) agreed on a blueprint for water reform, the National Water Initiative (the *NWI*).[160] The NWI requires that water access entitlements be tradeable, capable of being mortgaged and recordable on publicly-accessible water registers, and "have similar status to freehold land when used as collateral for accessing finance".[161] In

158 PPS Intergovernmental Agreement, clause 3.2(2).

159 ABA, S2 page 3.

160 *Intergovernmental Agreement on a National Water Initiative*, dated 25 June 2004.

161 *Intergovernmental Agreement on a National Water Initiative*, clause 31.

Victoria, for example, the *Water Act 1989* establishes a Victorian Water Register, and allows for interests in water access entitlements, including mortgages, to be recorded on that register.[162] That Act then provides that priority between competing interests in a water access entitlement is determined by the order in which the interests are registered.[163]

Irrigation rights, in contrast, are mostly contractual in nature. While the arrangements vary, an Irrigation Infrastructure Operator (an *IIO*) typically holds a water access entitlement on behalf of its members or customers. *Irrigation rights* are the shares in that water access entitlement that the IIO makes available to its members or customers, mostly through contractual arrangements between the IIO and its member or customer. Some IIOs maintain a register of their irrigation rights, and some will record encumbrances on that register as well. This is by no means uniformly the case, however.

I can see good arguments for keeping water access entitlements outside the Act, particularly if they are recorded on a register that reflects the NWI requirements. Keeping water access entitlements outside the Act would be consistent to some extent with land being outside the Act, particularly given the requirement in the NWI that mortgages over water access entitlements have a similar status to mortgages over freehold. It would also be consistent with the fact that water access entitlements were originally part of the bundle of rights that attached to ownership of land, rather than being separate property (as they now are).

It is more difficult to see, however, why irrigation rights (or any other rights related to the use of water) should be outside the Act. Unlike water access entitlements, there is no requirement that IIOs maintain a register of interests in the irrigation rights that they issue, that any such register record security interests, or that the register be available for search. While I can understand that IIOs may prefer to be outside the Act, I am not aware of any compelling reason why that should be the case, and can see that it would significantly enhance the ability of the Act to deliver on its objectives, and to achieve its potential, if irrigation rights were subject to the Act in the same way as any other type of contractual right.

I am very aware, however, that rights relating to the ownership and use of water are a topic of considerable sensitivity. For that reason, rather than propose specific changes, I propose to recommend that Government engage in a discussion of these matters with the States and Territories, with a view to exploring whether water access entitlements that comply with the requirements of the NWI should remain outside the Act, but that the Act should apply to all other water rights in the same way as the Act applies to personal property generally.

4.5.9.3 *Recommendation*

Recommendation 40: *That Government explore with the States and Territories whether ss 8(1)(i) and 8(5) could be amended so that water rights are only excluded from the Act if they are able to be recorded under a statutory registration scheme that complies with the expectations set out in the 2005 Intergovernmental Agreement on a National Water Initiative.*

162 *Water Act 1989* (Vic), Part 5A.

163 *Water Act 1989* (Vic), s 84Q.

4.5.10 Section 8(1)(j) – fixtures

4.5.10.1 The meaning of "fixture"

4.5.10.1.1 *The issue*

Section 8(1)(j) states that the Act does not apply to:

> (j) an interest in a fixture;

Section 10 defines the term "fixture" in this way:

> ***fixtures*** means goods, other than crops, that are affixed to land.

My understanding is that this definition was intended to do no more than reflect the common law meaning of the term "fixture". It is not entirely clear, however, whether it does this, and there is a risk that a court could take a different view – based, for example, on the emphasis in the definition on the requirement that the goods be "affixed" to land (rather than the wider range of factors that can influence whether goods are a fixture under the general law),[164] or the fact that the Act goes to the effort of defining the term at all.

A number of submissions proposed that the definition be clarified, or deleted.[165] In view of the potential uncertainty generated by the definition, and the fact that I believe it was not intended to do more than repeat the general law meaning of the term in any event, Consultation Paper 1 expressed the view that the definition should be deleted.

4.5.10.1.2 *Discussion of stakeholder feedback*

One respondent did not agree with this proposal. Another respondent suggested that the definition should instead be replaced with the definition of "fixtures" from the Sask PPSA, in order to benefit from the fact that that definition excludes building materials.[166] I suspect that the reference to "building materials" in the definition in the Sask PPSA relates to the fact that the Sask PPSA allows for security interests in goods to remain attached to the goods, and to continue to be subject to the Sask PPSA, even if the goods become a fixture. The thinking may have been that a security interest should not remain attached to goods, however, if they become part of a building on the land. If that is correct, then an amendment along those lines may become appropriate if the Act is amended so that it applies to fixtures as well – a topic that I discuss next. As long as the Act does not apply to fixtures, however, then I do not think that the language of the definition in the Sask PPSA would be appropriate.

All other respondents were in favour of deleting the definition of "fixture" from s 10.

4.5.10.1.3 *Recommendation*

Recommendation 41: *That the definition of "fixture" in s 10 be deleted.*

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164 See, for example, *Macintosh v Goulburn City Council* (1985) 3 BPR 9367; *Hawkins v Farley* [1997] 2 Qd R 361; and *National Dairies WA Ltd v Cmr of State Revenue* (2001) 24 WAR 70.

165 For example: AICM, S1 page 6; LCA, S1 page 4; QLS, S1 page 1; CW, S1 page 1; JLF, S2 page 3; LIV, S2 page 1.

166 DT, S2 page 11.

4.5.10.2 Should fixtures be brought into the Act?

4.5.10.2.1 *The issue*

A more challenging question is whether fixtures should be excluded from the Act at all. In contrast to the Act, the Canadian PPSAs do deal with fixtures.[167] However, the NZ PPSA does not.

The first public draft of the *Personal Property Securities Bill 2008*[168] contained provisions dealing with fixtures, modelled on the Canadian legislation. The following public draft of the Bill,[169] however, did not. This appears to have been in response to the signing in November 2008 of the PPS Intergovernmental Agreement, which stated that the Act should not apply to fixtures.[170]

The fact that the Act ultimately excluded fixtures has been the subject of a good deal of commentary, most of it critical.[171] A number of submissions also recommended that fixtures be brought into the Act.[172] Some of them recommended that the Act adopt a regime along the lines of the model in the Canadian PPSAs.

Not all submissions agreed, however, that fixtures should be brought within the Act.[173]

I can see clear value in developing a regime that allows a security interest in goods to continue in the goods if they become affixed to land. The current rules, under which the secured party under a perfected security interest can simply lose its security interest entirely if the goods are affixed to land, is one that can produce a very unhappy outcome for the secured party, and an unanticipated windfall for a person who has an interest in the land to which the goods become affixed. Equally though, I can understand that States and Territories could be reluctant to engage with a scheme that might compromise their ability to control who holds what types of interests in land within their borders. This is potentially more challenging here than will have been the case in Canada, as the Canadian PPSAs and Canadian land law are both enacted at the provincial level (so there will not have been a need to manage any State–Commonwealth sensitivities). This means that any rules to bring fixtures into the Act would need to be carefully constructed, to allay these concerns. It may well be, however, that a regime that is based on the Canadian model could achieve this.

Consultation Paper 1 invited stakeholders to express their views on this question.

4.5.10.2.2 *Discussion of stakeholder feedback*

A number of respondents said that they did not think that fixtures should be brought into the Act. They were of the view that fixtures should remain solely within the purview of real property law, and were concerned that allowing the Act to apply to fixtures would increase complexity and uncertainty.

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167 For example Sask PPSA, s 36.

168 *Personal Property Securities Bill 2008* (Cth), May 2008 Consultation Draft.

169 *Personal Property Securities Bill 2008* (Cth), November 2008 Exposure Draft.

170 PPS Intergovernmental Agreement, clause 3.2(3).

171 See for example A Bull, *Fixtures and the PPSA 2009: Fuzzy logic?* (2011) 27(5) BLB 93; Duggan & Brown, at para 2.9.

172 For example: AFC, S1 page 4; LCA, S1 page 3; MBA, S2 page 6; DT, S2 page 4.

173 For example: ABA, S2 page 4.

A significant majority of respondents agreed, however, they would like Government to explore with the States and Territories whether a mechanism could be found that would allow the Act to apply to security interests in goods that become fixtures, in harmony with State and Territory real property laws. It may be that a path cannot be found to achieve this, or that the view is reached that the benefits that this would bring are outweighed by the negative impacts, but the clear majority view among respondents was that this was worth further investigation.

4.5.10.2.3 ***Recommendation***

> **Recommendation 42:** *That Government explore with the States and Territories whether a regime can be developed, potentially along the lines of the principles applied in the Canadian PPSAs, that would allow fixtures to be brought within the Act.*

4.5.11 Sections 8(1)(ja) and 8(6) – pawnbrokers

4.5.11.1 ***The issue***

Sections 8(1)(ja) and 8(6) provide that the Act does not apply to certain security interests taken by pawnbrokers.

The Ontario PPSA also excludes pawnbroking transactions.[174] In contrast, the other Canadian PPSAs only exclude them from the enforcement provisions, not from the legislation as a whole.[175] The NZ PPSA does not exclude pawnbroking transactions at all.

Sections 8(1)(ja) and 8(6) were inserted into the Act by the *Personal Property Securities (Corporations and Other Amendments) Act 2010*. According to the Explanatory Memorandum for that Act,[176] pawnbroking transactions were excluded because they are regulated by specific State and Territory legislation.[177] My understanding, however, is that State and Territory pawnbroking legislation principally regulates the licensing of pawnbrokers and the relationship between pawnbrokers and their customers, and not the relationship between the pawnbroker's interest in the pawned goods and the interests of third parties. If that is correct, then it is not clear (as one submission noted)[178] why it should be appropriate to exclude them from the Act entirely, as that leaves unclear what rules should be applied to resolve competitions between the pawnbroker and (for example) another person who holds a security interest over the pawned goods that is subject to the Act. The answer presumably is that the general law would apply, but it is not clear why it is preferable to leave the competition to be resolved by old law rules, rather than apply the Act. There is at least a good argument that this exclusion should only relate to the application of the enforcement rules in Chapter 4, and that the Act should otherwise apply.

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174 Ontario PPSA, s 4(1)(d).

175 For example Sask PPSA, s 55(2)(b).

176 Para 9.18.

177 For example, the *Pawnbrokers and Second-hand Dealers Act 1996* (NSW); *Second-hand Dealers and Pawnbrokers Act 2003* (Qld); *Second-hand Dealers and Pawnbrokers Act 1996* (SA); *Second-hand Dealers and Pawnbrokers Act 1994* (Tas); *Second-Hand Dealers and Pawnbrokers Act 1989* (Vic); and the *Pawnbrokers and Second-hand Dealers Act 1994* (WA).

178 LCA, S2 page 5.

Consultation Paper 1 suggested that pawnbroking transactions should perhaps be excluded from the enforcement rules in Chapter 4, but that they should otherwise be subject to the Act.

4.5.11.2 ***Discussion of stakeholder feedback***

Not all respondents regarded this as a significant point. All of them agreed, however, that pawnbroking transactions should be excluded from the enforcement rules in Chapter 4, but that they should otherwise be subject to the Act.

These changes would enhance the Act's ability to achieve its objective of increased consistency of treatment for secured transactions. I think that they should be made.

4.5.11.3 ***Recommendation***

> **Recommendation 43:** *That ss 8(1)(a) and (b) be deleted, and that s 109 be amended to provide that Chapter 4 does not apply to security interests of the type described in s 8(6).*

4.5.12 Section 8(1)(jb) – interests in superannuation

4.5.12.1 ***The issue***

Section 8(1)(jb) states that the Act does not apply to interests held by a person in a superannuation fund or a superannuation–related or retirement–related investment. None of the Canadian PPSAs nor the NZ PPSA contains a similar provision.

This exclusion was inserted into the Act by the *Personal Property Securities (Corporations and Other Amendments) Act 2010*. According to the Explanatory Memorandum for that Act,[179] the exclusion seeks to implement the Government's retirement income policy by "prevent[ing] holders of interests in superannuation funds from using those interests as security for loans and other obligations not related to retirement income". It appears to be intended to reflect the restriction on the creation of securities over benefits under a superannuation scheme that is contained in the National Credit Code.[180]

Similar to the position regarding transfers of remuneration (discussed above in Section 4.5.6), it is not clear what is gained by excluding superannuation benefits from the operation of the Act. Excluding them from the Act will not of itself prevent a person from using them as security – all it achieves is that the security would be governed by the general law instead. It is difficult to see why that would be appropriate.

For this reason, Consultation Paper 1 suggested that security interests over superannuation benefits, to the extent that other laws such as the National Credit Code permit them, should be covered by the Act and not be left to the general law.

179 Para 9.20.

180 National Credit Code, s 50.

4.5.12.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal.[181] I believe, however, that the concern that lay behind that response is addressed by the discussion earlier in this report (in Section 4.2.3.3) to the effect that a beneficial interest in a trust will not usually be a security interest.

All other respondents agreed with the proposal.

In my view, deleting s 8(1)(jb) will enhance the Act's ability to achieve its objective of increasing consistency of treatment for secured transactions, without compromising superannuation law objectives.

4.5.12.3 ***Recommendation***

Recommendation 44: *That s 8(1)(jb) be deleted.*

4.5.13 Supplies of fit-out or other goods as part of a real property lease

4.5.13.1 ***The issue***

A number of submissions suggested that a landlord should not be required to register a financing statement to perfect a lease of any fit-out or goods that it may provide to a tenant as a part of a real property lease.[182] It was suggested that it was not appropriate to impose this burden on a landlord, because a financier to the tenant would expect (or at least not be surprised to learn) that some or all of the fit-out or goods on the premises belongs to the landlord, and that there was accordingly no need for a landlord to publicise this fact by perfecting.

The Act already excludes most leases of consumer property as part of a lease of land,[183] so this concern relates principally to leases of business premises.

I can readily understand why a landlord might prefer to remain outside the Act. I am however not persuaded that it would be appropriate to recommend such an exclusion. While a financier to the tenant may be aware that the fit-out or goods could have been provided by the landlord, it is perhaps just as likely that the fit-out or goods could have been provided by another financier. It is not clear why a lease of the fit-out should be outside the Act in one case, but not the other. Also, financiers are not the only third parties who might want to acquire an interest in the fit-out or goods on the tenant's premises. If the transaction were excluded from the Act, those third parties would not be protected.

For these reasons, Consultation Paper 1 suggested that there is not a clear case for excluding transactions of this type from the Act.

4.5.13.2 ***Discussion of stakeholder feedback***

A number of respondents took the view that the Act should not apply to a lease of fit-out of goods as part of a lease of land. One respondent on behalf of commercial landlords argued energetically that the Act should not apply to a lease of personal property which relates to a lease of premises or land.[184] That response maintained

181 ABA, CP1 page 15.

182 DLA, S2 page 7; LIV, S2 page 2; SCCA, S2 page 4.

183 Section 13(2)(c).

184 SCCA, CP1 page 2.

that it had never been the intention that the Act apply to aspects of the contractual relationship between landlord and tenant, and argued that questions of theoretical legal application and interpretation should not be preferred over the need to relieve commercial parties from the complexity and confusion of the Act.

I accept that the Act may not have been expressly intended to intrude into the contractual relationship between a landlord and their tenant. For the most part, though, the Act does not intrude into **any** contractual relationship between commercial parties. What the Act does do, however, is change the proprietary impacts of relationships between parties who enter into a transaction that meets the definition of a "security interest" in the Act. I also think it is clear that the drafters of the Act **were** aware that the Act could apply to a lease of personal property as part of a commercial lease of premises or land. This is evident from the fact that the Act expressly excludes a lease of consumer property as part of a lease of land, in s 13(2)(c). If the Act had not been intended to apply to any lease of personal property as part of a lease of land, then the exclusion in s 13(2)(c) would not have been necessary.

As I see it, the current policy setting on this question is not inadvertent, but deliberate. I understand that this has been a source of frustration for commercial real property lessors, but the great majority of respondents were of the view that this policy setting is appropriate, and I also see no clear case for recommending a change.

4.5.13.3 ***Recommendation***

> **Recommendation 45:** *That the Act not be amended to exclude or otherwise modify the rules for a lease of fit-out or other goods as part of a lease of real property, beyond what is already provided in s 13(2)(c).*

4.5.14 Turnover trusts

4.5.14.1 ***The issue***

A number of submissions suggested that the application of the Act should be clarified in relation to turnover trusts.[185]

A turnover trust can arise where one creditor to an obligor (the *junior creditor*) agrees with another creditor of the same obligor (the *senior creditor*) that it will hold any payments that it receives from the common obligor on trust for the senior creditor, and that it will pay any amounts it receives to the senior creditor until the senior creditor has been paid in full.

This arrangement has the potential to constitute the grant by the junior creditor to the senior creditor of a security interest over the junior creditor's rights to be paid by the common obligor. The Act states in s 12(6) that an arrangement does not give rise to a security interest simply because one creditor agrees to postpone payment of amounts owing to it until another creditor has been paid. A turnover trust is however different to this, because it goes one step further and provides that the junior creditor holds its rights on trust for the senior creditor to the extent of amounts owing to the senior creditor. This could be a security interest – a prospect that is implicitly acknowledged by s 268(2), which provides that a security interest

185 For example: ABA, S2 page 3; DIFA, S2 att B page 7.

will not vest on insolvency under s 267 if it is granted pursuant to a turnover trust of the type described in that section.[186]

One submission suggested that turnover costs be excluded from the Act.[187] I am also aware that the fact that the Act can apply to a turnover trust has been a source of some frustration. Turnover trusts are common in more complex corporate financings, and it is not unusual for the junior creditor in a turnover trust to be a major domestic or international bank (although the junior creditor can also very commonly be either a specialist mezzanine lender or an entity that is associated with the common obligor). The major banks, in particular, do not appreciate the prospect of being the subject of registrations to perfect turnover trusts.

Market practice under the Act in relation to turnover trusts is still evolving. A practice appears to be emerging that senior creditors will not register against a junior creditor if the junior creditor is an external lender to the common obligor and an entity of substance, but will register where this is not the case. That of course is ultimately a commercial decision.

Consultation Paper 1 expressed the preliminary view that it would not be appropriate to amend the Act to exclude turnover trusts.

4.5.14.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of excluding turnover trusts from the Act. One response was concerned to ensure that it be made clear that collections trusts of the type that are common in securitisation structures are not security interests for the purposes of the Act.[188]

All other respondents were of the view, however, that turnover trusts should not be excluded from the Act.

A fair argument can be made that a typical turnover trust does not in fact give rise to a security interest, because the funds that the junior creditor is agreeing to hold on trust for the senior creditor are the senior creditor's funds already – that is, the junior creditor is not holding the funds as security for amounts that the common obligor owes to the senior creditor, but rather is holding them for the senior creditor because they are the senior creditor's own money (in that the common obligor should have paid them to the senior creditor instead). If that argument is valid for a particular turnover trust arrangement, then the arrangement may be outside the Act on general principles. The argument could also be helpful in the characterisation of collections trust arrangements, where similar issues arise. Either way, I agree with the majority view of respondents that there are no compelling reasons for excluding turnover trusts generally from the Act, if the Act would otherwise apply to them.

4.5.14.3 ***Recommendation***

Recommendation 46: *That the Act not be amended to exclude turnover trusts.*

186 Section 268(2) is discussed in Section 8.7.6 below.

187 DIFA, S2 att A page 7.

188 ASF, CP1 page 13.

4.5.15 Cash deposits

4.5.15.1 ***The issue***

There has been considerable concern, particularly in the conveyancing industry, that the payment of a cash deposit for the sale and purchase of property such as land could give rise to a security interest over that deposit and so require the vendor to make a registration against the person who paid the deposit (ie the purchaser). A number of submissions suggested that the Act be amended to exclude cash deposits from the Act, or at least to clarify whether or not the Act applies to them.[189]

Whether or not any particular deposit arrangement gives rise to a security interest will depend of course on the terms of the arrangement and the surrounding circumstances. It can be seen why it might be thought that the payment of a deposit under such a contract could give rise to a security interest, as the payment gives the vendor an interest in personal property (the deposit), and the payment "secures" the purchaser's obligation to pay the balance of the purchase price and complete the transaction, by making it commercially more likely that they will do so (as the purchaser would otherwise risk forfeiting the amount that it has already paid). To my mind, however, that misconceives the nature of a security interest and the collateral that is subject to it. Under a security interest, the collateral operates as a fall-back, in that the secured party can have recourse to the collateral in order to recover what it is owed if the debtor fails to make the payments or perform the obligations when due. A cash deposit, in contrast, is not intended to be a reserve to which the vendor can turn if the purchaser does not meet its obligation to pay the purchase price. Rather, payment of the deposit is part-performance of the payment obligation itself. To give an example, if the purchase price for property is $100 and the purchaser pays a deposit of $10, that $10 does not function as an asset to which the vendor can have resort, if needed, in order to recover the unpaid $90. Rather, it is performance in part of the purchaser's obligation to make the total payment of $100.

Consultation Paper 1 expressed the view that no amendment was needed to clarify this further.

4.5.15.2 ***Discussion of stakeholder feedback***

One respondent was of the view that this question is so important that the Act should deal with it expressly. All other respondents agreed, however, that the Act did not need to be amended to clarify whether the payment of a cash deposit under a contract for the purchase of property could give rise to a security interest.

One respondent suggested that it would help to have an explanation of the relevant principles in this report, so that the explanation could be drawn on to assist in the interpretation of the Act under s 15AB(2)(b) of the *Acts Interpretation Act 1901*.[190] I am hopeful that the preceding discussion will be sufficient for that purpose.

189 For example: LIV, S2 page 1.

190 ABA, CP1 page 16.

4.5.15.3 ***Recommendation***

> **Recommendation 47:** *That the Act not be amended to clarify whether the making of a deposit under an agreement for the sale of property will give rise to a security interest.*

4.5.16 Securities lending arrangements

4.5.16.1 ***The issue***

I flagged above in Section 4.2.3.5 that I would return to the question of whether securities lending arrangements are or should be subject to the Act.

4.5.16.2 ***Discussion***

Two responses to Consultation Paper 1 suggested that the Act should expressly exclude securities lending arrangements.[191]

It may be that securities lending arrangements would fall outside the Act even without any express statement in the Act to that effect, because of the very nature of the arrangement. It is inherent in the nature of a security interest, for example, that there be some identifiable collateral. If the effect of a securities lending arrangement is that the transferor is able to place the securities into its general holding of securities of that type and then deal with them freely as part of its general business dealings, then it is difficult to say what the "collateral" that is subject to any security interest would be, as it would very quickly become impossible to identify anything as being the collateral for that purpose.

It is perhaps instructive though that this question has not been raised by the securities lending industry itself. I am also conscious that there has not been any broader consultation on this question, at least through this review. For these reasons, my view is that it would be premature for me to make a recommendation on this specific question. I am however prepared to recommend that Government explore this question further as part of the consultation process that I recommend below for other matters relating to financial assets.

4.5.16.3 ***Recommendations***

> **Recommendation 48:** *That the Act not be amended at this time to clarify whether securities lending arrangements are subject to the Act.*
>
> **Recommendation 49:** *That Government consider further, in consultation with industry, whether (and if so, how) securities lending arrangements, and potentially other similar arrangements, should be excluded from the Act.*

191 JLF, CP1 page 8; SMcC, CP1 page 13.

4.5.17 Minimum thresholds?

4.5.17.1 ***The issue***

Some submissions suggested that the Act should not apply at all to low-value transactions, or that the Act should deem a security interest for a low-value transaction to be automatically perfected, without any need for registration.[192] It was suggested that this would assist small businesses in particular, by sheltering them from the cost and effort involved in registering financing statements to perfect security interests where the value of the transaction involved does not warrant it. The second suggestion (that low-value transactions be deemed to be perfected) was coupled, to some extent, with another suggestion to the effect that financing statements should be required to indicate the amount secured by the security interest to which the financing statement relates (a suggestion that I will return to in Section 6.11.3 below).

Consultation Paper 1 indicated that I was not inclined to support those suggestions, for a number of reasons. First, while they would undoubtedly ease the burden of a secured party, they would adversely affect third parties dealing with the grantor, as third parties would not be able to detect the existence of the security interest. Secondly, secured parties are assisted by the fact that they generally should only need to register once per customer, not separately for each low-value delivery. Thirdly, the task of registration will hopefully be made easier by the changes to the operation of the Register that I recommend in Chapter 6 below. Finally, an exclusion for low-value items could open up opportunities for secured parties to game the system, by structuring their sale arrangements (for example) so that they supply goods in batches that sit below the threshold.

4.5.17.2 ***Discussion of stakeholder feedback***

All respondents agreed that the Act should not be amended to introduce minimum thresholds. It is also clear that no good case has been made for including minimum thresholds, or even for how they might work.

4.5.17.3 ***Recommendation***

Recommendation 50: *That the Act not be amended to provide that it does not apply to transactions or property below minimum thresholds.*

192 For example: ASBC, S1 page 2; CCF, S1 page 6; NSWBC, S1 page 4; NSWYL, S1 page 13. Not all submissions agreed: AICM, S2 page 26.

Chapter 5

Creating an effective security interest

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5.1 Attachment

5.1.1 Section 19(2) – the requirements for attachment

Section 19(1) of the Act states that a security interest is only enforceable against a grantor in respect of particular collateral if the security interest has "attached" to the collateral.

Section 19(2) sets out what is required for a security interest to attach to collateral. Section 19(2)(a) says that a security interest will only attach if, among other requirements:

> (a) the grantor has rights in the collateral, or the power to transfer rights in the collateral to the secured party; …

5.1.2 Section 19(2)(a) – what is meant by "rights in the collateral"?

5.1.2.1 ***The issue***

The Act does not define what it means by a person having "rights" in collateral. It is clear that a person will have rights in collateral for the purposes of s 19 if they own it. It is less clear, however, in what other circumstances a person can have rights in collateral for the purposes of the section.

In the eyes of the general law, for example, a person who buys goods subject to a retention of title clause has only a right to possess the goods, and not an ownership interest in them, until they have paid the purchase price. Similarly, a lessee under a lease only has the right to possess the leased goods, not an ownership interest in them. Despite this, the Act clearly contemplates that a purchaser of goods subject to retention of title, or a lessee of goods, can have sufficient rights in the goods to support attachment of a security interest, at least in favour of the seller or lessor.

The Act appears to try to close this gap with s 19(5). Section 19(5) says this:

> (5) For the purposes of paragraph (2)(a), a grantor has rights in goods that are leased or bailed to the grantor under a PPS lease, consigned to the grantor, or sold to the grantor under a conditional sale agreement (including an agreement to sell subject to retention of title) when the grantor obtains possession of the goods.

While s 19(5) confirms that a grantor will have sufficient rights in the collateral to support attachment for the types of security interests listed in the section, it does not clearly cover all the types of security interests that could arise when a grantor has only a possessory interest in the collateral. For example, it does not clearly cover leases or hire-purchase agreements that are security interests under s 12(1) but are not within the definition of PPS lease in s 13.

Some commentators argue that s 19(5) is not actually the source of the grantor's rights in the collateral for the transactions listed in the section, but that it only regulates the timing of the attachment.[1]

Consultation Paper 2 noted that it was not clear under the Act whether bare possession of personal property can be sufficient to enable the person in possession of the property to grant a security interest over that property to a third

1 See S McCracken, *Conceptualising the Rights of a Lessee under the Personal Property Securities Regime: The Challenge of 'New Learning' for Australian Lawyers* (2011) 34(2) UNSWLJ 547, at pages 555 to 556.

party as well, and not just back to the owner. The commentaries and case law in Canada and New Zealand are divided on this question.[2]

Some commentators argue that bare possession can be sufficient rights in collateral to support attachment of a security interest over the entire collateral. They accept however that this is subject to an important qualification, which is that the secured party only obtains a security interest in the defeasible possessory title of the person in possession. The security interest can be effective as against third parties, but would be subject to the rights of the true owner.

Consultation Paper 2 went on to note that an alternative approach is to argue that bare possession of collateral is not necessarily sufficient to enable the possessor to grant security over the entire collateral, and to argue that bare possession of personal property should only be sufficient rights in the property for the person in possession to grant a security interest over that property back to the owner, by virtue of s 19(5). This would mean that a person would only be able to grant a security interest over collateral if:

- the person owns the collateral;
- the person has possession of the collateral, and it is granting the security interest back to the owner; or
- the person is treated by the Act as if it were the owner of the collateral, by virtue of being the grantor of another security interest over it.

It would follow from this that a person who is in possession of property on some other basis would only be able to grant a security interest over its possessory rights, not over the property itself.

Consultation Paper 2 invited stakeholders to comment on this.

5.1.2.2 *Discussion of stakeholder feedback*

Respondents provided a range of insightful observations on this question. I believe that the views can be condensed into two possible approaches, and that they can be summarised in the following way.

Approach 1 – the "unitary" model

The starting point for this approach is the time-honoured property law principle of *nemo dat quod non habet* – you can only give what you have. If a person has possession of property but not under a transaction that gives rise to a security interest, then they can only give security over that possessory interest (or as some put it, the security interest is bounded by the grantor's own limited interest in the collateral).

If the transaction gives rise to a security interest over collateral, however, then this approach takes the view that the Act treats the grantor as if it had ownership of the collateral, even if that is not the case at general law. Seen this way, the *nemo dat* principle still allows a grantor to give security over the collateral to another secured party, or to sell it (whether subject to the security interest, or free of it), because in the eyes of the Act the grantor is in substance the owner.

2 See B Whittaker, *The Scope of 'Rights in the Collateral' in Section 19(2) of the PPSA – Can Bare Possession Support Attachment of a Security Interest?* (2011) 34(2) UNSWLJ 524; and S McCracken, *Conceptualising the Rights of a Lessee under the Personal Property Securities Regime: The Challenge of 'New Learning' for Australian Lawyers* (2011) 34(2) UNSWLJ 547.

Approach 2 – the "possession" model

The starting point for the second approach is also *nemo dat quod non habet*. Under this approach, however, the Act does not need to be taken as treating a grantor of a security interest as if it were the owner, if that is not in fact the case at general law. Instead, this approach relies on the fact that a person who has possession of property is regarded by the general law as having all the rights of an owner of the property, defeasible only by the superior rights of the true owner.

Comparison of the approaches

I am advised that the first approach (the "unitary" model) is consistent with the understanding in Canada of the structure that underpins the Canadian PPSAs. It has been described to me in that context as being part of the Act's "internal logic". It also helps to explain a number of provisions in the Act that otherwise appear to be flawed or incomplete – see, for example, the discussion in Sections 5.1.2.1 and 7.7.8.1 – and it respects the Act's objective of treating all security interests in the same way, regardless of who has title to the collateral. This approach would criticise the second approach (the "possession" model) as elevating form over substance in a way that the Act has endeavoured to eliminate.

The possession model is less consistent with the analysis that is applied overseas to the Canadian PPSAs. In its favour, though, is the fact that it is more consistent with the balance of our general law, and that it removes the need to read a broad assumption into the Act. It also eliminates the risk that a person might be regarded as the owner of collateral under the Act but not for purposes outside the Act (or vice versa). It does however complicate the analysis of the Act, and introduces the risk that different security interests might be treated in different ways under the Act because of the form of the transactions that produced them, rather than their substance.

The possession model also struggles to explain how the Act applies in some respects to security interests in intangible property, and in particular to transfers of an account. The Act clearly contemplates that a person who has transferred an account will continue to have sufficient rights in the account to transfer it again, or to grant security over it in some other way. The possession model does not readily explain how that might be possible, and would perhaps require a deeming provision to be included in the Act to ensure that the Act did achieve this outcome.[3]

As a matter of broad policy, I prefer the unitary model. While it is somewhat counter-intuitive to accept that the Act can treat a person as if they were the owner of collateral when they are not the owner in the eyes of the general law, it is important to note that the Act does not actually make the person the owner. The Act simply puts the person in the same position, for the purposes of the Act only, that they would have been in if they **were** the owner. The "real" owner will remain the owner outside the Act. It may seem odd to have laws that treat different people as if they own the same property for different purposes, but I am not aware at this stage of any circumstances in which that could produce a clash of outcomes. It is also not unheard-of under Australian law – a person can be regarded as the owner of property for tax purposes, for example, even if they do not own the property

3 In contrast to the Act and the Canadian PPSAs, this seems to be the approach taken in Article 9. See Article 9, §9-318(b).

as a matter of general law. As I see it, the unitary model is also more consistent with the Act's broader objective of achieving consistency of treatment for all security interests, regardless of the location of title to the collateral as a matter of general law.

What is perhaps more important, though, is to see how the two different approaches work in practice. To that end, Annexure C contains a table that explains how the unitary model works in a range of situations.

It has not been possible in the time available to complete this review, however, to produce a corresponding table of outcomes for the possession model. In fairness to the proponents of that model, however, it would be appropriate to do so before any final decision is taken as to which of the two models is to be preferred in the interpretation of the Act. For that reason, I propose to recommend to Government that it provide interested stakeholders with an opportunity to present further arguments in favour of either model, and for proponents of the possession model to demonstrate how it would work in practice by completing a corresponding version of the table in Annexure C, before Government makes a final decision as to which of the models it prefers. I also propose to recommend that Government then include an explanation of the chosen model in the Explanatory Memorandum for any legislation that might be passed in due course to implement other recommendations in this report.

Section 19(5)

Whichever model is adopted, it is clear that s 19(5) needs to be amended.

Some responses argued that s 19(5) could even be deleted. In my view, though, it is preferable to retain the section, but to amend it. The section can serve a useful purpose, by specifying the point in time at which attachment occurs under a security interest where the grantor does not have title as a matter of general law. This would be helpful, whichever of the models is adopted.

5.1.2.3 *Recommendations*

Recommendation 51: *That Government:*

- *provide stakeholders with an opportunity to present further arguments in support of the competing models that have been proposed to explain the reach of the concept of "rights in the collateral" in s 19(2)(a), including by allowing proponents of the "possession" model to complete a corresponding version of the table that is attached to this report as Annexure C;*
- *decide on the basis of the discussion in this report and that further input, which of those two models it prefers; and*
- *include an explanation of the preferred model in the Explanatory Memorandum for the legislation that amends the Act to implement other recommendations in this report.*

Recommendation 52: *That s 19(5) be amended to clarify that it applies to all security interests that arise in circumstances where the secured party has title to the collateral as a matter of general law.*

5.1.3 Section 19(2)(a) – what is meant by "the power to transfer rights in the collateral to the secured party"?

5.1.3.1 ***The issue***

Section 19(2)(a) states that a security interest can attach to collateral, even if the grantor does not have rights in the collateral, if the grantor has the power to transfer rights in the collateral to the secured party.

This additional wording is also found in the Canadian PPSAs[4] and in Article 9,[5] but not in the NZ PPSA.

It is not clear what this additional wording is intended to address. The Official Comments to Article 9 suggest that the language was included there because the alternative test for attachment (that the grantor have rights in the collateral) would only permit the grantor to give security over those rights (based on the *nemo dat* principle), rather than over the entire collateral.[6] According to one text on Article 9, the language reflects the Article 9 thinking that a person who has transferred an account would otherwise not be able to grant a further security interest over it, because they no longer had rights in the collateral.[7] Article 9 covers this gap by stating expressly that a transferor of an account has the power to transfer the account to another secured party, if the first transfer has not been perfected.[8] The reference to a security interest being able to attach if the grantor has "the power to transfer rights in the collateral to the secured party" is a direct reference to that deeming provision.

It has been suggested in the context of the Canadian PPSAs that the language is needed to facilitate the granting of security interests over securities entitlements, perhaps as a reflection of the fact that a holder of a securities entitlement may not have a direct property interest in the underlying pool of securities that is held by the intermediary.[9]

It is not clear that either of these explanations is applicable in the context of the Act. In particular, if you accept the correctness of the unitary model that I discuss above, then the grantor of a security interest over collateral is taken under the Act to have sufficient rights in collateral to grant security over it to another secured party as a consequence of the Act's own internal logic, so the "power to transfer rights" language is not needed to plug a conceptual gap.[10] This suggests that this additional language may be superfluous for the purposes of the Act. That view is also supported by a leading Canadian commentary in relation to the Canadian PPSAs.[11]

For these reasons, Consultation Paper 2 proposed that the language be deleted.

4 For example Sask PPSA, s 12(1)(b).

5 Article 9, §9-203(b)(2).

6 Official Comment 6 to §9-203.

7 R Nowka, *Mastering Secured Transactions – UCC Article 9* (2nd ed) (Carolina Academic Press, 2014), Ch 2, Part B2.

8 Article 9, §9-318.

9 See, for example, Richard H McLaren, *The 2011 Annotated Ontario Personal Property Security Act* (Carswell, 2011) page 140.

10 Even if Government decides in due course to prefer the possession model, so that it is necessary to include some additional language to clarify the basis on which the transferor of an account can continue to grant security interests over it, my view is that the "power to transfer rights" language is not adequate to do that.

11 Cuming Walsh & Wood, pages 249 to 250.

5.1.3.2 ***Discussion of stakeholder feedback***

A small number of respondents were not convinced that the references in s 19(2) to "power to transfer rights in the collateral to the secured party" should be deleted. The great majority of respondents agreed, however, that the words had no role to play in the structure of the Act, and should be deleted.

The reasons why these words have been included in Article 9 and the Canadian PPSAs do not appear to be relevant to the Act. The words do not appear in the NZ PPSA, and this does not appear to be a concern in that jurisdiction. In my view, the words perform no function, and create confusion and uncertainty. Deleting them would improve the Act.

5.1.3.3 ***Recommendation***

Recommendation 53: *That s 19(2)(a) be amended to read:*

"(a) the grantor has rights in the collateral; and".

5.1.4 The need for a security agreement

5.1.4.1 ***The issue***

One submission suggested that s 19 be expanded to confirm that a security interest only arises if there is a security agreement between the grantor and the secured party.[12]

I am not convinced that this is necessary. As the submission noted, this is implicit already, for example because s 12 says that it is a requirement for a security interest that it arise under a "transaction". It is also difficult to see how a security interest could arise other than voluntarily or by operation of law, and security interests that arise by operation of law are excluded by ss 8(1)(b) and (c).

Section 19 currently allows a security interest to attach to collateral whether or not there is a security agreement in writing – that is, it allows a security interest to attach to collateral under an oral security agreement. I do not take the submission as arguing that this should change. If s 19 were to be amended as suggested, the drafting would need to allow for both oral and written security agreements, and for unilateral grants of security such as by deed (where the security interest arises as the result of a unilateral act of the grantor, even though that act was part of a broader consensual transaction).

For these reasons, Consultation Paper 2 suggested that the benefit that would be gained from this additional drafting may not justify the effort involved, particularly as a focus of this review is to simplify the Act, rather than add to its complexity.

5.1.4.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that the Act should be amended to state that a security interest will only attach to collateral if there is a security agreement between the grantor and the secured party. One of those respondents drew attention to a case before the Australian courts in which this was being

12 LCA, S2 page 9.

argued as an issue.[13] That case has now been reported, as *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd*[14].

Dura Constructions concerned money that had been paid by into court by an appellant, as a condition to obtaining a stay of execution of a judgment. The money was held in a bank account in the joint names of the solicitors for the opposing parties. The appellant went into liquidation while the money was still in the account.

The appeal was unsuccessful, and the respondent claimed the money in the account. The appellant argued, however, that the respondent's interest in the money was a security interest for the purposes of the Act, and that the respondent had not perfected that security interest. The appellant argued as a consequence that any interest that the respondent may have had in the money had vested in the insolvent appellant, under s 267.

The Victorian Court of Appeal analysed the nature of the respondent's interest in the funds at some length. It came to the conclusion that the respondent had a charge over the funds, but that the charge was not a security interest for the purposes of the Act. The court decided that the respondent's charge over the funds was not subject to the Act, for two related reasons. First, the court held that the respondent's interest in the funds arose by operation of the general law, and so was outside the Act by virtue of s 8(1)(c). Secondly, the court formed the view, based on an analysis of the language of the Act, academic commentary and Canadian case law, that a security interest can only arise under a consensual transaction between the parties, and that this was not the case on the facts before the court.[15]

That decision was consistent with the view reached by a single judge of the Victorian Supreme Court in another case earlier that year.[16]

The *Dura Constructions* case raises a number of interesting legal issues. Given the decision reached by the Victorian Court of Appeal in that case and by the Victorian Supreme Court in the earlier decision, though, it seems to me that there is no pressing need to clarify in the Act that a security interest will only arise under the Act if it is the product of a consensual transaction between grantor and secured party.

The great majority of respondents were also of the view that it was not necessary to amend the Act to say this.

5.1.4.3 *Recommendation*

> **Recommendation 54:** *That s 19 not be amended to state that a security interest can only arise under a security agreement.*

13 AD, CP2 page 4.

14 *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd* [2014] VSCA 326.

15 *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd* [2014] VSCA 326, paragraphs 110 to 126.

16 *Sandhurst Golf Estates Pty Ltd v Coppersmith Pty Ltd* [2014] VSC 217.

5.2 Enforceability against third parties

5.2.1 Section 18 – general rules about security agreements

5.2.1.1 ***The issue***

Sections 18(2) and (4) contain the following rules:

> (2) A security agreement may provide for security interests in after-acquired property.
> …
>
> (4) A security agreement may provide for future advances.

Similar provisions are found in the Canadian PPSAs[17] and the NZ PPSA.[18]

The points addressed in ss 18(2) and (4) may have been matters of uncertainty under prior Canadian law, so that it was desirable to include provisions in the Canadian PPSAs to clarify the legal position.[19] Consultation Paper 2 expressed the view, however, that they were relatively self-evident propositions under Australian law, and that the Act could perhaps be simplified without adverse effect by deleting them.

5.2.1.2 ***Discussion of stakeholder feedback***

A number of respondents agreed that the provisions could be deleted. The majority of respondents suggested, however, that they should be retained. One of those responses pointed out that the proposition may be self-evident in relation to traditional security interests, but that it was helpful for the Act to confirm that the propositions also hold true for security interests that would not have been thought of as securities under prior law.[20]

I can see the force of that argument, and so do not propose to recommend that ss 18(2) and (4) be deleted. I do consider however that two aspects of s 18(4) should be clarified. First, security interests commonly do not secure advances that are "provided" for by the security agreement itself, but secure advances that are provided for by other documents (such as a loan agreement). Section 18(4) does not properly reflect this. Secondly, it is not clear why s 18(4) refers only to future advances, and not to future obligations as well. In my view, it would improve the quality of the Act if both these matters were addressed.

5.2.1.3 ***Recommendations***

Recommendation 55: *That ss 18(2) and (4) be retained.*

Recommendation 56: *That s 18(4) be amended to read:*

> *"(4) A security interest may secure payment or other obligations that are incurred after the security interest is granted."*

17 For example Sask PPSA, ss 13(1) and 14(1).

18 NZ PPSA, ss 43 and 71.

19 See Cuming Walsh & Wood, pages 260 to 261.

20 AD, CP2 page 5.

5.2.2 Section 20(2) – form and content of a security agreement

5.2.2.1 *The issues*

Section 20 sets out what is required for a security interest to be enforceable against a third party in respect of particular collateral. To be enforceable against a third party, the security interest needs to be attached to the collateral. In addition, s 20(1)(b) states that one of the following needs to apply:

> (b) (i) the secured party possesses the collateral;
>
> (ii) the secured party has perfected the security interest by control;
>
> (iii) a security agreement that provides for the security interest covers the collateral in accordance with subsection (2).

The existence of the security agreement, or just its terms?

Section 20(2) describes what is required for a security agreement to "cover collateral". One of those requirements is that the security agreement be "evidenced by writing". It is not entirely clear from s 20(2), however, whether the writing needs to evidence the **existence** of the security agreement, or just its terms. This will not be an issue for most security agreements, as the writing for most security agreements will evidence both the terms of the agreement and the fact that it has been entered into. This is not always the case, however. It is not uncommon in commercial transactions for the proposed terms of an agreement to be set out in writing, but for the agreement itself to be entered into orally, or by some act of one of the parties that constitutes acceptance of the written offer. In arrangements for the supply of goods subject to a retention of title clause, for example, the retention of title clause and other contractual terms will often be contained in a set of standard trading conditions that the supplier provides to the purchaser at the outset of the trading relationship. Those trading terms will set out the conditions that are to apply to any agreements that are subsequently entered into for the sale and purchase of specific goods, but will not themselves constitute the actual sale and purchase agreement.

Consultation Paper 2 expressed the view that s 20(2) should only require that the **terms** of the security agreement be evidenced by writing, not the fact that the agreement has been entered into.

What terms of the security agreement does the writing need to evidence?

A security agreement will normally contain provisions that address a range of issues. They can include:

- the identity of the parties
- the grant of the security interest
- the identity of the collateral
- enforcement triggers and remedies
- financial and operational undertakings.

If a security agreement includes all these matters, does s 20 require that they all be evidenced by writing?

Section 20 serves a similar purpose to the Statute of Frauds,[21] in that it is designed to ensure that a secured party can only enforce its security interest against third parties if there is objective evidence of the existence of the security interest and of the parties' agreement as to the collateral that is to be subject to it.[22] Consultation Paper 2 suggested, if that is accepted as correct, that s 20 should only require that the writing evidence the terms of the security interest and the identity of the collateral, and not any other terms that also happen to be part of the security agreement as well.

How should the collateral be described?

Section 20(2)(b) also states that a security agreement will only cover collateral if:

> (b) the writing evidencing the agreement contains:
>
> (i) a description of the particular collateral, subject to subsections (4) and (5); or
>
> (ii) a statement that a security interest is taken in all of the grantor's present and after-acquired property; or
>
> (iii) a statement that a security interest is taken in all of the grantor's present and after-acquired property except specified items or classes of personal property.

These requirements are then expanded on by ss 20(4) and (5).

As a matter of general contract law, the terms of a security agreement need to be sufficiently certain to enable a court to identify exactly what property is subject to the security. At general law, a variety of sources may be drawn on to determine this – if the secured property is not expressly identified in the agreement, for example, it may be possible to identify the property through other means, outside the language of the agreement. In contrast, s 20(2)(b) requires that the writing for the security agreement also describe the collateral in the manner described in the section. It is not clear why this is necessary.

As mentioned above, the intention behind s 20 is to ensure that the writing provides evidence of the term of the security interest and of the parties' agreement as to the identity of the collateral. However, s 20(2)(b) will not necessarily achieve this, as the writing only needs to contain a "description" of the collateral, and the term "description" is defined in s 10 in a manner that only requires the security agreement to identify the class of property that the collateral belongs to, not the precise collateral itself.

It could be argued that little is gained by the additional documentation requirement in s 20(2)(b). Consultation Paper 2 suggested that an alternative approach could be to simply follow the requirements of the general law, and only require that the description of the collateral in the writing be sufficient to enable the collateral to be identified, including where appropriate through resort to extrinsic evidence. This would be consistent with the approach taken in at least one Canadian jurisdiction, Ontario.[23]

21 Statute of Frauds 1677. Parts of the Statute of Frauds continue in Australian law, in relation to guarantees and real estate transactions.

22 Duggan & Brown, paragraph 4.25.

23 Ontario PPSA, s 11(2)(a)(i).

Suggested recasting of s 20(2)

Consultation Paper 2 suggested that the combined effect of the changes discussed above could allow s 20(2) to be recast along these lines (and for ss 20(4) and (5) to be deleted):

(2) (a) A security agreement covers collateral in accordance with this subsection if the items described in paragraph (b) are evidenced by writing that is:

(i) signed by the grantor (see subsection (3)); or

(ii) adopted or accepted by the grantor by an act, or omission, that reasonably appears to be done with the intention of adopting or accepting the writing.

(b) The items referred to in paragraph (a) are:

(i) the terms of the security interest that is provided for by the security agreement; and

(ii) a description of the collateral that is sufficient to enable it to be identified.

5.2.2.2 *Discussion of stakeholder feedback*

Most respondents were in favour of the proposed changes. There was a clear consensus that ss 20(4) and (5) are unhelpful and should be deleted. There was also consensus that the description of the collateral should only need to be sufficient to enable the collateral to be identified.

Responses did express some concern with the drafting of proposed paragraph (b)(i), and its requirement that the writing identify "the terms of" the security interest. The concern was that this might in fact require that all the terms associated with the security interest needed to be set out in the writing, rather than just the security clause itself. That was not the intention.

One response suggested that the writing should also identify the parties to the security agreement.[24] That may not always be practicable, however – for example, where a supplier of goods on retention of title terms sends its standard trading terms to a potential customer. It would still be necessary, of course, to prove that an agreement had been entered into, and the identity of the grantor (whether or not in the writing) would need to be established as part of that process.

5.2.2.3 *Recommendations*

Recommendation 57: *That s 20(2) be recast along these lines:*

"(2) (a) A security agreement covers collateral in accordance with this subsection if the items described in paragraph (b) are evidenced by writing that is:

(i) signed by the grantor (see subsection (3)); or

(ii) adopted or accepted by the grantor by an act, or omission, that reasonably appears to be done with the intention of adopting or accepting the writing.

24 ASF, CP2 page 4.

(b) The items referred to in paragraph (a) are:

(i) the security interest that is provided for by the security agreement; and

(ii) a description of the collateral that is sufficient to enable it to be identified."

Recommendation 58: *That ss 20(4) and (5) be deleted.*

5.2.3 Section 20(2) – what happens if collateral is transferred?

5.2.3.1 *The issue*

If a grantor transfers collateral that is subject to a security interest and the security interest remains attached to the collateral in the hands of the transferee, the Act treats the transferee of the collateral as having become the grantor of the security interest in place of the original grantor. (I discuss this in more detail in Section 7.2.)

A number of submissions pointed out that it is not clear from s 20(2) whether the security interest will only continue to be enforceable against a third party after the transfer if the transferee enters into a fresh security agreement with the transferor.[25] It would not be appropriate to require this. The original security agreement will be sufficient to satisfy the evidentiary function behind s 20 (see Section 5.2.2), and there is no need to require the secured party to enter into a fresh agreement with the transferee, even assuming it could convince the transferee to do so.

Consultation Paper 2 agreed that it would be useful to amend s 20 to clarify this.

5.2.3.2 *Discussion of stakeholder feedback*

One respondent did not agree with this proposal.[26] The respondent noted that the Act takes a different approach to the Canadian PPSAs in relation to the effect of a transfer of collateral, by treating the transferee as the new grantor of the security interest, as the Canadian PPSAs do not (except for limited purposes). The respondent suggested that the Act should be amended to align itself with the Canadian approach.

I discuss this proposal later in this report, in Section 7.2. It can be seen from that discussion that I would not want to make such a recommendation without further investigation being made into the implications that this would have for the operation of the Act more generally.

All other respondents agreed that it would be appropriate to amend the Act to clarify that the requirements of s 20(2) only need to be satisfied with the original grantor of a security interest over collateral, not with a person who subsequently becomes the grantor as the result of the collateral being transferred to it.

25 AFC, S2 att A page 3; LCA, S2 page 10.

26 LW, CP2 page 17.

5.2.3.3 ***Recommendation***

> **Recommendation 59:** *That s 20(2) be amended to make it clear that the requirements in the section need only be satisfied with the original grantor of a security interest over collateral, and not with a person who subsequently becomes the grantor as the result of the collateral being transferred to it.*

5.3 Perfection

5.3.1 Introduction

The Act provides for five ways in which a security interest can be perfected over collateral. If the security interest has attached to the collateral and is enforceable against a third party, it can be perfected by any of registration, possession or (for certain types of collateral) control. These modes of perfection all require the secured party to do something if it wants its security interest to be perfected.[27] A security interest may also be perfected, either temporarily or permanently, by force of a provision to that effect in the Act. These additional modes of perfection are automatic, and do not require that any particular action be taken by the secured party.

I discuss issues relating to perfection by registration, and in particular the operation of the Register, in Chapter 6. This Section 5.3 looks at issues in relation to the other modes of perfection.

5.3.2 Perfection by possession

5.3.2.1 Seizure or repossession

5.3.2.1.1 ***The issue***

The three main modes of perfection over collateral (registration, possession and control) all have a publicity objective, in that they function as a form of notice to outsiders that the personal property in question could be subject to a security interest.[28] If a secured party perfects its security interest by taking possession of the collateral, for example, the fact that the secured party rather than the grantor has possession should serve as a warning to others that the grantor may not have clear title.

Section 21(2)(b) provides, however, that a secured party's possession of collateral will not be sufficient to perfect its security interest if the possession is as a result of seizure or repossession. The point is restated in s 123(4) as well. This limitation on the extent to which possession can perfect a security interest is different to the requirements in s 20 for the security agreement to be enforceable against a third party, however, as it appears that possession as a result of seizure or repossession will suffice for the purposes of that section.[29]

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27 There is one exception to this, for security interests that are perfected by control over an ADI account. See Section 5.3.7.3.

28 See the discussion of this in Section 4.1.2 above.

29 Although some commentators read a similar limitation into the NZ equivalent of s 20(2)(b)(i) – see Gedye Cuming & Wood, para 36.2.

The position under s 21(2)(b) reflects the approach taken by the NZ PPSA,[30] and by all of the Canadian PPSAs[31] other than Ontario (which takes the opposite approach).[32]

A number of arguments have been advanced in support of the approach taken in the NZ PPSA and in the majority of the Canadian PPSAs. The principal argument is that the surrender of possession by the grantor to the secured party is intended to be a voluntary act of the debtor, akin to the concept of a pledge. Seizure or repossession, by contrast, is involuntary (at least as far as the grantor is concerned). It has also been suggested that allowing seizure or repossession to perfect a security interest could give rise to other, more practical challenges.[33]

The Ontario approach, in contrast, focuses on the role of perfection as a means of notifying outsiders that the secured party may have a security interest in the collateral. The Ontario approach takes the view that possession that is the result of seizure or repossession can satisfy the publicity objective as effectively as possession that is taken before default.

Consultation Paper 2 indicated that I was inclined to favour the Ontario approach, and to recommend that possession by seizure or repossession be sufficient to perfect a security interest as well.

5.3.2.1.2 ***Discussion of stakeholder feedback***

A number of respondents were in favour of following the Ontario approach. The majority, however, were not.

One respondent made the good point that allowing possession through seizure or repossession to be sufficient for the purposes of s 20 would risk defeating the writing requirements of that section, as a secured party that had failed to reduce its security agreement to writing (and so did not have a security agreement that was enforceable against third parties) would automatically rectify that lapse when they enforced their security interest by seizing the collateral.[34] That, in my view, would not be a desirable outcome.

This insight has led me to the view that s 20 should be amended to make it clear that possession will not be sufficient to make a security interest enforceable against third parties, if the possession is through seizure or repossession of the collateral. I am also comfortable with adopting the majority view among stakeholders that possession through seizure or repossession should not be sufficient to perfect a security interest either.

5.3.2.1.3 ***Recommendations***

Recommendation 60: *That the language "(other than possession as a result of seizure or repossession)" in s 21(2)(b) be retained.*

Recommendation 61: *That the language "(other than as a result of seizure or repossession)" be inserted after "the collateral" in s 20(1)(b)(i).*

30 NZ PPSA, s 41(1)(b)(ii).
31 For example Sask PPSA, s 24(1).
32 Ontario PPSA, s 22(1).
33 Cuming Walsh & Wood, page 310.
34 LW, CP2 page 5.

5.3.2.2 Bearer investment instruments

5.3.2.2.1 *The issue*

Section 24(6)(b) states that a person will only be taken to have possession of an investment instrument that is evidenced by a certificate if, among other requirements:

> (b) a transfer of the investment instrument may be registered on books maintained for that purpose by or on behalf of the issuer (or the certificate states that a transfer of the instrument may be so registered); …

One submission pointed out that this seems to suggest that it may not be possible to perfect by possession over a bearer investment instrument.[35] Consultation Paper 2 noted that this is unlikely to have been the intent,[36] but agreed that it would helpful to clarify the Act by removing the uncertainty.

5.3.2.2.2 *Discussion of stakeholder feedback*

All respondents agreed that it would be helpful to clarify that s 24(6) only applies to registrable investment instruments.

5.3.2.2.3 *Recommendation*

> **Recommendation 62:** *That s 24(6) be amended to clarify that it only applies to a security interest over a registrable investment instrument.*

5.3.3 Perfection by control – introduction

Section 21 provides that a security interest will be perfected over the following types of collateral, listed in s 21(2)(c), if the secured party has "control" of the collateral:

(i) an ADI account;

(ii) an intermediated security;

(iii) an investment instrument;

(iv) a negotiable instrument that is not evidenced by a certificate;

(v) a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation;

(vi) satellites and other space objects.

It can be seen that these categories of collateral, with the exception of satellites and other space objects, are all intangibles. This means that it is not possible to perfect over them by possession.[37] The notion of perfection by control operates in many respects as a functional equivalent to perfection by possession, for the types of property listed in the section.

35 LCA, S2 page 10.

36 See also Duggan & Brown, para 5.20.

37 As a practical matter, it may be difficult to perfect by possession over satellites and other space objects as well.

Perfection by control is also a feature of the Canadian PPSAs,[38] and of Article 9.[39] Perfection by control is not provided for, however, in the NZ PPSA.

When assessing the rules for perfection by control, it is important to remember that perfection of a security interest is intended to serve a publicity function – that is, to provide third parties with an opportunity to become aware that a secured party might have a security interest in particular collateral. Perfection by possession does this.[40] It also follows from the nature of possession that only one secured party can be perfected by possession over an item of collateral at any given time. These factors assist perfection by possession to serve its publicity function. As will be seen from the discussion below, however, perfection by control does not necessarily deliver an equivalent outcome.

5.3.4 Perfection by control – intermediated securities

5.3.4.1 Should the Act deal separately with intermediated securities?

5.3.4.1.1 *The issue*

The concept of an intermediated security was not known to Australian law before the Act. The term derives from two international conventions, the Hague Securities Convention and the UNIDROIT Securities Convention.

Traditionally, an investor in a financial asset had a direct legal relationship with the issuer of the asset. In the case of a share, for example, the shareholder was registered as the owner of the share in the issuing company's share register. If the shareholder wanted to transfer the share, it would execute a transfer form and lodge it (together with the share certificate) with the company. The company would then issue a fresh share certificate in the name of the transferee.

This is an inefficient method of dealing in a financial asset, and is said to have become increasingly unmanageable in the United States in the 1960s as a result of growth in the volume and speed of trading in securities. Technology and the state of the law at that time apparently did not allow this problem to be solved through the issue of uncertificated securities along the lines of our CHESS system (discussed further below). Instead, market participants turned to a solution that relied on the electronic systems that were maintained by brokers and other intermediaries. Under that solution, individual investors are not registered on an issuing company's books as the holder of shares. Rather, one intermediary is registered as the holder of all the shares. This intermediary (often called the "top-tier" intermediary) establishes "accounts" in its records for other intermediaries, and records in those accounts the number of shares that it holds for each of them. Each of these "middle-tier" intermediaries then establishes accounts in its books for each of its customers, on the same basis. The same arrangement then continues down through further "middle-tier" intermediaries, to the intermediary that maintains the account for the end investor.

This system allows interests in financial assets to be traded through electronic entries in the records of the intermediaries. It has the effect, however, that the end investor no longer has a direct relationship with the issuer of the financial asset, but only with its immediate intermediary.

38 Apart from Prince Edward Island. See, for example, Sask PPSA, s 24.1.

39 Article 9, §9-314.

40 Particularly as ss 24(1) and (2) make it clear that the secured party needs to have actual possession of the collateral, to the exclusion of the grantor.

Financial assets are now traded across borders and time zones, and this intermediated system for holding and trading financial assets has expanded across the world as well. Because of the speed and frequency with which investors deal with financial assets on international markets, trading activity can be significantly impeded if a person who takes an interest in a financial asset cannot be confident about the legal effect of their transaction, for example because the transferor (or its intermediary) is based in an unfamiliar jurisdiction. The objective of the Conventions is to remove this impediment, by standardising the legal rules that signatory countries apply in relation to dealings in intermediated interests in financial assets. Australia, however, is not yet party to either Convention.

The concept of an intermediated security is not only novel to Australian eyes, but also rather elusive. It is defined in s 15(1) in these terms:

> (1) An ***intermediated security*** is the rights of a person in whose name an intermediary maintains a securities account.

Section 15 does not explain what it means by the "rights" of the holder of an intermediated security. They would generally be understood to be either or both of the holder's contractual rights against the intermediary, and a beneficial interest in the pool of the securities that the intermediary holds for that person and the intermediary's other customers. Unlike the position in the United States and Canada (discussed immediately below), though, Australia does not have a legislative framework that clarifies this and other related questions, at least at this stage.

As just noted, the intermediated system for holding and trading in financial assets was developed in the United States. United States law accommodates the intermediated holding system with a comprehensive set of rules, contained in Article 8 of the UCC. Article 8 defines the nature of an investor's interest in financial assets held through an intermediary (referred to in Article 8 as a "securities entitlement"), and introduces the concept of "control" as a mechanism that enables a purchaser of an interest in a financial asset (called a "protected purchaser") to be confident that it can acquire title to the interest free of adverse claims. Article 9 then draws on the legislative framework in Article 8 to provide specific rules for security interests over securities entitlements, including by allowing a secured party to perfect by control.

Canada has followed a similar path. All the Canadian PPSA provinces[41] have enacted a Securities Transfer Act that follows very closely the content of Article 8 of the UCC, and have made corresponding consequential amendments to their Canadian PPSAs, including to incorporate a concept of perfection by control. [42]

Australia does not have an equivalent of Article 8 of the UCC, or of the Canadian Securities Transfer Acts. As noted earlier, Australia is also not yet party to either the Hague Securities Convention or the UNIDROIT Securities Convention. These facts make it appropriate to ask whether it may have been premature for the Act to include provisions that deal specifically with intermediated securities.

Consultation Paper 2 invited stakeholders to comment on this.

41 Other than Prince Edward Island.

42 The Canadian civil law jurisdiction Quebec does not have a Canadian PPSA, but has made corresponding changes to its own equivalent legislation.

5.3.4.1.2 ***Discussion of stakeholder feedback***

The majority of respondents were of the view that it was helpful for the Act to deal expressly with intermediated securities, even though the Act did not contain the comprehensive legislative package of Article 8 of the UCC or of the Securities Transfer Acts.

A number of responses made the point that the law and market practice affecting dealings in financial assets are complex and specialised, and not well understood by those who do not work in the area. They cautioned that changes to the provisions affecting intermediated securities should only be made with care, and with full industry consultation.

I am satisfied that the changes I am proposing in relation to the application of the Act to intermediated securities are appropriate. I agree, though, that the review has not had the benefit of substantial input from specialists in the law and practice of dealings in financial assets. I also agree that it would be desirable to demonstrate that the proposed changes do have the broad support of the industry that they will affect, before the changes are put into effect. For that reason, I propose to recommend specific changes to the way the Act deals with intermediated securities as appropriate, but also to recommend in relation to a number of those proposed changes that Government discuss them further with industry before they are implemented.

5.3.4.1.3 ***Recommendation***

Recommendation 63: *That the Act retain the concept of an intermediated security.*

5.3.4.2 **Are the options for perfecting by control appropriate?**

5.3.4.2.1 ***The issue***

It will be convenient for a person who holds a security interest over an intermediated security to be able to perfect that security interest without needing to register a financing statement against the grantor. The option of perfecting a security interest over an intermediated security by control may also facilitate the smooth operation of the markets on or through which interests in financial assets are traded. In those respects, the ability to perfect by control clearly has value.

It could be argued however that perfecting a security interest over an intermediated security by control, unlike perfection by registration or possession, does not necessarily satisfy the publicity objective behind perfection, in that it does not necessarily provide third parties with an ability to determine whether an intermediated security may be encumbered. If perfection by control over intermediated securities is to be retained, there is merit in considering whether the methods by which this can be done should be amended so that they are better able to put third parties on notice of the existence of the security interest that it perfects.

Consultation Paper 2 suggested that it might be appropriate to structure those methods in such a way that only one secured party at a time can be perfected by control (as is the case for security interests over tangible collateral that are perfected by possession), or so that a secured party will only be perfected by control if it is able to ensure that the intermediated security cannot be dealt with without its consent.

5.3.4.2.2 ***Discussion of stakeholder feedback***

A number of respondents agreed with this proposition. Others, however, were reluctant to express a view on the question. I expect that this reluctance relates, at least in part, to the point I made above about this being a complex area, and one that is not well understood by those who do not specialise in it.

A number of responses made the point again that any changes should only be made after further industry consultation. I am comfortable with taking that approach.

5.3.4.2.3 ***Recommendation***

> **Recommendation 64:** *That Government explore, in consultation with experts in the financial investments industry, how the mechanisms for perfecting by control over an intermediated security can be structured to better achieve the publicity objective of perfection, such as by ensuring that a secured party will only be perfected by control if it is able to ensure that the intermediated security cannot be dealt with without its consent.*

5.3.4.3 **Can the concept of an intermediated security be simplified?**

5.3.4.3.1 ***The issue***

The definition of "intermediated security" in s 15(1) is a combination of three concepts:

- the **rights** of a person,
- in whose name an **intermediary**,
- maintains a **securities account**.

I touched on the topic of the likely meaning of the "rights" of the holder of a securities account a little earlier in this report, in Section 5.3.4.1.

The term "intermediary" is defined in ss 15(2) to (6). It is quite a technical definition, and focuses not on the role performed by the entity, but rather on the nature of the licences that the entity holds. One submission suggested that this is not desirable, and that the requirement that the intermediary be licensed should be removed.[43] That would be consistent with the approach taken under the UCC and in Canada. In those jurisdictions, however, the scope of the rules relating to intermediated securities is framed by the rules in Article 8 of the UCC or one of the Securities Transfer Acts, and there are no corresponding rules in Australia's legal framework at present. This demonstrates again the difficulty of providing for intermediated securities in the Act without the balance of the accompanying legal framework found in the United States and Canada.

The current approach to the definition of "intermediary" is however consistent with the UNIDROIT Securities Convention, which contemplates that a contracting state might want to limit the scope of the concept in this way.[44]

43 JLF, S2 page 10.

44 UNIDROIT Securities Convention, Article 5(a).

The expression "securities account" is also defined, in s 15(7). For the most part, it relies on a further term, "financial product". That term is defined in s 10, in this way:

> ***financial product:***
>
> (a) for the purposes of the definition of investment instrument in this section—has the meaning given by the *Corporations Act 2001*; and
>
> (b) for any other purposes—means any of the following, or an interest in any of the following, other than cash:
>
> (i) shares;
>
> (ii) bonds;
>
> (iii) any other financial instrument;
>
> (iv) any other financial asset.

Consultation Paper 2 suggested that would make the Act more comprehensible and easier to work with, if the concept of an intermediated security could be simplified, and invited shareholders to suggest ways in which this could be done.

5.3.4.3.2 ***Discussion of stakeholder feedback***

Similar to the questions discussed in the preceding sections, most respondents were reluctant to express firm views on this question, preferring to leave it to further industry consultation. Again, I am comfortable with approaching the question in this way.

5.3.4.3.3 ***Recommendation***

Recommendation 65: *That Government explore, in consultation with experts in the financial investments industry, whether and if so how the concept of an intermediated security can be simplified.*

5.3.4.4 **What if the intermediary is itself the secured party?**

5.3.4.4.1 ***The issue***

It is common for a custodian of financial assets to include a requirement in its trading terms for its customer to grant it a security interest (often called a lien) over all the assets that the customer holds through the custodian. This security interest is often expressed to be over the benefit of the customer's accounts with the custodian.

The ways in which a security interest can be perfected by control over an intermediated security are set out in s 26. Those methods of perfection all appear to assume that the secured party is a different person to the intermediary. As one of the submissions pointed out, this makes it unclear whether the intermediary itself can perfect by control if it is also the secured party, and appears to suggest that it may only be able to perfect by registration.[45]

I see no good reason why an intermediary should be any less able than other secured parties to perfect a security interest by control over intermediated securities that are held with it. Article 8 of the UCC and the Canadian Securities Transfer Acts do allow an intermediary to perfect by control, and even go on to

45 JLF, S2 page 12.

deem that perfection to be automatic (similar to the position that an ADI enjoys when it has security over an ADI account with it – see Section 5.3.7.1 below).

For these reasons, Consultation Paper 2 proposed that it be made clear that the intermediary itself is also able to perfect by control.

5.3.4.4.2 ***Discussion of stakeholder feedback***

Respondents were more confident with this question. All agreed that the intermediary itself should also be able to perfect by control.

One respondent made the good point that it may not be appropriate to provide that only one secured party at a time can perfect by control if this change is made, as that would otherwise effectively preclude the possibility that anyone other than the intermediary itself could perfect by control.[46] While I had flagged that option as a possible recommendation in Consultation Paper 2, I no longer propose to pursue it, for this reason.

5.3.4.4.3 ***Recommendation***

> **Recommendation 66:** *That the Act be amended to make it clear that an intermediary can perfect a security interest by control over intermediated securities held with it.*

5.3.4.5 **How should CHESS securities be categorised?**

5.3.4.5.1 ***The issue***

As one submission pointed out, the Act classifies financial products listed on the Australian Stock Exchange and held through the CHESS system as intermediated securities, rather than as investment instruments.[47] They are intermediated securities because the operator of the CHESS system is an "intermediary" as defined in s 15(2)(b), and because the records that it maintains of holdings and transfers of financial products are defined to be "securities accounts", by s 15(7)(b). They are not investment instruments, because the definition of "investment instrument" excludes anything that is an intermediated security.

The classification of an ASX-listed security held through CHESS as an intermediated security rather than an investment instrument is counter-intuitive, because the manner in which securities are held in the CHESS system is very different to the type of custody arrangement that is at the heart of the concept of an intermediated security. The CHESS operator does not hold pools of securities as custodian for individual investors. Rather, the CHESS operator functions as a registrar for the entities that issue the securities, in that it maintains a sub-register of the entity's shares or other securities as an agent of the issuing entity. This is almost the reverse of a custody arrangement, as the CHESS operator is acting for the issuer of the securities, not the person who has invested in them.

Consultation Paper 2 expressed the view that the Act would be simpler and more intuitive if shares or other securities listed on the Australian Stock Exchange and held through the CHESS system were treated as investment instruments, rather than as intermediated securities.

46 DLA, CP2 page 5.

47 LCA, S2 page 8.

5.3.4.5.2 ***Discussion of stakeholder feedback***

One response suggested that it might be preferable to continue to treat CHESS securities as intermediated securities, for consistency with their treatment overseas.[48] That response also suggested that both concepts (of an intermediated security, and of an investment instrument) should be amalgamated into a single concept, in which case it would no longer be necessary to decide which category CHESS securities should belong to.

All other responses that expressed a view on this question agreed, however, that CHESS securities should be categorised as investment instruments, and not as intermediated securities, as long as this did not adversely affect their treatment under the Act.

5.3.4.5.3 ***Recommendation***

> **Recommendation 67:** *That the Act be amended so that shares or other securities listed on the Australian Stock Exchange and held through the CHESS system are investment instruments, rather than intermediated securities.*

5.3.4.6 **How should cash be treated?**

5.3.4.6.1 ***The issue***

It can be seen from Section 5.3.4.3.1 above that the definition of "financial product" is quite broad, at least as it applies to intermediated securities. However, it excludes "cash".

This is consistent with the Hague Securities Convention and the UNIDROIT Securities Convention. The reason for the exclusion of cash from the corresponding concept in those Conventions is however not clear.

From a secured party's perspective, the exclusion of cash is inconvenient. If a secured party takes a security interest over a grantor's interest in shares held through a custodian, the secured party is likely to want its security interest to also attach to any dividends that the custodian receives (on the grantor's behalf) in relation to the shares. The exclusion of cash has the effect however that the secured party cannot perfect by control over those amounts. Instead, it would need to perfect by registration, undermining the benefit of being able to perfect by control at all.

The difficulty is even more acute for the intermediary itself, if it is the secured party. Its security interest will typically be over the benefit of the various accounts that the grantor holds with it as intermediary. If the grantor directs the intermediary to sell some or all of the securities that it holds through the secured party (as intermediary), this will convert the asset that the grantor holds through the intermediary into cash, held by the intermediary on behalf of the grantor. The intermediary would want its security interest to grip that cash in the same way as it previously gripped the securities. As the security interest cannot be perfected over the cash by control, however, the intermediary would need to register a financing statement if it wanted to perfect that security interest.

48 JLF, CP2 page 9.

Some intermediaries deal with this by holding cash for customers in a way that qualifies as an "investment instrument" (see below), such as a cash management trust. This option may not always be available, however.

For these reasons, Consultation Paper 2 expressed the view that a secured party should be able to perfect by control over cash that is held through an intermediary in the same way as it can perfect by control over other intermediated financial assets.

5.3.4.6.2 ***Discussion of stakeholder feedback***

The views of respondents were evenly divided on this question. A number of respondents were in favour of allowing a secured party to perfect by control over a holding of cash through an intermediary, in the same way as for intermediated securities generally. An equivalent number of respondents were not.

It is interesting to note that this is currently a live issue in Canada. One respondent advised that the Ontario Bar Association has recommended to the Ontario government that the Ontario PPSA be amended to allow a security interest over cash held by an intermediary to be perfected by control.[49] That recommendation was the subject of some industry debate after it was first made, as a result of which the Ontario Bar Association prepared a modified version of its proposal. That modified proposal is still being considered by government in Ontario.

In my view, it is worth considering whether a secured party should be able to perfect by control over cash held through an intermediary. I accept, however, that this proposal should be considered by Government in more detail, in consultation with representatives of the financial investments industry, before a final decision is made.

5.3.4.6.3 ***Recommendation***

> **Recommendation 68:** *That Government explore, in consultation with experts in the financial investments industry, whether the Act should be amended to allow a secured party to perfect by control over cash that is held through an intermediary in the same way as it can perfect by control over other financial assets.*

5.3.5 Perfection by control – investment instruments

5.3.5.1 The meaning of "investment instrument"

5.3.5.1.1 ***The issue***

A security interest may also be perfected by control if it is over an "investment instrument". That term is defined in s 10 by means of a lengthy and detailed list of specific financial instruments or assets. The meanings of the individual items in that list rely in turn on further definitions that are contained in the Corporations Act.

While this approach minimises duplication across the statute book, it does make the definition very unwieldy and unhelpful for users of the Act, as the definitions from the Corporations Act are themselves very complex. This can make it very difficult for a user of the Act to work out whether a particular financial asset is or is

49 AD, CP2 page 9.

not an investment instrument. The Act would be easier to understand and to work with, if the term could be defined in a simpler and more user-friendly way.

It should also be asked whether using defined terms from the Corporations Act is appropriate from a policy perspective, as the scope of those defined terms will have been set by reference to matters of corporations law policy. Those policies may well not be relevant for a secured transactions law. As one submission pointed out, for example, this has the result that the definition captures units in unit trusts that are managed investment schemes, but not otherwise.[50] That might not be an appropriate outcome under the Act.

As a separate question, it should be asked why it ought to be possible to perfect by control over all the types of financial products that are currently within the definition of investment instrument in s 10. It is not readily apparent, for example, why it should be possible to perfect by control over derivatives (paragraph (c) of the definition), foreign exchange contracts (paragraph (d)) or certain options for the allotment of investment instruments (paragraph (d)).

Consultation Paper 2 stakeholders to comment on these questions.

5.3.5.1.2 ***Discussion of stakeholder feedback***

The majority of responses on these questions were in favour of simplifying the definition of "investment instrument", and of testing whether perfection by control should be available for all of the types of collateral that are currently covered by the definition. A number made the same point as I noted in Section 5.3.4.1.2 in relation to intermediated securities, though, which is that it would be valuable to test these questions through further industry consultation, before any changes are made. It is important that any changes that are made have the support of industry to the extent that this is practicable, so I am comfortable with proceeding on that basis.

5.3.5.1.3 ***Recommendation***

> **Recommendation 69:** *That Government explore, in consultation with experts in the financial investments industry, whether the definition of "investment instrument" in s 10 could be simplified, for example along the same lines as paragraph (b) of the definition of "financial product" in s 10 of the Act.*

5.3.5.2 **The options for perfecting by control over an investment instrument**

5.3.5.2.1 ***The issue***

A security interest over an investment instrument can be perfected by control in a number of ways, set out in s 27. Similar to the position in relation to intermediated securities, the mechanisms for perfecting by control over an investment instrument do not all clearly deliver on the publicity objective, although the majority of the options provided in s 27 are more likely to achieve this in relation to investment instruments than the options for perfecting by control over intermediated securities in s 26.

50 JLF, S2 page 5.

In the same way as discussed in Section 5.3.4.2 above for intermediated securities, Consultation Paper 2 queried whether the modes of perfecting by control over an investment instrument should be tightened so that only one secured party at a time can be perfected by control, or to ensure that a secured party will only have control of it is able to ensure that the investment instrument cannot be dealt with without its consent.[51]

5.3.5.2.2 ***Discussion of stakeholder feedback***

A number of respondents on this question were comfortable with the proposition that the methods of perfection by control over investment instruments should be tightened. Others made the same point as in Section 5.3.4.1.2, though, which is that these questions should be tested further with industry specialists before any changes are made. Again, I am comfortable with taking that approach.

5.3.5.2.3 ***Recommendation***

> **Recommendation 70:** *That Government explore, in consultation with experts in the financial investments industry, how the mechanisms for perfecting by control over an investment instrument can be structured to better achieve the publicity objective of perfection, such as by ensuring that a secured party will only have control if it is able to ensure that the investment instrument cannot be dealt with without its consent.*

5.3.6 Perfection by control over investment assets – should there be greater consistency?

5.3.6.1 ***The issue***

The Act ensures that there is no overlap between the definitions of intermediated security and investment instrument, despite their close relationship. It does this by providing that personal property that might otherwise be an investment instrument will not be an investment instrument, if it is also within the definition of intermediated security.

While that removes the risk of definitional overlap, it does not greatly assist users of the Act, as they still need to work out which definition to apply. This can be important if they want to perfect by control, because the methods of perfecting by control in ss 26 and 27, though similar, are different in some subtle but significant ways.[52] Some of the differences may reflect the different nature of the collateral involved, but others do not.

Consultation Paper 2 suggested that it would simplify the operation of these provisions if they could be made more consistent.

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51 This would also respond to the concern expressed in one submission at the possibility that multiple secured parties could perfect by control through the simple expedient of each taking a power of attorney. See LCA, S2 page 10.

52 A secured party faces the same challenge if it wants to perfect by registration, as it will need to decide which collateral class it should register against. There can even be some financial assets that fall through the cracks between the two definitions, and a security interest over such a financial asset can only be perfected by registration, against a different collateral class again.

5.3.6.2 ***Discussion of stakeholder feedback***

A number of respondents on this question suggested again that this should be deferred to further industry consultation. The great majority agreed, however, that it would be desirable to align the mechanisms for perfection by control as between intermediated securities and investment instruments, to the extent this is practicable.

5.3.6.3 ***Recommendation***

> **Recommendation 71:** *That Government explore, in consultation with experts in the financial investments industry, how to make the mechanisms for perfection by control in ss 26 and 27 as consistent as is possible.*

5.3.7 Perfection by control – ADI accounts

5.3.7.1 The meaning of "ADI account"

5.3.7.1.1 ***The issue***

The term "ADI account" is defined in s 10:

> ***ADI account*** means an account, within the ordinary meaning of that term, kept by a person (whether alone or jointly with one or more other persons) with an ADI that is payable on demand or at some time in the future (as agreed between the ADI and the person or persons).

Put simply, an ADI account is a bank account. However, a bank account is only an ADI account if it is held with an entity that is authorised to carry on banking business under the *Banking Act 1959*. It does not extend (for example) to foreign banks that are not so authorised, even if they are authorised to carry on banking business under the equivalent laws of another jurisdiction.

One submission queried why the term should be limited in this way.[53]

It may be that the definition has been limited to ADIs because it was thought that the term "ADI account" would be used in the Act in ways that had implications for the integrity of the Australian banking system. However, the submission made the point that a number of the provisions that refer expressly to ADI accounts are not there for the protection of the ADI or the banking system more generally, but rather for the benefit of parties dealing with the ADI. This is the case, for example, in s 33(1)(c) (which provides for the automatic perfection of a security interest in some types of proceeds), and in s 340(5) and the related provisions in Part 9.5 of the Act (which provide that some ADI accounts may be a "circulating asset"). Those provisions are discussed later in this report.[54] If they remain in their current form, consideration should be given to expanding those provisions to apply to bank accounts more generally.

In the context of the perfection rules, however, it is clear that the definition is there to benefit ADIs. It does this in two ways.[55] First, the Act makes it clear that only

53 JLF, S2 page 5.

54 See Sections 7.4.6.1 and 9.2.1 below.

55 Perfection by control also gives the ADI a superior priority position. See Section 7.7.4.1 below.

the ADI itself can perfect by control over an ADI account with it.[56] Secondly, the Act provides that the ADI's perfection is automatic. If an ADI has a security interest over an ADI account with it, then it is automatically perfected by control by force of the Act, without the need for the ADI to register a financing statement.[57]

Consultation Paper 2 invited stakeholders to comment on whether the provisions dealing with ADI accounts should also apply to banks more broadly.

5.3.7.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that the definition of "ADI account" should not be widened. All other responses, however, were in favour of making this change.

I am not aware of any persuasive reason why the benefits afforded to ADIs under the Act should not be available to other banks as well. I agree that it would be appropriate to make this change.

5.3.7.1.3 ***Recommendation***

> **Recommendation 72:** *That the term "ADI account" be replaced with a more generic term such as "bank account", and that the definition of the term in s 10 be expanded to include accounts that are held with other financial institutions, for example if they are subject to a corresponding regulatory framework in another country.*

5.3.7.2 **Should a secured party other than the ADI itself be able to perfect by control?**

5.3.7.2.1 ***The issue***

Like the Act, Article 9 provides that a bank's security interest over an account with it is automatically perfected.[58] Unlike the Act, however, Article 9 allows other secured parties to perfect by control over a bank account as well, either by entering into a control agreement with the bank, or by becoming the holder of the account.[59]

An early draft of the Act did allow for secured parties other than the ADI itself to perfect by control over an ADI account.[60] That language did not survive into the final form of the Act.

The two methods by which a secured party (other than the bank itself) may perfect a security interest by control under Article 9 are either to enter into a control agreement with the bank, or to become the holder of the account. Both those methods have parallels in pre-PPSA law. Before commencement of the Act, a person who took a mortgage over a bank account could ask the bank to acknowledge the existence of its mortgage, and to agree to act on instructions from the mortgagee if the account holder defaulted on its obligations to the mortgagee. It was also open to a mortgagee to require its customer to transfer funds in the account into a new account in the mortgagee's name.

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56 Section 25.

57 Section 75.

58 Article 9, §9-104(a)(1).

59 Article 9, §9-104(a)(2) and (3).

60 *Personal Property Securities Bill 2008* (Cth), May 2008 Consultation Draft, cl 32.

It is of course still open to a secured party to ask an ADI to enter into a control agreement. That agreement could assist the secured party as a practical matter to control the flow of funds into and out of the account. A secured party can also still require its grantor to transfer funds in an account into a different account, in its name. Because these steps will not perfect the secured party's security interest, however, the secured party would need to perfect by registration as well.

I had anticipated that submissions might propose that a secured party other than the ADI itself should be able to perfect over an ADI account by control, by entering into a control agreement with the ADI or by taking over the account. However, no submissions raised these issues.

Consultation Paper 2 invited stakeholders to comment on this.

5.3.7.2.2 ***Discussion of stakeholder feedback***

A small number of respondents suggested that secured parties other than ADIs should also be able to perfect by control over an ADI account. The great majority of respondents, however, were of the view that only the ADI itself should be able to perfect by control over an ADI account with it.

One respondent suggested that perfection by control over an ADI account should be available not only to the ADI, but also to its wholly-owned subsidiaries, and to third parties who hold security on the ADI's behalf.[61] That may be advantageous for the ADI, but would not reflect the reasons why it may be thought appropriate from a policy perspective to allow perfection by control by the ADI itself (particularly if that perfection is automatic, as I discuss below). I am not in favour of extending the availability of perfection by control over ADI accounts in this way.

5.3.7.2.3 ***Recommendation***

Recommendation 73: *That the Act not be amended to allow a secured party other than the ADI itself to perfect by control over an ADI account.*

5.3.7.3 **Should perfection by control over an ADI account be automatic?**

5.3.7.3.1 ***The issue***

If an ADI has a security interest in an ADI account with it, then the security interest is perfected automatically, without the need to register a financing statement.[62] This is consistent with the position under Article 9.[63]

This is clearly a convenient position for ADIs, as they are perfected without needing to register against their customers. If it is accepted, however, that the primary purpose of perfection is to provide a mechanism for putting third parties on notice that a secured party may have security over a particular grantor's collateral, then this automatic perfection is not so easy to justify, as it does not put outsiders on notice that the bank may have security over the account with it.

61 ABA, CP2 page 8.

62 Section 75.

63 Article 9, §9-104(a)(1).

Two factors may mitigate this concern. First, it is common knowledge that a bank's standard account terms will typically contain a set-off clause that allows the bank to reduce all of its outstanding positions in relation to a customer down to one net balance. The same can also be achieved, at least to some extent, by the banker's right at general law to combine accounts. Both set-off and combination of accounts are outside the Act.[64] Secondly, many observers may already expect banks to routinely include a security interest in their standard account terms. Either way, the general expectation is likely to be that banks are able to arrange their affairs in a way that ensures that they are not obliged to repay amounts owing to a customer on a bank account, until the customer has paid the bank all amounts owing to it. In other words, it could be argued that there is in fact no need for an ADI to separately publicise the existence of a security interest in an ADI account with it, such as by registration.

For these reasons, Consultation Paper 2 suggested that the current position under the Act, which allows an ADI to be automatically perfected by control over an ADI account with it, could be thought to be appropriate.

5.3.7.3.2 ***Discussion of stakeholder feedback***

A small number of respondents were not in favour of allowing an ADI's perfection by control over an ADI account to continue to be automatic. All other respondents, however, were in favour of continuing with the current position. I agree with that majority view.

5.3.7.3.3 ***Recommendation***

> **Recommendation 74:** *That a security interest held by an ADI in an ADI account with it continue to be automatically perfected by control.*

5.3.8 Perfection by control – negotiable instruments that are not evidenced by a certificate

5.3.8.1 ***The issue***

Section 21(2)(c)(iv) provides that a security interest may be perfected by control over a negotiable instrument that is not evidenced by a certificate. The mechanism for perfecting by control over such a negotiable instrument is then set out in s 29.

The term "negotiable instrument" is defined in s 10 to have a meaning that is significantly broader than the meaning of that term at general law. The breadth of that definition is discussed later in this report.[65] For present purposes, it is sufficient to note that negotiable instruments are by their nature physical instruments, at least in the eyes of the general law, and that Australian law does not recognise such a thing as a negotiable instrument that is only in electronic form.[66]

Even if it is accepted that it could be possible for a negotiable instrument to exist in electronic form, it should be asked why it is appropriate to allow a security interest over such a negotiable instrument to be perfected by control, when that option is not available for most other payment intangibles.

64 Section 8(1)(d).

65 See Section 7.6.13.1 below.

66 As one submission noted, the notion of a negotiable instrument in electronic form is also not easy to reconcile with the definition of "negotiable instrument" itself. See JLF, S2 page 14.

Consultation Paper 2 expressed the view that ss 21(2)(c)(iv) and 29 should be deleted, unless it can be shown that they have a meaningful role to play in the Australian commercial environment.

5.3.8.2 ***Discussion of stakeholder feedback***

Respondents had mixed views on this question. A number made the point that the Act provides for perfection by control over an uncertificated negotiable instrument because it is not possible to perfect over such an instrument by possession. The point I was trying to make in Consultation Paper 2, however, is that the concept of an "uncertificated" negotiable instrument is at it heart an illogical one as a matter of Australian law, and that it is not desirable to clutter the Act with provisions that may not do any harm, but do not have any meaning and so have the capacity to cause confusion and uncertainty.

A number of responses referred to financial assets that might be thought to be uncertificated negotiable instruments, but I do not believe that they can correctly be described in that way. Again, the reason for this is that the expression "uncertificated negotiable instrument" is at its heart an oxymoron.

A number of respondents agreed with the suggestion that ss 21(2)(c)(iv) and 29 should be deleted.

I have separately recommended that Government undertake further consultations with experts in the financial assets industry in relation to the way in which the Act applies to intermediated securities and investment instruments. In deference to the views of those respondents who were not convinced of the desirability of deleting references to uncertificated negotiable instruments from the Act, I am comfortable with recommending that Government discuss this issue further with industry as well, before a final decision is made on whether ss 21(2)(c)(iv) and 29 should be deleted.

5.3.8.3 ***Recommendation***

> **Recommendation 75:** *That Government explore, in consultation with experts in the law of negotiable instruments, whether ss 21(2)(c)(iv) and 29 are meaningful, or should be deleted.*

5.3.9 Perfection by control – letters of credit

5.3.9.1 ***The issue***

Section 21(2)(c)(v) provides that a security interest may be perfected by control over:

> (v) a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation;

The Act does not state positively what a secured party needs to do in order to perfect by control over such a right. Rather, the guidance that it provides is curiously expressed in the negative. Section 28 states:

> 28 **Control of a letter of credit**
>
> A secured party does not have control of a right evidenced by a letter of credit, to the extent of any right to payment or performance of an obligation by the issuer or a nominated person, unless the issuer or nominated person has consented to assigning the proceeds of the letter of credit to the secured party.

Section 28 derives from a provision in Article 9.[67] The Official Comments to that provision draw a distinction between the right to draw on a letter of credit, and the right to receive the payment that is due if a draw is made.[68] Section 28 appears to be targeted at the latter, but this could be clearer. More fundamentally, though, s 28 does not appear to achieve the publicity objective of perfection, as it will not be readily apparent to an outsider that the payer under the letter of credit has consented to an assignment of the proceeds until the letter of credit is called, by which stage it may be too late.

This means that perfection by control over rights under a letter of credit, at least as currently formulated, does not sit well with the publicity objective of perfection.

For this reason, Consultation Paper 2 suggested that it might be appropriate to delete ss 21(2)(c)(v) and 28. Consultation Paper 2 also asked stakeholders whether this mode of perfecting over rights under a letter of credit was in fact being relied on by secured parties, as an alternative to registration.

5.3.9.2 ***Discussion of stakeholder feedback***

The views of respondents on this question were quite evenly divided, with roughly equal numbers for and against the suggestion that ss 21(2)(c)(v) and 28 should be deleted.

One respondent observed, in relation to the corresponding rule in Article 9, that §9-329(1) provides that a security interest that is perfected by control in this way has priority over other security interests that are not so perfected.[69] The Official Comments to that Article state that this "is consistent with international letter-of-credit practice and provides finality to payments made to recognized assignees of letter-of-credit proceeds".[70]

I do not have information before me that would assist me to determine whether this justification for the corresponding rule in Article 9 is also a sufficient justification for having the rule in the Act. I will therefore recommend that Government consult further with appropriate specialists in the field of letters of credit, in order to decide whether or not ss 21(2)(c)(v) and 28 should be deleted.

5.3.9.3 ***Recommendation***

> **Recommendation 76:** *That Government explore, in consultation with experts in the law and practice of letters of credit, whether ss 21(2)(c)(v) and 28 are appropriate, or whether they should be deleted.*

5.3.10 Perfection by control – satellites and other space objects

5.3.10.1 ***The issue***

Section 21(2)(c)(vi) states that a security interest may be perfected by control over:

(vi) satellites and other space objects.

67 Article 9, §9-107.
68 Official Comment 4 to §9-107.
69 AD, CP2 page 11.
70 Article 9, §9-329, Official Comment 2.

Unlike the other types of collateral over which a security interest may be perfected by control, the Act provides no guidance on how to perfect by control over satellites or other space objects.

Section 21(2)(c)(iv) may have been included in the Act in response to work that has been done by UNIDROIT under the auspices of the Cape Town Convention, in relation to dealings in interests in space assets. That work resulted recently in the 2012 *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Space Assets*. The inclusion of satellites and other space objects in s 21(2)(c) as a category of property over which a security interest may be perfected by control is however hard to reconcile with that Protocol, as the Protocol appears to rely principally on registration, rather than control, as the means by which a person can publicise their interest in a space asset.

Consultation Paper 2 expressed the view that s 21(2)(c)(vi) should be deleted.

5.3.10.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal. All other respondents, however, were in agreement that s 21(2)(c)(iv) should be deleted.

5.3.10.3 ***Recommendation***

Recommendation 77: *That s 21(2)(c)(vi) be deleted.*

5.3.11 Perfection by control – performance bonds and bank guarantees?

5.3.11.1 ***The issue***

One submission queried whether it should also be possible to perfect by control over performance bonds and bank guarantees.[71] I expect that this suggestion was made because s 21(2)(c)(v) currently allows a security interest over rights under a letter of credit to be perfected by control, and performance bonds and bank guarantees perform a similar function to letters of credit.

I have recommended in Section 5.3.9 that Government should consider whether s 21(2)(c)(v) should be deleted. For the reasons given there, Consultation Paper 2 indicated that I did not propose to recommend that the Act be amended to extend the ability to perfect by control to performance bonds and bank guarantees.

Consultation Paper 2 invited stakeholders to comment on this.

5.3.11.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of amending the Act to allow a security interest over the benefit of a performance bond or bank guarantee to be perfected by control. All other respondents, however, were of the view that this was not appropriate.

It can be seen from the discussion of letters of credit in Section 5.3.9 that a justification for allowing a security interest over the benefit of a letter of credit to be perfected by control is that this is consistent with international letter-of-credit practice. Even if that is a sufficient justification for retaining ss 21(2)(c)(v) and 28 in

71 JLF, S2 page 11.

the Act, I am not aware that it would justify extending perfection by control to other instruments, even if those other instruments can perform a similar function to a letter of credit.

5.3.11.3 ***Recommendation***

> **Recommendation 78:** *That the Act not be amended to enable a person with a security interest over a performance bond or bank guarantee to perfect the security interest by control.*

5.3.12 Temporary perfection

5.3.12.1 Introduction

As I have mentioned earlier in this report, the primary purpose of requiring a secured party to perfect a security interest in collateral is to publicise the existence of the security interest, so that third parties have an opportunity to learn of the existence of the security interest before they decide whether to take a potentially competing interest in the collateral.[72]

The Act recognises however that there are some situations in which a secured party's security interest should be afforded the benefits (or at least some of the benefits)[73] of perfection for a short period, to give the secured party a window of time within which it can take steps to perfect (or re-perfect) its security interest by registration, possession or control. Those situations are summarised in the table below.

	Section of the Act	Situation	Maximum period of temporary perfection
1.	22	Security interest is over goods in the possession of a bailee. The bailee has issued a negotiable document of title to the goods, but the secured party has not received it yet.	5 business days
2.	33(2)	Security interest attaches to proceeds but is not otherwise automatically perfected.	5 business days
3.	34(1)	Collateral is transferred.	24 months (or in some circumstances, 5 business days)

72 See Section 4.1.2 above.

73 A security interest that is only temporarily perfected is more susceptible to being defeated by a claim of a buyer or lessee. See s 52 of the Act, discussed in Section 7.6.11 below.

	Section of the Act	Situation	Maximum period of temporary perfection
4.	35	Security interest is perfected by possession over goods held by a bailee, and goods are temporarily returned to the grantor or debtor for certain purposes.	5 business days
5.	36	Security interest is in a negotiable instrument or investment instrument is perfected by possession or control, and possession or control is given to the grantor or debtor for certain purposes.	5 business days
6.	38	A sale or lease of goods creates an account or chattel paper, which is transferred. If the goods are returned for certain reasons, the transferee is deemed to have a security interest over the returned goods.	5 business days
7.	39	Collateral subject to a perfected, registered or otherwise effective security interest overseas is relocated to Australia.	56 days (or in some circumstances, 5 business days)
8.	40	Security interest over intangible property or financial property was governed by foreign law (and was effective under that law), but the grantor becomes located in Australia.	56 days (or in some circumstances, 5 business days)

The Canadian PPSAs[74] and the NZ PPSA[75] contain provisions that are broadly similar to most of these provisions.

5.3.12.2 **The grace periods**

5.3.12.2.1 ***The issues***

Five business days

The temporary perfection period in each of ss 22, 33(2), 35, 36 and 38, as well as in ss 34(1), 39 and 40 in some situations, is 5 business days. The corresponding period in the Canadian PPSAs is generally 15 days,[76] and in the NZ PPSA is 10 working days.[77]

74 For example Sask PPSA, ss 5(3), 6(1), 7(3), 7.1(6) and (7), 24(4), 26, 28(3) and 29(4).

75 NZ PPSA, ss 27, 28, 31 and 47 to 49.

76 See note 74.

77 See note 75.

In my view, 5 business days is not a realistic timeframe for the purposes of these provisions. It is understandable that the drafters of the Act would want to keep the period of temporary perfection to a minimum, because temporary perfection is not apparent to third parties and so does not satisfy the publicity purpose of perfection. However, restricting the period of temporary perfection to 5 business days comes close to making temporary perfection a protective mechanism in name only, as it is too short a period for most secured parties to be able to take advantage of it.

For this reason, Consultation Paper 2 suggested that the Act should adopt the New Zealand approach, and allow a secured party 10 business days, not just 5 business days, within which to perfect before losing the benefit of temporary perfection.

56 days

The principal period of temporary perfection in ss 39 and 40 is 56 days. The corresponding period under the NZ PPSA is 60 days.[78]

It is not clear why the drafters of the Act settled on a period of 56 days for these provisions. Whatever the reason, the choice of 56 days for the temporary perfection period appears rather odd to the reader, and is slightly less straightforward to work with. For this reason, Consultation Paper 2 suggested that there is some (albeit modest) value in following the New Zealand approach, and making these periods in the Act 60 days as well.

5.3.12.2.2 ***Discussion of stakeholder feedback***

All respondents agreed with both proposals.

5.3.12.2.3 ***Recommendations***

Recommendation 79: *That the references in ss 22(4), 33(2), 34(1), 35(2), 36(2), 38(3), 39(3)(b)(ii) and 40(3)(b)(ii) to "5 business days" be replaced with "10 business days".*

Recommendation 80: *That the references in ss 39(3)(b)(i) and 40(3)(b)(i) to "56 days" be replaced with "60 days".*

5.3.12.3 **The effect of expiry of a period of temporary perfection**

5.3.12.3.1 ***The issue***

If a secured party perfects its security interest by registration, possession or control before expiry of a period of temporary perfection, then it will be able to preserve the benefit of having been temporarily perfected.

If a secured party does not perfect its security interest within the required time, the consequences vary. In the case of some of the temporary perfection provisions, the temporary perfection simply expires at the end of the period, and the security interest becomes unperfected at that time. For the other temporary perfection provisions, however, the security interest is taken to have not been perfected at all during the temporary perfection period. Using the same table as in Section 5.3.12.1 above, the division as between these two outcomes is as follows:

78 NZ PPSA, ss 27(1)(a) and 31(a).

	Section of the Act	Situation	Maximum period of temporary perfection	Effect of expiry of period on the security interest
1.	22	Security interest is over goods in the possession of a bailee. The bailee has issued a negotiable document of title to the goods, but the secured party has not received it yet.	5 business days	Never perfected
2.	33(2)	Security interest attaches to proceeds but is not otherwise automatically perfected.	5 business days	Perfection just expires
3.	34(1)	Collateral is transferred.	24 months (or in some circumstances, 5 business days)	Perfection just expires
4.	35	Security interest is perfected by possession over goods held by a bailee, and goods are temporarily returned to the grantor or debtor for certain purposes.	5 business days	Perfection just expires
5.	36	Security interest is in a negotiable instrument or investment instrument is perfected by possession or control, and possession or control is given to the grantor or debtor for certain purposes.	5 business days	Perfection just expires
6.	38	A sale or lease of goods creates an account or chattel paper, which is transferred. If the goods are returned for certain reasons, the transferee is deemed to have a security interest over the returned goods.	5 business days	Perfection just expires

	Section of the Act	Situation	Maximum period of temporary perfection	Effect of expiry of period on the security interest
7.	39	Collateral subject to a perfected, registered or otherwise effective security interest overseas is relocated to Australia.	56 days (or in some circumstances, 5 business days)	Never perfected
8.	40	Security interest over intangible property or financial property was governed by foreign law (and effective under that law), but the grantor becomes located in Australia.	56 days (or in some circumstances, 5 business days)	Never perfected

The reasons for the differing approaches are not readily apparent.

Consultation Paper 2 asked whether stakeholders were able to provide an explanation for the different approaches. It went on to suggest, if there is no good reason for the distinction being drawn, that the same rule should apply in all cases, and that the temporary perfection should simply expire at the end of the period if the secured party has not separately perfected its security interest by then.

5.3.12.3.2 ***Discussion of stakeholder feedback***

One respondent suggested that there may be good reasons for the differences in treatment, but did not explain what those reasons might be. All other respondents agreed, however, that the same rule should apply in all cases.

5.3.12.3.3 ***Recommendation***

> **Recommendation 81:** *That ss 22, 39 and 40 be amended to provide that temporary perfection simply expires at the end of the period provided for in the section.*

5.3.13 Other methods of perfection?

5.3.13.1 ***The issue***

One submission suggested that a transfer of an account or chattel paper should be able to be perfected by giving notice of the transfer to the obligor, or by taking other steps that would require the obligor to make payments to the transferee (or someone on its behalf), rather than to the transferor.[79] This was said to be directly analogous to perfection by possession or control of other types of collateral, and appropriate for that reason.

79 JLF, S2 page 8.

I accept that it might be convenient to secured parties to have another potential method of perfecting over accounts or chattel paper. In my view, however, this proposal would compromise the ability of the Act to achieve the publicity objective of perfection. If a secured party could perfect a transfer of an account by giving notice to the obligor, then a third party would only be able to detect the existence of the transfer by making enquiries of the obligor. That could be administratively cumbersome, and the obligor would in any event not be obliged to respond to a request for information. This would add to the workload for a searcher, and make the results of the search process less reliable. It would involve a return to some of the difficulties involved in the law regarding transfers of accounts that the Act sought to overcome, as discussed above in Section 4.3.1.2.

For these reasons, Consultation Paper 2 expressed the view that it would not be appropriate to recommend this proposal.

5.3.13.2 ***Discussion of stakeholder feedback***

One respondent argued that a secured party should be able to perfect over an account by notice to the obligor.[80] All other respondents were of the view, however, that this would not be appropriate. I agree with that majority view.

5.3.13.3 ***Recommendation***

Recommendation 82: *That the Act not be amended to enable a transferee of an account or chattel paper to perfect its security interest by giving notice of the transfer to the obligor, or by taking other steps that would require the obligor to make payments to the transferee (or someone on its behalf).*

5.3.14 Continuity of perfection

5.3.14.1 Section 56

5.3.14.1.1 ***The issue***

Section 56 explains how a security interest can be perfected in different ways at different times. It says this:

> (1) For the purposes of this Act, a security interest is continuously perfected after a particular time if the security interest is, after that time, perfected under this Act at all times.
>
> (2) A security interest may be continuously perfected after a particular time even if, after that time, it is perfected in 2 or more different ways:
>
> (a) at any particular time; or
>
> (b) at different times.

One submission pointed out that the wording of s 56 is not easy to follow,[81] and suggested that it be replaced with the following simpler formulation from s 23(1) of the Sask PPSA:

80 ASF, CP2 page 8.

81 LCA, S2 page 13.

23(1) If a security interest is originally perfected pursuant to this Act and is again perfected in some other way pursuant to this Act without an intermediate period when it is unperfected, the security interest is continuously perfected for the purposes of this Act.

Consultation Paper 2 agreed that amending s 56 in this way would be a worthwhile simplification of the Act.

5.3.14.1.2 ***Discussion of stakeholder feedback***

All respondents were in favour of this suggestion.

One respondent made the good point that the drafting of s 23(1) of the Sask PPSA does not clearly allow a security interest to be continuously perfected by a series of consecutive financing statements (because it refers to a security interest being re-perfected "in some other way").[82] Under the Act, in contrast, it is possible to continuously perfect a security interest with a series of separate financing statements. The drafting of the revision to s 56 will need to allow for this.

5.3.14.1.3 ***Recommendation***

Recommendation 83: *That s 56 be amended to reflect the language of s 23(1) of the Sask PPSA, but in a way that still permits a security interest to be continuously perfected by a series of financing statements.*

5.3.14.2 **Re-perfection**

5.3.14.2.1 ***The issue***

One submission noted that the Act does not make express provision for a situation where a registration has been discharged or allowed to lapse in error.[83] The submission drew attention to s 35(7) of the Sask PPSA, which affords a secured party in these circumstances a 30-day window to re-perfect without losing the benefit of continuous perfection (except as against other security interests, for advances made or contracted for during the intervening period).

The other Canadian PPSAs have similar provisions.[84] The NZ PPSA does not.

Consultation Paper 2 expressed the view that a provision along the lines of s 35(7) of the Sask PPSA should not be included in the Act. While it would provide some relief for secured parties that discharge a registration in error or fail to renew a registration on time, it would complicate the priority rules in a way that I do not feel would justify the outcome. It could, for example, give rise to circular priority disputes between multiple secured parties for which there is no solution, as discussed later in this report in Section 7.7.6.

5.3.14.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of the proposal that the Act include a provision along the lines of s 35(7) of the Sask PPSA. The great majority, however, were not. I agree with that majority view, for the reasons set out above.

82 LM, CP2 page 9.

83 DT, S2 page 8.

84 See Cuming Walsh & Wood, pages 298 to 299.

5.3.14.2.3 ***Recommendation***

Recommendation 84: *That the Act not be amended to include a provision of the type found in s 35(7) of the Sask PPSA.*

Chapter 6
Perfection by registration

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6.1 The Register needs to be easier to work with

6.1.1 General observations

A key theme from the submissions was that the Act and the Register are both too complex.

The Act will be read for the most part by legal practitioners and experienced business people. Many users of the Register, in contrast, will have no legal training, and no experience in working with complex legal concepts. This means that simplification is even more important for the Register than it is for the Act as a whole. The operation of the Register, and the rules that underpin it, need to be as simple and clear as possible, so that both registrants and searchers can use the Register effectively and with confidence. As I noted in the Interim Report:

> Small businesses find the register daunting – full of jargon, and unfamiliar concepts. When registering a financing statement, the register asks them to answer questions that they cannot readily understand. Often they cannot even understand why the question is being asked. This leaves a registrant in the very unsatisfactory position of not knowing whether they have answered the questions accurately, or whether (despite their efforts) their registration is incorrect, leaving them unperfected and exposed.
>
> Similarly, a searcher of the register cannot always be confident that they are searching against the correct grantor details. Sometimes a search generates so many results, or such broad results, that the searcher is unable to properly assess what they mean.
>
> There is a potential for tension between these two sets of concerns, as any steps that are taken to make the process of registering a financing statement simpler and more certain could have the result that the information generated by a search becomes less useful to the searcher. It is nonetheless clear that much can and needs to be done to make the conduct of registrations and searches on the register simpler, more comprehensible and more certain.[1]

Consultation Paper 4 identified a number of steps that could be taken to achieve this, and invited stakeholders to provide feedback on them.

6.1.2 Layout of the Register

6.1.2.1 ***The issue***

A number of submissions commented that the layout of the Register, and the order and manner in which it presents its questions, could be made more intuitive and user-friendly.[2]

A number of the recommendations made in other parts of this report would simplify the Register, and make it easier to use. I agree, however, that the overall design of the Register should be revisited. The Register should be organised from the perspective of the user, and particularly the perspective of the unsophisticated user, so that it is as simple and easy to work with as possible.

1 Interim Report, page 27.

2 For example: AFC, S1 page 5 and att B page 16; AICM, S1 page 26; DIFA, S1 att B page 3; LCA, S2 page 17; LIV, S2 page 3; MBA, S2 page 4.

Comments regarding the layout of the Registrar's website also went beyond the operation of the Register itself, to include other aspects of the website such as the accessibility of related information regarding the Act and the Regulations. I am advised that AFSA already has a project under way to refresh the layout of the website generally, and that the relevant comments in the submissions will be taken into account in that process.

Consultation Paper 4 proposed as a recommendation that the layout of the Register, and the order and manner in which it asks questions of a registrant or a searcher, be reviewed in order to make the Register as simple and easy to use as possible, particularly from the perspective of an unsophisticated user.

6.1.2.2 ***Discussion of stakeholder feedback***

This proposed recommendation received unanimous support from stakeholders. It is clear that stakeholders are of the view that the layout of the Register can be improved, and made more accessible and intuitive for users.

6.1.2.3 ***Recommendation***

> **Recommendation 85:** *That the layout of the Register, and the order and manner in which it asks questions of a registrant or a searcher, be reviewed in order to make the Register as simple and easy to use as possible, particularly from the perspective of an unsophisticated user.*

6.2 Introductory data fields

6.2.1 "Consumer property" and "commercial property"

6.2.1.1 The use of "consumer property" versus "commercial property" in a registration

6.2.1.1.1 ***The issue***

Item 4(a) of the table in s 153(1) of the Act requires that collateral be described in a registration as either "consumer property" or "commercial property".

The expression "consumer property" is defined in s 10 in this way:

> ***consumer property*** means personal property held by an individual, other than personal property held in the course or furtherance, to any degree, of carrying on an enterprise to which an ABN has been allocated.

Section 10 defines "commercial property" to be any personal property that is not consumer property.

How these expressions affect the registration of a financing statement

A registration against collateral that is consumer property is subject to two special rules. First, the end time for the registration cannot be more than 7 years after the time at which it is registered.[3] Secondly, if the collateral is also serial-numbered property, then the registration can only describe the collateral (by its serial number), and may not identify the grantor at all.[4]

3 Item 5(b) of the table in s 153(1) of the Act.

4 Item 2(a) of the table in s 153(1) of the Act.

Some submissions proposed that the distinction between consumer property and commercial property be removed from the Act.[5] There are a number of reasons why this might be desirable.

- A registrant needs to understand the difference between the two concepts, and in particular the subtlety of the fact that collateral is not consumer property if it is held in the course or furtherance "to any degree" of carrying on a business that has an ABN. This makes the registration process more difficult, particularly for an unsophisticated user of the Register, and more uncertain.
- A registrant has no way of knowing what the grantor will in fact use the collateral for. They can of course ask the grantor, but the secured party is exposed if the grantor gives the wrong answer (whether through inadvertence or otherwise). Again, this produces risk and uncertainty for the secured party.
- It is not clear what the implications are if a registration identifies collateral as consumer property when it was not, or vice versa. It is also not clear what the consequences are if a registration was initially correct but later becomes incorrect because the grantor changes his or her use of the collateral. Again, this produces risk and uncertainty for the secured party.
- For these reasons, some secured parties take the view that the only clear way to protect themselves is to make two registrations – one against consumer property, and one against commercial property. This adds clutter to the Register.

This distinction between consumer property and commercial property for the purposes of registering a financing statement is unique to the Act, and does not appear in any of the Canadian PPSAs or the NZ PPSA. Under the Canadian PPSAs and the NZ PPSA, registrations against individual grantors can be made for the same length of time as registrations against other types of grantors, and an individual grantor's name must be included in the registration even if the collateral is serial-numbered property.

The purpose behind the distinction between the expressions

The more restrictive registration rules for security interests over consumer property appear to be motivated by consumer protection considerations. The more limited duration for a registration protects consumers against having unnecessarily long-term registrations made against them, and the requirement that a grantor's name not be included if the collateral is serial-numbered property protects their privacy. If the distinction between consumer property and commercial property is to be removed, then these concerns would need to be addressed in another way.

The 7-year limit on the registration period

It is not clear how great the risk is that a secured party might want to make a registration against an individual for a period that significantly exceeds the expected term of the finance that it is providing.

If a secured party does make an unnecessarily long registration, the grantor would be able to rely on mechanisms in the Act, such as s 167 and the amendment demand mechanisms in Part 5.6, to deal with this.[6] The 7-year limit on the

5 For example: JLF, S1 page 7.

6 See Sections 6.10.4 and 6.10.5 below.

registration period for consumer property provides individual grantors with an additional layer of protection against overly-long registrations. I do not have any evidence before me that indicates whether this additional protection is needed.

If it is felt that a consumer does need to be protected by providing that the maximum term of a registration against the consumer is 7 years, then an alternative might be to apply the requirement to all individual grantors, regardless of the use to which they are putting the collateral. I expect that only a relatively small proportion of financings to individuals would run for more than 7 years, and if that is correct then making this change would not impose a significant additional burden on secured parties.

Serial-numbered property

I do not have any evidence before me that might substantiate how great the privacy concern would be if the grantor's details needed to be included in a registration against serial-numbered property that is consumer property. The Act already accepts that the grantor's details need to be included if serial-numbered property is commercial property (such as a tradesperson's utility vehicle). Section 172 of the Act also restricts who is allowed to search the Register against an individual, and for what purposes. For these sorts of reasons, it might be argued that it is unnecessary to provide that a security interest from an individual over serial-numbered property may only be registered against the serial number, if the collateral is consumer property.

If the privacy concern is nonetheless thought to be sufficiently important, an alternative might be to provide that all registrations over serial-numbered property may only be made against the serial number if the grantor is an individual, regardless of the use to which the collateral will be put. I expect that it would be relatively uncommon for a secured party to take security over serial-numbered property from an individual and not register against the serial number, and if that is the case then this would not impose a material additional burden on secured parties.

Consultation Paper 4 expressed a preliminary view that the rules should be simplified so that:

- a registration does not need to indicate whether the collateral is consumer property or commercial property;
- all registrations against individuals have a maximum term of 7 years; and
- a registration against serial-numbered property may not identify the grantor, if the grantor is an individual.

6.2.1.1.2 ***Discussion of stakeholder feedback***

Consumer vs commercial property

Some responses queried whether the privacy concerns that led to the distinction being drawn between consumer and commercial property had abated sufficiently for the Act to be amended so that the distinction no longer affects the way in which a registrant completes a registration. I do not have any information before me on that question. I believe however that any continuing privacy concerns are addressed by my proposed recommendation below about the circumstances in which a registration may include a grantor's name. In any event, the distinction is difficult for registrants to apply and a source of confusion for users of the Register, and in my view needs to be dealt with.

All other responses supported the proposal that the question (of whether the collateral is consumer property or commercial property) should not need to be answered as a step in the registration process.

Registration period for individual grantors

Views were more evenly divided on whether there should be a maximum registration period of 7 years for all registrations against individual grantors. While the majority of respondents were in favour of this proposal, a substantial number felt it was either unnecessary (particularly given the protection already afforded to individual grantors by s 167), or because financiers do extend some longer-term facilities to individuals. Responses argued that the Act should not impose on those financiers the burden of ensuring that they renew their registrations, if they need to, at the end of the 7-year period.

I am advised by AFSA that approximately 19.5% of registrations against individual grantors have a registration period of more than 7 years. It is not clear, however, just what proportion of those registrations relate to financing arrangements that are likely to extend beyond 7 years. In any event, most secured parties maintain sophisticated diary systems, and review their customer facilities on a regular basis, so it is likely that most secured parties may not be significantly burdened by having to track their registrations and to renew them after 7 years if needed.

On the one hand, I can see that it would simplify the Act if there were a standard maximum registration period for all grantors. On the other hand, I do not see that a clear case has been made for doing away with the 7-year maximum registration period for individual grantors. On balance, my conclusion is that the 7-year maximum period for individual grantors (or for registrations against serial-numbered property that may not identify the grantor, because the grantor is an individual) should remain, and that it should apply to all individual grantors, regardless of the use to which they propose to put the collateral.

I am told that the need to renew registrations has not been a significant issue in New Zealand.[7]

Serial-numbered property and grantor details

Views were also quite evenly divided on whether a registration against serial-numbered property should be allowed to include the grantor's details, if the grantor is an individual.

A number of the respondents who were against this proposal were concerned that it might inadvertently lead to clutter on the Register, if it meant that any registration that included collateral with a serial number could only be made against that serial number as a separate registration. That, however, is not the intention of the proposal. The intention of the proposal is that a registration to perfect a security interest granted by an individual over a specific item of serial-numbered property must be registered against the serial number alone. If the security interest is granted over more collateral than just a specific item of serial-numbered property (for example, over a business that happened to include a motor vehicle), however, then the registration can be made against the grantor's details, in the same way as for all other grantors. Of course, the secured party may want to make a specific registration against the serial number as well in order to protect itself against the taking free rule in s 44, but that is a separate matter.

7 The situation in New Zealand is assisted, apparently, by the fact that the register sends an email to the secured party to alert it to the fact that its registration will shortly expire.

6.2.1.1.3 ***Recommendation***

Recommendation 86: *That the Act be amended so that:*

- *a registration does not need to indicate whether the collateral is consumer property or commercial property;*
- *all registrations against individuals, or against serial-numbered property that may not identify the grantor because the grantor is an individual, must have a maximum term of 7 years; and*
- *a registration that is made against only serial-numbered property and that identifies the serial number may not identify the grantor, if the grantor is an individual.*

6.2.1.2 **Other uses of the terms "consumer property" and "commercial property"**

6.2.1.2.1 ***The issue***

The terms "consumer property" and "commercial property" are also used in a small number of other places in the Act. They are used, for example, in s 20(4) in the context of the rules for describing collateral in a security agreement. I have separately recommended that s 20(4) be deleted.[8] Apart from that, the term "consumer property" is only used in s 13(2)(c), and the term "commercial property" is only used in s 157(3)(a). It seems unnecessary to retain the definitions just for the purposes of these sections – for example, s 13(2)(c) could instead refer to a lease of property "predominantly for personal, domestic or household purposes" (or adopt the language used in the corresponding provision in the NZ PPSA,[9] and refer to "household furnishings and appliances"), and s 157(3)(a) could instead be amended to provide that s 157(1) does not apply to individual grantors. The expressions are also used in the Regulations, but similar types of changes could be made there as well.

If these changes were made, then the definitions of consumer property and commercial property could be deleted entirely.

Consultation Paper 4 invited stakeholders to comment on this proposal.

6.2.1.2.2 ***Discussion of stakeholder feedback***

This proposal had the clear support of all respondents. In my view, the changes contemplated by this proposal will make the Act easier to understand and use, and should be made.

6.2.1.2.3 ***Recommendation***

Recommendation 87: *That the definitions of "consumer property" and "commercial property" in s 10 of the Act be deleted.*

8 See Section 5.2.2 above.

9 NZ PPSA, s 16.

6.2.2 The "inventory" question

6.2.2.1 ***The issue***

Item 8 of the table in s 153(1) of the Act states that a registration needs to include any matters that are prescribed by the Regulations. Item 1 of the table in clause 4.1 of Schedule 1 to the Regulations states that a registration for collateral that is commercial property must indicate "whether or not the collateral may include inventory". The item states that the purpose of this rule is to determine "whether collateral may include inventory, for Part 9.5 of the Act".

Part 9.5 of the Act contains the rules that determine whether collateral is a "circulating asset". This suggests that the word "inventory" in this context has its general law meaning,[10] not the specific meaning given to it in s 10 of the Act. However, this is not apparent from the Register itself.

A number of submissions recommended that this question be deleted from the Register, on the basis that it is confusing for registrants and does not serve any useful purpose.[11]

I agree that it is difficult to see that much is achieved by requiring a registrant to answer this question. It might make it marginally easier for an insolvency practitioner to determine whether assets of an insolvent grantor could be circulating assets, but that seems to be a very modest benefit when compared with the uncertainty and confusion that the question is causing for other users of the Register. I note also that the registration systems under the Canadian PPSAs and the NZ PPSA do not include a question along these lines.

Consultation Paper 4 expressed the view that the Register would be easier to use, and the utility of the Register would not be materially compromised, if this question were deleted.

6.2.2.2 ***Discussion of stakeholder feedback***

All respondents were in favour of deleting the "inventory" question from the Register.

The "inventory" question adds little value, and is the source of confusion and uncertainty for registrants. In my view, it should be deleted.

6.2.2.3 ***Recommendation***

> **Recommendation 88:** *That item 1 of the table in clause 4.1 of Schedule 1 to the Regulations be deleted.*

6.2.3 The "control" question

6.2.3.1 ***The issue***

Item 2 of the table in clause 4.1 of Schedule 1 to the Regulations states that a registration against collateral that is commercial property must indicate "whether or not the collateral may be subject to control". The item states that the purpose of

10 By virtue of s 341(1B) of the Act.

11 JLF, S1 page 12; DIFA, S1 att B page 3; EDX, S1 page 4; LCA, S1 page 12; QLS, S1 page 10; CW, S1 page 8; HW, S2 page 2. Not all submissions agreed: AICM, S2 page 22.

this requirement is to determine "whether collateral may be subject to control, for Part 9.5 of the Act".

The registration systems under the Canadian PPSAs and the NZ PPSA do not require this.

A number of submissions recommended that this question also be deleted from the Register.[12] Again, they made the point that the question is confusing for registrants, and serves little or no useful purpose.

Similar to the position in relation to the "inventory" question (as discussed above), I agree that it is difficult to see that the "control" question adds much value. Again, it may make it marginally easier for an insolvency practitioner who has been appointed to an insolvent company to determine what assets of the insolvent grantor might be circulating assets, but any benefit would seem to be outweighed by the confusion that this question causes for other users of the Register.

For these reasons, Consultation Paper 4 expressed the view that the "control" question should also be removed from the Register.

6.2.3.2 ***Discussion of stakeholder feedback***

All respondents were in favour of deleting the "control" question from the Register.

I recommend later in this report that the circulating asset provisions in Part 9.5 be restructured in a way that would remove the need to determine whether or not a secured party had "control" of collateral.[13] The "control" question becomes even less relevant if that recommendation is adopted. Even if that recommendation is not adopted, however, my view is that the "control" question adds no value, and that the Register will be less confusing for users if the question is deleted.

6.2.3.3 ***Recommendation***

> **Recommendation 89:** *That item 2 of the table in clause 4.1 of Schedule 1 to the Regulations be deleted.*

6.2.4 The "subordinate" question

6.2.4.1 ***The issue***

Item 6 of the table in s 153(1) of the Act states that a registration may include an indication of whether the security interest is (or is to be) subordinated to any other security interest. The item makes it clear that this field in the Register is only optional, and does not need to be completed.

The registration systems under the Canadian PPSAs[14] and the NZ PPSA[15] include a similar (and similarly optional) field.

12 JLF, S1 page 11; AICM, S1 page 24; EDX, S1 page 4; LCA, S1 page 12; QLS, S1 page 10; CW, S1 page 8. Again, not all submissions agreed: AICM, S2 page 22.

13 See Section 9.2.1.1.

14 For example Sask PPSA, s 45(6).

15 NZ PPS Regs, reg 8 and para 19 of Schedule 1.

A number of submissions recommended that this field also be removed from the Register.[16] They argued that it has little or no practical effect as between the secured parties involved in the subordination (or priority) arrangement, and has no impact on third parties. I am also advised by AFSA that as at 23 February 2015, the field had been completed in only 15,601 current registrations, out of a total of 6,410,514 current registrations[17] – that is, in approximately 0.24% of current registrations.

The "subordinate" field adds little if any value, and deleting it would make the Register easier to use. For these reasons, Consultation Paper 4 expressed the view that this field should also be removed.

6.2.4.2 ***Discussion of stakeholder feedback***

Again, all respondents agreed that the "subordinate" question should be deleted.

This is another question in the registration process that adds little or no value, and generates confusion and uncertainty for registrants. In so doing, it detracts from the objectives of the Act. In my view, it should also be deleted.

6.2.4.3 ***Recommendation***

Recommendation 90: *That item 6 of the table in s 153(1) be deleted.*

6.2.5 The "PMSI" question

6.2.5.1 ***The issue***

Item 7 of the table in s 153(1) of the Act requires a registration to indicate whether the security interest to which it relates is (or is to be) a PMSI to any extent.

One submission suggested that it be clarified that a registration that does not tick the PMSI box can nonetheless perfect a PMSI, but on the basis that the PMSI does not benefit from the super-priority afforded by s 62.[18] The submission was concerned that such a registration could be ineffective because of the requirements in s 153, or because it could be "seriously misleading" for the purposes of s 164.

I separately recommend in Section 7.7.8.11 below that the Act be amended to remove item 7 of the table in s 153(1). The balance of this discussion is only relevant if that recommendation is not adopted.

I agree that a security interest that is a PMSI should be able to be perfected by a registration that does not tick the PMSI box, on the basis that it is then an "ordinary" security interest for priority purposes. Consultation Paper 4 invited stakeholders to indicate whether they agree with this as well.

6.2.5.2 ***Discussion of stakeholder feedback***

A number of respondents on this question merely restated their view that the PMSI box should be deleted. Of the respondents that provided a view on the specific question, nearly all were in favour of the proposition that a registration that does not tick the PMSI box can nonetheless perfect a PMSI, but without the s 62 priority.

16 For example: JLF, S1 page 13; DIFA, S1 att B page 3; EDX, S1 page 4; ABA, S2 page 6. Again, not all submissions agreed: AICM, S2 page 22.

17 Excluding migrated security interests.

18 ABA, S2 page 6.

This issue goes away if the PMSI box is deleted. If the PMSI box is retained, though, then I agree that the Act should operate in the way described, and that this should be clarified.

6.2.5.3 ***Recommendation***

> **Recommendation 91:** *If item 7 of the table in s 153(1) is retained, that it be made clear that a registration that does not tick the PMSI box can nonetheless perfect a PMSI, but on the basis that the PMSI cannot benefit from the super-priority afforded by s 62.*

6.3 The collateral classes

6.3.1 *The issue*

The rules

Item 4(c) of the table in s 153(1) of the Act provides that the collateral covered by a financing statement "must belong to a single class of collateral prescribed by the regulations". Clause 2.3(1) of Schedule 1 to the Regulations prescribes the following classes of collateral for this purpose:

(a) agriculture;

(b) aircraft;

(c) all present and after-acquired property;

(d) all present and after-acquired property, except:

(e) financial property;

(f) intangible property;

(g) motor vehicles;

(h) other goods;

(i) watercraft.

In practice, the Register breaks the classes "intangible property" and "financial property" down even further, in this way:

Financial property	**Intangible property**
• Chattel paper • Currency • Document of title • Intermediated security • Investment instrument • Negotiable instrument	• Account • General intangible • Intellectual property – Circuit layout – Copyright – Design – Patent – Plant breeder's right – Trade mark

If the collateral is an aircraft, or is other serial-numbered property that is consumer property, then it must be described by its serial number.[19] In all other cases, the registrant is not required to provide any specific description of the collateral, and only needs to indicate which class the collateral belongs to. The Register provides a free-text field for all collateral classes other than "all present and after-acquired property", but the free text field does not need to be completed, and can be left blank.

The approaches overseas

The rules for describing collateral in a financing statement under the Canadian PPSAs and the NZ PPSA fall into two broad categories. In New Zealand,[20] collateral must be assigned to one or more of these collateral types:

- goods: motor vehicles;
- goods: aircraft;
- goods: livestock;
- goods: crops;
- goods: other;
- documents of title;
- chattel paper;
- investment securities;
- negotiable instruments;
- money;
- intangibles;
- all present and after-acquired property;
- all present and after-acquired property, except.

For all collateral types other than "all present and after-acquired property", a "further description" must also be provided.[21]

The Canadian province of Ontario applies a similar methodology. Under the Ontario PPSA,[22] however, collateral is divided into only 5 categories:

- consumer goods;
- inventory;
- equipment;
- accounts;
- other.

A person making a registration under the Ontario PPSA only needs to indicate which of these categories the collateral belongs to. There is a free text field in which the registrant may include a more specific description of the collateral, but unlike New Zealand this is only optional, and the field can be left blank.

19 Clause 2.2(1)(a)(i) of Schedule 1 to the Regulations.

20 NZ PPS Regs, para 8(1) of Schedule 1.

21 NZ PPS Regs, para 3(2) of Schedule 1.

22 *Minister's Order under the Personal Property Security Act* (Ont), clause 3(1)(f).

The Canadian PPSA jurisdictions other than Ontario take a rather different approach.[23] They do not require a registrant to allocate the collateral to one or more collateral classes. Instead, the rules for the description of collateral in a registration in those jurisdictions are the same as the rules for describing collateral in a security agreement. In other words, the registration must simply describe the collateral. The description may be by reference to one or more of the types of collateral that are specified for this purpose, but does not need to be. Instead, collateral can be described:

- by item or kind;
- as all present and after-acquired property; or
- as all present and after-acquired property, except for excluded property (which must be described by item or kind).

Ontario has announced that it intends to align its rules for collateral descriptions with the requirements that apply elsewhere in Canada.[24] I have been advised that this decision is driven principally by a desire to harmonise the rules in Ontario with the rules in the other Canadian PPSA jurisdictions, rather than by any strong dissatisfaction with the current approach.

The concerns

The current rules under the Act and the Regulations for the description of collateral in a financing statement are unsatisfactory in a number of ways. First, it may not be clear what the correct collateral class is for a particular item of collateral (for example, whether particular goods are a "motor vehicle" or just "other goods", or whether an interest in a trust is "financial property" or "intangible property"). Where this is not clear, a registrant will be tempted to make two registrations, one against each class, to ensure that one of the registrations is effective to perfect its security interest. This adds to the clutter on the Register.

To some extent, this may be an unavoidable feature of any registration system that relies on distinctions between collateral classes. The concern is exacerbated under the Act, however, by the number of classes, and by the technicality of the rules that distinguish between them.

Registrants have also been frustrated by the requirement in s 153(1) that the collateral covered by any one registration must belong to a single class. This can make it necessary for a secured party to register multiple separate financing statements for the one transaction. If a secured party takes security over a farming enterprise, for example, it is likely to need to register a separate financing statement against each of these collateral classes: agriculture; intangible property; motor vehicles; and other goods. Because a registrant will understandably want its registration process to be as simple (and inexpensive) as possible, this has led in part to the practice of secured parties instead registering overly broad financing statements against the single collateral class "allpap" or "allpap except", a practice which I discuss further in Section 6.10.4 below.

Similar issues affect searchers. A person who searches the Register to determine whether a particular item of personal property might be encumbered may need to take more than one class of collateral into account when analysing the search results, if it is not clear which class the property in question might belong to.

23 For example *Personal Property Security Regulations* (Sask), reg 14(2).

24 Cuming Walsh & Wood, page 349.

Even if it is clear which class the property belongs to, the searcher will still need to examine any registrations that have been made against the "allpap" or "allpap, except" classes. Searchers can also be frustrated by the fact that a registration generally only needs to indicate the class to which collateral belongs, as the lack of a more specific description means that a person who is considering taking an interest in an item of property cannot just rely on search results to confirm whether the property may be subject to an existing security interest. Instead, the searcher needs to undertake further investigations.

What are the options?

Submissions suggested a number of changes in response to these concerns. Some submissions proposed that the number of collateral classes be reduced,[25] although not all submissions were in favour of this suggestion.[26] Other submissions proposed that a registrant be able to register against more than one class of collateral at the same time.[27] Some submissions said it should be mandatory for a registration to include more information about the collateral in the free text field.[28] Some submissions suggested that a registration should be required to attach a copy of the security agreement.[29]

One submission also made the point that it is not desirable that the Register include sub-categories of collateral class that are not provided for by the Regulations, and recommended that the Register and the Regulations be aligned with each other.[30]

A number of submissions proposed that the Register incorporate a new class of collateral, called "all present and after-acquired property relating to".[31] This collateral class could be used, for example, where a secured party takes security over all of the assets of a grantor in relation to a particular enterprise or activity – for example, if the grantor is giving security over the assets from time to time of a particular factory or at a particular location, or the assets from time to time of a particular trust.

How should the options be assessed?

These proposals for change would affect different stakeholders in different ways. For example, the proposal to reduce the number of classes of collateral would help a registrant when registering a financing statement, but could make a searcher's task of interpreting search results more difficult. The proposal that a registrant be required to provide particulars about the collateral in the free text field would help searchers, but would add to the work and risk involved for a person who is registering a financing statement.

The core purpose of the Register is to provide a person who is proposing to take an interest in another person's personal property with an opportunity to determine whether a secured party might have a competing interest in the property. The most complete way of fulfilling that purpose would be to require the secured party to

25 For example: EDX, S1 page 4.

26 AICM, S2 page 23.

27 For example: JLF, S1 page 8; AFC, S1 att B page 13; AICM, S1 page 16; LCA, S1 page 7; QLS, S1 page 7; CW, S1 page 5.

28 For example: CW, S1 page 8; LCA, S1 page 11; AICM, S1 page 23; DIFA, S1 page 3.

29 For example: DIFA, S2 att A page 6. I return to this proposal in Section 6.11.2 below.

30 JLF, S1 page 10.

31 For example: AICM, S1 page 16; LCA, S1 page 7.

include an exact description of its collateral in its financing statement, and to only register its financing statement after the security agreement had been entered into. However, the rules for identifying collateral in a registration need to strike a balance between the competing needs and expectations of secured parties, searchers and grantors, and this would not be a desirable approach for stakeholders as a whole.

At the time Consultation Paper 4 was released, there was not enough information before the review to propose recommendations on these questions. Consultation Paper 4 did suggest however that one option could be to retain the current approach of designating collateral classes, but to reduce the number of collateral classes, and make the distinctions between them more intuitive. Consultation Paper 4 went on to suggest that it might be possible to reduce the collateral classes down to these 7 categories:

- serial-numbered property;
- other goods;
- accounts;[32]
- other intangible property;
- all present and after-acquired property;
- all present and after-acquired property except;
- all present and after-acquired property relating to.

This would mean that the only difficult questions for a registrant were whether or not goods were serial-numbered property, and whether or not an intangible was an account.

As a counter-balance to this, a registrant could then be obliged to include more information about the collateral in the free text field. This is discussed in Section 6.10.4 below.

Consultation Paper 4 invited stakeholders to express views on these and any other proposals for finding the right balance between the interests of secured parties, searchers and grantors.

6.3.2 *Discussion of stakeholder feedback*

Multiple collateral classes?

A small number of responses were not in favour of allowing a single registration to be made against multiple collateral classes, on the basis that one of the other solutions was preferable. All other responses, however, were in favour of amending the Register so that a single registration could be made against several collateral classes, using a common free text field. A number of responses emphasised the importance of making this change. I agree that this would be a valuable enhancement.

Allpap relating to?

The majority of responses were also in favour of amending the Regulations to provide for an "allpap relating to" collateral class. There was some divergence of views amongst those responses, however, as to how the class should be described (eg whether it should be "allpap relating to", "allpap in connection with"

32 This is included for the purposes of s 64. See Section 7.7.9.6 below.

or “allpap (limited)”). Not all responses agreed, though, that this new collateral class was the best solution. A number of responses also pointed out that an “allpap relating to” collateral class would not be needed if the Act is amended to allow a single registration to be made against multiple collateral classes with a common free text field. I agree that an “allpap relating to” collateral class becomes unnecessary if the Act is amended to allow registrations against multiple collateral classes.

Abolish collateral classes entirely?

A number of responses argued in favour of adopting the majority Canadian model, and abolishing collateral classes entirely. I am told that businesses and practitioners in Canada are quite comfortable working with that system, and it is instructive to note that Ontario is also proposing to replace its collateral class registration system with that alternative system.

Despite this, I do not propose to recommend that we abolish collateral classes for registrations. There are two reasons for this. First, while I believe that there is a clear case for simplifying and rationalising the collateral classes, I do not believe that a clear case has been made for abolishing them entirely. As I see it, the collateral class system can perform a useful triage role for searchers, as it can reduce the number of registrations that a searcher needs to examine. If a searcher is considering whether to take security over a grantor’s intangible property, for example, the searcher can electronically sift the search results by collateral class, and then ignore any registrations that have been made against collateral classes (such as motor vehicles, or other goods) that are clearly not relevant to the investigation. If there are no collateral classes, however, then that is not possible. I am also told that collateral descriptions in registrations under the majority Canadian model can be quite lengthy, and that this can add significantly to the work involved in reviewing a search.

Secondly, even if I were minded to recommend that we move to the majority Canadian model, I would not want to do so without further analysis, or without affording all stakeholders an opportunity to comment on the proposal.

Keep collateral classes, but simplify them?

My preferred approach is to keep collateral classes, but to reduce the number of classes and simplify the distinctions between them. This approach was supported by the majority of respondents.

Most respondents also agreed that the identity of the collateral classes should be amended to reflect the list that was proposed in Consultation Paper 4.

Some responses observed that the collateral class “serial-numbered property” would need to consist of a number of sub-classes, being one for each type of serial-numbered property. I agree with that observation. Some responses queried whether we need a separate class for accounts, particularly if it has been included solely to allow an accounts financier to identify that it will be relying on s 64 to take priority over PMSI holders. Those responses suggested in the alternative that the registration process include a box (eg an “Are you claiming s 64 priority?” box), that an accounts financier could tick where appropriate. I have recommended earlier in this Chapter, however, that a number of boxes be eliminated from the registration process in order to make that process simpler and easier to understand. I would be reluctant to erode the benefits of those changes by introducing a new question that could itself cause confusion and uncertainty,

particularly as it will not be a relevant question for the overwhelming majority of registrants. My preference is to require an accounts financier to identify that it might be claiming s 64 priority by registering against the "accounts" class.

6.3.3 *Recommendations*

Recommendation 92: *That item 4(c) of the table in s 153(1) and the functionality of the Register be amended to enable a registration to be made against a number of collateral classes at the same time, using a common free text field.*

Recommendation 93: *That the collateral classes on the Register be changed to the following 6 classes:*

- *serial-numbered property (with appropriate sub-classes for the different types of serial-numbered property);*
- *other goods;*
- *accounts;*
- *other intangible property;*
- *all present and after-acquired property;*
- *all present and after-acquired property except.*

6.4 The free text field

6.4.1 Introduction

Submissions made four types of comments in relation to the use of the free text field in a registration:

- that the legal effect of the field be clarified;
- that it be compulsory to use the field to provide a more complete description of the collateral;
- that the manner in which the field is used be limited, particularly for the "allpap except" collateral class; and
- that the field also be available for use where a registration is made against the "allpap" collateral class.

6.4.2 The legal effect of the free text field

6.4.2.1 *The issue*

The free text field is not referred to anywhere in the Act or the Regulations. This means that it does not have any express statutory effect.

This might suggest that a registration is not limited by any description of collateral that might be included in the free text field. For example, a registration against the collateral class "other goods" might be able to perfect a security interest over any "other goods", not just any goods that are described in the free text field.

This would however be a very counter-intuitive outcome, and there are good grounds for arguing that it is not correct. Even though the Act and the Regulations specify requirements for a registration, it does not necessarily follow that a more

specific description of collateral on the Register has no legal effect. It could well be argued that a registration against the collateral class "other goods" that then describes a specific item of goods should be regarded as being only a registration against those specific goods, unless it is clear from the description that they are only examples, and not intended to limit the effect of the registration.

Even if the lack of statutory recognition of the free text field means that it does not technically limit the breadth of the registration, it is likely that a registration that was claimed to apply to a particular item of collateral would be "seriously misleading" under s 164 in relation to that item, if the free text field contained a description of collateral that did not include it.

Consultation Paper 4 invited stakeholders to comment on whether the Act should be amended to clarify the legal effect of the free text field.

6.4.2.2 ***Discussion of stakeholder feedback***

One response expressed the view that the legal effect of the free text field was already sufficiently clear. Some of the responses noted that the issue would fall away if we dropped collateral classes entirely and moved to the majority Canadian model (see the discussion above). All other responses were of the view, however, that it would be desirable to clarify the legal effect of the free text field. Some of those responses observed that there is a provision in the Ont PPSA that does this.[33]

I agree that it would be helpful to amend the Act to make it clear that a registration that contains text that describes collateral is only effective to perfect a security interest in the collateral that is so described.

6.4.2.3 ***Recommendation***

> **Recommendation 94:** *That the Act be amended to make it clear that a registration that contains text that describes collateral is only effective to perfect a security interest in the collateral that is so described.*

6.4.3 Should the free text field be compulsory?

6.4.3.1 ***The issue***

The Register is not designed to be a definitive record of precisely what collateral is subject to a secured party's security interest. Rather, its function is to alert a searcher to the fact that particular personal property, or personal property of a particular type, may be subject to a secured party's security interest. If a searcher is alerted to the fact that an item of personal property may be subject to a security interest, then the searcher needs to use other tools (such as s 275 of the Act) to make further enquiries.

The registration process is made easier for a registrant if it is not required to provide a detailed description of the collateral. This is particularly the case for advance registrations, when the registrant may not know precisely what the collateral will ultimately be. A registrant will have some incentive not to use an overly broad description, so that the secured party does not receive unnecessary

33 Ont PPSA s 46(2.1).

requests for information under s 275, but a registrant will generally want to use description that errs on the broad side, to avoid the risk of inadvertently leaving collateral out. For repeat secured parties such as financial institutions or sellers of goods on retention-of-title terms, broad descriptions are also advantageous from a systems perspective, as they remove the need to prepare tailored descriptions for individual transactions.

Searchers, however, will prefer more detail, as a more detailed description makes it easier for the searcher to determine whether or not a registration could apply to particular collateral. This can reduce the need for the searcher to make follow-up enquiries. A grantor will also not want a registration to be broader than necessary, as this could otherwise give searchers an impression that the grantor's assets were more heavily encumbered than was in fact the case.

How is a balance to be found between these competing perspectives? In Ontario, another system that uses collateral classes, the accompanying free text field is optional (as is the case under the Act, at present).[34] The NZ PPSA requires a registration to include a "further description", but does not describe how detailed that description needs to be.[35] A leading commentary on the NZ PPSA takes the view that the "further description" does not need to describe the collateral in detail, and can be quite generic (eg "computers").[36]

A number of submissions suggested that it should be compulsory to complete the free text field, for all collateral classes other than the "allpap" class or for serial-numbered property.[37] Consultation Paper 4 expressed the view, however, that it would not be appropriate for the Act to mandate a specific level of detail for the description of collateral in a registration, particularly if this was to be a condition of what is required for a registration to be effective. A requirement of this type would be very difficult for a secured party to work with, particularly for advance registrations. It would also expose the secured party to additional risk, as its registration could be ineffective if the level of detail did not meet the mandated requirements.

6.4.3.2 ***Discussion of stakeholder feedback***

Responses were divided on this question. A majority of respondents were in favour of leaving the free text field optional. A significant minority of responses, however, were of the view that a registrant should be obliged to complete the free text field, so that the registration gave searchers a more accurate picture of the collateral.

Some of those responses suggested that we follow the New Zealand approach of requiring that the registration contain a "further description", without specifying what that might require. I am uncomfortable with recommending that approach, however, if the consequence of a failure to provide a sufficient "further description" is that the registration is ineffective, as that would expose a secured party to the uncertainty of not knowing what is required for it to make a valid registration. That could be particularly problematic for a registration that is made before the collateral has been identified. I can see however that it is desirable to do something to curtail unnecessarily over-reaching registrations, and I return to this question in Section 6.10.4 below, in the context of s 151 of the Act.

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34 Cuming Walsh & Wood, pages 348 to 349.

35 NZ PPS Regs, para 8(2) of Schedule 1.

36 Gedye Cuming & Wood, page 459.

37 For example: LCA, S1 page 11; QLS, S1 page 9; CW, S1 page 18; AICM, S2 page 30.

6.4.3.3 ***Recommendation***

> **Recommendation 95:** *That the Act not be amended to oblige a registrant to include details of collateral in the free text field as a condition to making it an effective registration.*

6.4.4 What type of information should be allowed in the free text field?

6.4.4.1 ***The issue***

A number of submissions discussed the practice that has developed under which a registrant registers a financing statement under the "allpap except" collateral class, and then describes the "except" so that the registration operates in effect to perfect a security interest over "all present and after-acquired property except property that the secured party does not have a security interest over".[38] The submissions argued that this type of "except" description is uninformative and unhelpful, and should not be allowed. It has also been suggested that this use of the collateral class does not comply with the Regulations, because the definition of "allpap except" in reg 1.8 requires that the excepted property be identified "by item or class".

It is true that this type of description is not particularly informative, as it does not provide the reader with information that helps them to determine just what collateral might or might not be covered by the registration. However, it is no less unhelpful than using the "allpap" collateral class to perfect a security interest that is over less than all the grantor's personal property, and it seems clear that this is permitted by the Act.[39]

I am generally not in favour of recommending rules to ban specific practices, as they add to the complexity of the Act. This particular practice may also become less important if my other recommendations in this Chapter 6 are adopted. In any event, this practice is part of the broader issue of the extent to which registrants should be able to make overly broad registrations. I return to this in Section 6.10.4 below.

6.4.4.2 ***Discussion of stakeholder feedback***

A small number of responses thought that this particular practice should be prohibited. All other responses agreed, however, that it should not be banned, even though a number of those responses did not approve of it.

While this practice might be unhelpful for searchers, it is no more unhelpful than the most likely alternative, which is to simply use the "allpap" collateral class (without the "except"). I also agree with the view put in some of the responses that the practice may become less prevalent if the Act is amended to allow one registration to be made against more than one collateral class (see Section 6.3 above). I do not think that the practice should be banned.

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38 For example: AFC, S1 att B page 18; AICM, S1 page 23; DIFA, S1 att B page 6; LCA, S1 page 11; QLS, S1 page 9; CW, S1 page 8; DLA, S2 page 5.

39 See, for example, Example 1 to s 151(1) of the Act.

As I understand it, this use of the "allpap except" collateral class was developed to avoid an argument that the use of the "allpap" class could be seriously misleading because it is over-reaching, on the basis that a registration using this "allpap except" formulation was at least not claiming to be broader than the security interests that it in fact perfects. The formulation also makes it easier for a secured party to convince a grantor or incoming secured party that it does not need to amend its registration when it releases an item of collateral from its security.

6.4.4.3 ***Recommendation***

> **Recommendation 96:** *That the Act not be amended to prohibit the practice of registering a financing statement against the "allpap except" collateral class, and then describing the "except" so that the registration operates in effect to perfect a security interest over "all present and after-acquired property except property that the secured party does not have a security interest over".*

6.4.5 Should the free text field be available for the "allpap" class?

6.4.5.1 ***The issue***

One submission suggested that the free text field should also be available for use with a registration against the collateral class "allpap".[40]

It is not readily apparent why this would be helpful. If anything, it could cause confusion – if a security interest is over all a grantor's present and after-acquired property, it is not clear what a further description might need to say.

Consultation Paper 4 invited stakeholders to comment.

6.4.5.2 ***Discussion of stakeholder feedback***

One respondent suggested that there was no downside to making the free text field available for "allpap" registrations, and another respondent said that its members had mixed views on the question. All other respondents agreed in principle, however, that there should be no need to activate the free text field for the "allpap" collateral class.

It might be thought that there is no harm in making the free text field available for "allpap" registrations. In my view, though, there is a risk that registrants might then use the free text field for purposes for which it is not designed and so increase confusion and uncertainty. My view is that there is no clear case for making this change.

6.4.5.3 ***Recommendation***

> **Recommendation 97:** *That the Register functionality not be amended to activate the free text field for a registration against the collateral class "allpap".*

40 JLF, S1 page 21.

6.5 The description of claimed proceeds

6.5.1 *The issue*

Item 4(d) of the table in s 153(1) of the Act provides that any description of proceeds in a registration must comply with the Regulations. Clause 2.4 of Schedule 1 to the Regulations allows proceeds to be described in a way that identifies the particular proceeds, that identifies a class to which the proceeds belong, or that simply describes the proceeds as "all present and after-acquired property". The Register accommodates all of these options, but makes "all present and after-acquired property" the default choice.

I discuss these provisions in Section 7.4.6 below, and recommend there that the Act be amended so that a security interest over proceeds is automatically perfected, if the security interest over the original collateral was perfected by registration. If that recommendation is adopted, then it will no longer be necessary to separately describe the proceeds in the registration, and clause 2.4 of Schedule 1 to the Regulations could be deleted.

6.5.2 *Discussion of stakeholder feedback*

The great majority of respondents agreed that clause 2.4 of Schedule 1 to the Regulations should be deleted.

The questions regarding the nature of proceeds that the Register asks in the course of a registration are confusing for the uninitiated. They also become unnecessary if the Act is amended so that a security interest over proceeds is automatically perfected, if the security interest over the original collateral was perfected by registration. In my view, item 4(d) in s 153(1), and clause 2.4 of Schedule 1 to the Regulations, should be deleted.

6.5.3 *Recommendation*

Recommendation 98: *That item 4(d) of the table in s 153(1), and clause 2.4 of Schedule 1 to the Regulations, be deleted.*

6.6 Serial-numbered property

6.6.1 What types of property should be serial-numbered property?

6.6.1.1 ***The issue***

The provisions

Item 4(b) of the table in s 153(1) of the Act states that collateral may or must be described by serial number, if this is allowed or required by the Regulations. Clause 2.2 of Schedule 1 to the Regulations identifies the following types of collateral as the ones that may or must be described by serial number in a registration:

- motor vehicles;
- aircraft;
- watercraft; and

- certain types of intellectual property (designs, patents, plant breeder's rights, trade marks, or licences over any of them).

Where is serial-numbered property referred to in the Act?

The concept of serial-numbered property is used in the Act in a number of ways.

- *Identification of the grantor*

  If collateral is required by the Regulations to be described by serial number and is consumer property, then the registration may not include the grantor's details.[41] (I have recommended separately that the concept of consumer property be deleted, and that this rule apply to all individual grantors. See Section 6.2.1 above.)

- *Effectiveness of a registration*

  If the Regulations state that collateral must be described in a registration by serial number, the registration will be defective if it does not.[42]

- *Registration period*

  If collateral is described in a registration by serial number, the term of the registration cannot exceed 7 years.[43] (I am recommending separately that this be changed. See Section 6.6.2 below.)

- *Taking free rules*

  The Act contains a number of taking free rules that are specific to serial-numbered property.[44] Some of the other taking free rules, in contrast, are qualified so that they do not apply to serial-numbered property, at least to some extent.[45] (Again, I am recommending some changes to this. See Sections 7.6.4 to 7.6.7 below.)

- *Other references*

  The Act also refers to serial-numbered property in a number of other provisions, in a more ancillary way.[46]

Other jurisdictions

The Canadian PPSAs and the NZ PPSA also have a concept of property that may or must be described by serial number in a registration. The concept in those jurisdictions is however much narrower than the term as used in the Act. In the majority of the Canadian PPSA jurisdictions, for example, the concept covers only goods such as motor vehicles, trailers, mobile homes, aircraft, boats and outboard motors.[47] In Ontario and Yukon, the concept applies only to motor vehicles.[48] In New Zealand, the term is limited to motor vehicles and aircraft.[49]

41 Item 2(a) of the table in s 153(1) of the Act.
42 Section 165(a) of the Act.
43 Item 5(b) of the table in s 153(1) of the Act.
44 Sections 44 and 45 of the Act.
45 Sections 46 and 47 of the Act.
46 Such as ss 8(6), 68, 165(a) and (b), and 171.
47 See Cuming Walsh & Wood, page 331.
48 See Cuming Walsh & Wood, page 331.
49 NZ PPS Regs, reg 3.

How broad should the concept be?

One submission suggested that the concept of serial-numbered property was too narrow, and should be broadened.[50] This was proposed as a response to the risk faced by a secured financier of equipment if its grantor leases the equipment to another person under a lease that is a security interest, but neglects to perfect its security interest in the leased goods. The perceived risk is that the lessee could become insolvent, so that the unperfected security interest under the lease then vests in the insolvent lessee. The suggestion in the submission, that the categories of serial-numbered property be expanded, was coupled with a suggestion that the secured financier in such a situation could register a financing statement against the serial number, and that this should be sufficient to perfect all "downstream" security interests over the equipment, at least for the purposes of preventing any downstream interest from vesting in an insolvent downstream grantor.[51] The submission suggested, for example, that the concept of serial-numbered property could be expanded to include goods such as computers, medical equipment, shipping containers and skip bins.

Another submission suggested that the concept of serial-numbered property should be extended to include Life Numbers that are allocated to thoroughbred horses.[52]

However, not all submissions took the view that the concept of serial-numbered property should be broadened.[53]

Consultation Paper 4 suggested that it may not be appropriate to extend the concept of serial-numbered property. There were two reasons for this – one pragmatic, and one based on principle.

- The pragmatic reason is that a serial-numbered system for identifying property needs to be manifestly robust, and able to provide each affected asset with a unique and verifiable number. This is best able to be achieved if the serial numbers are issued by or under the supervision of a government body, and I expect that a serial number such as a manufacturer's bar code would not be sufficiently robust or unique for these purposes. It may also be difficult for the Register to accommodate a wide range of different types of serial number.
- The reason based on principle is that an extension of the categories of serial-numbered property may advantage secured parties that want to be able to register against serial numbers, but would disadvantage other secured parties that do not. For example, it would expose those other secured parties to additional risk under s 44 of the Act (as that section currently stands). It would also increase the registration burden for secured parties where the grantor is an individual, because this would require the secured party to register against the serial number, whether or not it would otherwise have wanted to.

Consultation Paper 4 went on to query whether the categories of serial-numbered property should instead be reduced.

Consultation Paper 4 invited stakeholders to comment on these questions.

50 AFC, S1 att B page 9.

51 See Section 6.11.5 below.

52 TBA, S1 page 2.

53 See for example ABA, S2 page 2.

6.6.1.2 ***Discussion of stakeholder feedback***

One response suggested that boat engines should also be serial-numbered property.[54] According to the response, this would have the potential to improve the market for the financing of watercraft, particularly for so-called "boat-motor-trailer" packages.

The great majority of responses, however, were not in favour of broadening the categories of serial-numbered property.

Views were more mixed on whether the categories should be narrowed. The majority of responses were in favour of leaving the categories unchanged, but a number were in favour of narrowing them, for example by excluding intellectual property, or by reducing it to just motor vehicles.

The concept of serial-numbered property performs two principal roles in the Act:

- It determines the scope of the taking free rule in s 44.
- It influences the registration requirements for registrations against individuals, under item 2 of the table in s 153(1).

Section 44

I discuss s 44 later in this report, in Section 7.6.4.3. It will be seen from that discussion that two explanations have been given for the inclusion of s 44 in the Act. One explanation is that s 44 is there to ameliorate the consequences of the fact that collateral may be subject to an otherwise-undiscoverable security interest granted by a previous owner. According to the second explanation, however, s 44 is a consumer protection measure, designed to make it easier for individuals wanting to acquire an interest in serial-numbered collateral to determine whether the collateral is encumbered. If the first explanation is correct, then that would suggest that the concept of serial-numbered property should be a broad one, in order to maximise the protection of the section. If the second explanation is correct, though, then it could be argued that the concept should be limited to the types of property that consumers are likely to want to purchase – perhaps just motor vehicles and watercraft.

It can be seen from the discussion in Section 7.2 that my view is that the Act currently deals with the risk of undiscoverable security interests granted by previous owners through the taking free rule for temporarily-perfected security interests in s 52, not through s 44. The Act is different in that respect to the Canadian PPSAs, which do rely on their equivalent of s 44 to address this risk. If that is correct, then the primary role for s 44 is to assist consumers. And if that is correct, then there is less of a need for the concept of serial-numbered property to extend to property of a type that consumers do not normally purchase.

Section 153(1)

Item 2 of the table in s 153(1) is designed to protect the privacy of individuals. This suggests that the concept of serial-numbered property should capture the types of property that individuals are likely to grant security over, at least in non-business transactions – again, perhaps just motor vehicles and watercraft.[55]

54 AFC, CP4 page 9.

55 It is less clear that privacy concerns should be relevant where an individual grants security over business assets, such as intellectual property.

This analysis tends to suggest that the concept of serial-numbered property should be limited to motor vehicles and watercraft.

In my view, the arguments for and against restricting the concept of serial-numbered property are finely balanced. While I can see that there are policy arguments in favour of restricting the concept to motor vehicles and watercraft, I accept that the majority view of respondents was that there is no clear case for change. On that basis, I do not propose to recommend that the concept of serial-numbered property be altered.

6.6.1.3 ***Recommendation***

> **Recommendation 99:** *That clause 2.2 of Schedule 1 to the Regulations not be amended.*

6.6.2 The registration period for serial-numbered property

6.6.2.1 ***The issue***

The maximum possible registration period for a registration against serial-numbered property is 7 years. It is not clear why this needs to be the case. It could be argued that a registration against serial-numbered property should be able to have the same registration period as for any other type of collateral, for the relevant type of grantor.

Consultation Paper 4 suggested that a registration against serial-numbered property should perhaps have a maximum period of 7 years if the grantor is an individual, but that it otherwise should be able to have the same registration period as a registration for any other type of collateral.

6.6.2.2 ***Discussion of stakeholder feedback***

A small number of responses did not agree with the proposal that a registration against serial-numbered property should be limited to 7 years if the grantor is an individual. This was consistent with the view expressed earlier by those respondents that the registration period for registrations against individuals should not be limited to 7 years, but should be the same as for all other types of grantor. All responses agreed, however, that the registration period for a registration against serial-numbered property should be the same as the registration period for a registration against any other collateral, for that type of grantor.

In my view, this change would remove an inconsistency in the Act, and make the Act easier to work with.

6.6.2.3 ***Recommendation***

> **Recommendation 100:** *That the table in s 153(1) be amended to provide that a registration against serial-numbered property have the same registration period as for any other collateral, for the relevant type of grantor.*

6.6.3 Motor vehicles

6.6.3.1 ***The issue***

The definition of the term "motor vehicle" is found in reg 1.7 of the Regulations. It is as follows:

> (1) For the definition of motor vehicle in section 10 of the Act, personal property described in subregulation (2) or (3) is a motor vehicle.
>
> (2) The personal property:
>
> (a) is built to be propelled, wholly on land, by a motor that forms part of the property; and
>
> (b) is capable of a speed of at least 10 km/h; and
>
> (ba) has 1 or more motors that have a total power greater than 200 W; and
>
> (c) has any of the following:
>
> (i) a vehicle identification number;
>
> (ii) a chassis number;
>
> (iii) the manufacturer's number; and
>
> (d) does not run on rails, tram lines or other fixed path.
>
> (3) The personal property:
>
> (a) is capable, when being towed by, or attached to, a motor vehicle, of travelling at a speed greater than 10km/h; and
>
> (b) is a piece of machinery or equipment that is equipped with wheels and designed to be attached to, or towed by, a motor vehicle; and:
>
> (c) has any of the following:
>
> (i) a vehicle identification number;
>
> (ii) a chassis number;
>
> (iii) the manufacturer's number.

This is quite an elaborate definition. As I understand it, the language is a compilation of the corresponding definitions from the State and Territory motor vehicle securities legislation that was replaced by the Act.

The boundaries of the definition are often unclear, in part because of its complexity. In response to industry concerns, the definition was amended with effect from 1 July 2014 so that personal property is only a motor vehicle if it is both capable of a speed of 10 kph and has motors with a total output over 200W (previously, property could be a motor vehicle if it satisfied either of these requirements).[56] Submissions were divided on whether this was a desirable amendment.[57] I do not have information before me that would enable me to assess the effects of the change, and am not in a position to express a view on it.

56 Reg 1.7 of the Regulations, as in force before commencement of the *Personal Property Securities (Motor Vehicles) Regulation 2014*.

57 See for example: AFC, S1 page 14; AICM, S2 page 9.

The current complexity of the definition makes it difficult in some cases for a registrant to know whether to register a financing statement against the collateral class "motor vehicle" or "other goods". It is similarly difficult for a searcher to know which collateral class to search against. This technical complexity is undesirable, particularly as registrants and searchers are likely to be lay persons, with no legal training.

Consultation Paper 4 suggested that it is worth exploring whether this complexity could be eliminated.

6.6.3.2 ***Discussion of stakeholder feedback***

Respondents had a range of views on this issue. Some argued that the current definition was adequate, and that no change was required. Two responses argued that the amendments made as of July last year should be reversed.[58] A number of responses agreed that it would be valuable to simplify the term, but were not able to offer suggestions as to how this might be done.

One response suggested in this context that the definition of a motor vehicle could perhaps be determined by whether or not it has a vehicle identification number (VIN).[59] In other words, if goods have a VIN then they are a motor vehicle, but if they do not have a VIN, then they are not. This proposal certainly has the virtue of simplicity. It would be easy to work with for most users, as all road vehicles are required by law to have a VIN (as I understand it), so a person who is looking to take an interest in a motor vehicle (in the vernacular sense) could be confident that it was serial-numbered property under the Act. It would also eliminate the problem, identified by one submission, that manufacturers can use the same numbering system for their chassis numbers or manufacturer's numbers, with the result that a number of separate items of collateral can have the same serial number.[60]

The time available for completion of this report has not allowed me to look more closely into the suggestion that the meaning of motor vehicle be determined by whether the goods in question have a VIN, in particular to understand how broad a net this proposal would cast. Care would also need to be taken with any transitional measures, as security interests would continue to be taken over older vehicles that did not have a VIN but did have a chassis number or manufacturer's number (as they are currently permitted to be used as a serial number, if a vehicle does not have a VIN).[61] I do believe, however, this this is worth further consideration.

6.6.3.3 ***Recommendation***

Recommendation 101: *That Government explore whether the current definition of "motor vehicle" in reg 1.7 of the Regulations could be amended so that a vehicle is a motor vehicle (and is only a motor vehicle) for the purposes of the Act and the Regulations if it has a vehicle identification number.*

58 CAFBA, CP4 page 5; AFC, CP4 page 10.

59 SP, CP4 page 14.

60 MBA, S2 page 6.

61 Clause 2.2(3)(c) of Schedule 1 to the Regulations.

6.6.4 Motor vehicles – the July 2014 amendment – a transitional concern

6.6.4.1 *The issue*

As just noted, the definition of "motor vehicle" was amended with effect from 1 July 2014 in a way that made the definition narrower than had previously been the case.

One submission expressed concern that an inadvertent effect of this amendment could be to cause some existing registrations to be ineffective.[62] In particular, the submission argued that this could be the case if a secured party held security over personal property that was a motor vehicle as defined before 1 July 2014, but which ceased to be a motor vehicle because of the change to the definition. If the secured party had perfected its security interest by registration against the collateral class "motor vehicle", that registration will have been effective to perfect the security interest until 1 July 2014. From 1 July 2014, however, the collateral will have become "other goods", and a registration made on or after 1 July 2014 would need to be made against that collateral class instead.

Consultation Paper 4 expressed the view that the amendment to the definition of motor vehicle was not intended to make existing registrations defective, but went on to agree that it would be desirable to confirm this, perhaps in the Regulations themselves.

One consequence of the change to the definition of motor vehicle is that a person who searches the Register for security interests over an item of personal property that was previously within the collateral class "motor vehicle" but is now just "other goods" will need to conduct the search against both collateral classes. One possible response to this might be to require the secured party to make a replacement registration (that is, against the "other goods" collateral class) in order to re-perfect its security interest, within some transitional period. Rather than impose this burden on secured parties, however, Consultation Paper 4 expressed the view that searchers should conduct dual searches in these circumstances. While this imposes some additional burden on searchers, the need to conduct dual searches would ease with the passage of time.

6.6.4.2 *Discussion of stakeholder feedback*

One response suggested that this issue could be dealt with through the mechanisms in ss 165(d) and 166 that allow some registrations to remain effective for up to 60 months despite a defect.[63] I am not entirely confident, however, that this solution would work. In any event, all other respondents were in favour of confirming through the Regulations that the change did not render a previously-effective registration into an ineffective one. In my view, that is the better way to proceed.

Two responses argued that the amendment made to the definition of "motor vehicle" in July 2014 should be reversed.[64] I do not have any information before me, however, that would justify that course of action, particularly as Government has only recently decided to make the amendment. In particular, I am not aware of any new information having come to light that might make it appropriate to reconsider that decision.

62 JLF, S2 page 28.

63 AD, CP4 page 10.

64 CAFBA, CP4 page 5; AFC, CP4 page 10.

6.6.4.3 ***Recommendation***

> **Recommendation 102:** *That the Regulations be amended to clarify that a registration made against the collateral class "motor vehicle" before 1 July 2014 will continue to be effective to perfect a security interest taken under a security agreement entered into before 1 July 2014 in a "motor vehicle" within the meaning of that term that applied under the Act before 1 July 2014, despite commencement of the Personal Property Securities (Motor Vehicles) Regulation 2014.*

6.6.5 Aircraft

6.6.5.1 ***The issue***

Clause 2.2(1)(b) of Schedule 1 to the Regulations appears to have the effect that an aircraft must be described by serial number if it is commercial property.

It must be asked why a secured party should be obliged to include the serial number for an aircraft in a registration. This may not always be practicable. For example, if a company has given all-assets security to its bank and some time later acquires a corporate jet, the secured party's security over the aircraft may not be perfected by the registration (as the Act currently stands), because the registration may be ineffective with respect to the aircraft under s 165(a). It is not clear why this should be the case.

Consultation Paper 4 proposed that clause 2.2(1) of Schedule 1 to the Regulations be amended to make it clear that a registration to perfect a security interest over aircraft may include the aircraft's serial number, but is not required to.

6.6.5.2 ***Discussion of stakeholder feedback***

All responses were in support of this proposal.

In my view, there is no good reason for requiring that a registration can only perfect a security interest over an aircraft if the registration is against its serial number. It will remove an inconsistency from the Act, and streamline its operation, if this amendment is made.

6.6.5.3 ***Recommendation***

> **Recommendation 103:** *That item 2.2(1) of Schedule 1 to the Regulations be amended so that a registration to perfect a security interest over aircraft may include the aircraft's serial number, but is not required to.*

6.6.6 Watercraft

6.6.6.1 ***The issue***

Clause 2.2(3)(d) of Schedule 1 to the Regulations states that the serial number for watercraft (other than outboard motors) is its "official number" under the *Shipping Registration Regulations 1981* or, if it does not have an official number, its "hull identification number".

One submission suggested that it would be beneficial if the serial number for watercraft could also include an International Maritime Organisation (*IMO*) number.[65]

6.6.6.2 ***Discussion***

As I understand it, a watercraft will only have an "official number" if it is registered in Australia. The definition of "hull identification number" in reg 1.6 of the Regulations also appears to only apply to small craft. This would seem to have the result that it is not possible to register against serial number for a security interest over a large vessel if it is not registered in Australia.

I do not have sufficient information before me regarding IMO numbers to be able to express a view on whether they should be a serial number for the purposes of the Act. I would propose however that Government consider this suggestion.

6.6.6.3 ***Recommendation***

> **Recommendation 104:** *That Government consider whether clause 2.2(3)(d) of Schedule 1 to the Regulations should be amended to provide that the serial number for a watercraft that does not have an official number is its International Maritime Organisation (IMO) number, if it has one.*

6.6.7 Intellectual property licences

6.6.7.1 ***The issue***

Clauses 2.2(1)(a)(ii)(E) and (c)(iii)(E) of Schedule 1 to the Regulations provide that a licence of intellectual property that is serial-numbered property is itself also serial-numbered property.

Even if Government decides to continue to treat certain types of intellectual property as serial-numbered property, it should be asked why the concept extends to licences over such intellectual property as well.

The concept of serial-numbered property may have been extended to licences of intellectual property because a licence to exploit intellectual property can be equivalent in a commercial sense to ownership of the intellectual property, if the licence is exclusive. The definition of serial-numbered property, however, captures not just exclusive licences, but all licences.

Consultation Paper 4 expressed the view that the concept of serial-numbered property should be limited to the intellectual property itself, and not include licences as well, in the absence of an appropriate explanation to the contrary.

6.6.7.2 ***Discussion of stakeholder feedback***

The majority of respondents agreed with the proposal that the concept of serial-numbered property should not extend to a licence of intellectual property, even if it does extend to the intellectual property itself. Some respondents did not agree, however, and argued that the change was not needed.

The extension of the concept of serial-numbered property to a licence of intellectual property, using the serial number of the intellectual property itself, is to my mind a trap for the unwary. I accept however that views among stakeholders

65 ABA, S2 page 2.

are divided on this question, and that there is no compelling case for change. On that basis, I do not propose to recommend that the Regulations be amended so that intellectual property licences would cease to be serial-numbered property under the Act.

6.6.7.3 ***Recommendation***

> **Recommendation 105:** *That items 2.2(1)(a)(ii)(E) and (c)(iii)(E) of Schedule 1 to the Regulations not be deleted.*

6.6.8 Patent application numbers

6.6.8.1 ***The issue***

Clause 2.2(3)(f) of Schedule 1 to the Regulations contemplates that a registration against a patent may be identified by its patent application number, if it does not have a patent number issued by IP Australia. One submission suggested, however, that this is at best only a temporary protection for a secured party, because a different number is issued when the patent is issued.[66] This means that it is not possible to make a lasting registration against a patent held by an individual until the patent is issued. If the grantor of the security interest is a body corporate, the secured party also faces the risk that a registration made at that time could be outside the 20-business day period prescribed by s 588FL of the Corporations Act.

I see no easy solution to this problem. It may be that the secured party will simply need to remain vigilant, to ensure that it can make a fresh registration when the formal patent number is issued. Vigilance on the part of the secured party will of course not resolve the timing issue under s 588FL of the Corporations Act. That issue will go away, however, if s 588FL of the Corporations Act is deleted. See Section 9.2.2.1 below.

6.6.8.2 ***Discussion of stakeholder feedback***

Only a few respondents commented on this question, and their views were evenly balanced. Some argued in favour of finding a way to fix the problem. Others argued that secured parties should simply manage the risk by re-registering against the patent number when it is issued (particularly if the risk under s 588FL is dealt with by deleting that section).

That, on balance, is my view as well. If a secured party were able to "permanently" perfect a security interest over a patent by registering against its patent application number, then any future searcher would need to search against not only the final patent number, but also against the patent application number, no matter how many years may have passed since the patent number was issued. In my view, the better solution is to leave it to the secured party to re-register when the patent number is issued. It is important in this context to note that the secured party is likely to have a window of up to 60 months to do this, under s 166. That, it seems to me, should provide the secured party with a reasonable level of protection.

66 JLF, S1 page 17.

6.6.8.3 ***Recommendation***

> **Recommendation 106:** *That the Act and the Regulations not be amended to allow a secured party to permanently perfect a security interest over a patent by registering against its patent application number.*

6.7 Grantor identifiers

6.7.1 Individual grantors – AML/CTF Act data

6.7.1.1 ***The issue***

Item 2(b) of the table in s 153(1) of the Act provides that a financing statement with respect to a security interest that is granted by an individual needs to include the grantor's name and date of birth, evidenced in accordance with the Regulations.[67] Clause 1.2 of Schedule 1 to the Regulations provides that a grantor's name and date of birth are to be taken from the following source:

- if the secured party has the information for the grantor in data held by the secured party because of the operation of the *Anti-Money Laundering and Counter-Terrorist Financing Act 2006* (the *AML/CTF Act*) – that data;
- if that option does not apply – the grantor's driver's licence, if they have one;
- if neither of the above options applies – the grantor's proof of identity or proof of age card, if they have one;
- if none of the above options applies – the grantor's Australian passport, if they have one;
- if none of the above options applies – the grantor's Australian visa, if they have one;
- if none of the above options applies – the grantor's non-Australian passport, if they have one; and
- in any other case – the grantor's birth certificate.

The Canadian PPSAs rely primarily on an individual grantor's birth certificate as the source of the grantor's details.[68] Under the NZ PPSA, an individual grantor's name can be sourced from:

> [any] official document such as a birth certificate, marriage certificate, certificate of New Zealand citizenship, passport, driver's licence, or other similar official document evidencing the name currently used by the [grantor].[69]

Article 9, in contrast, relies primarily on the grantor's driver's licence details.[70]

One difficulty faced by any system that records registrations against an individual's name is the fact that the individual may go by several versions of their name. He or she may be commonly known by a nickname, for example, or may not like their first name and use their middle name instead. If a grantor is married and has

67 Unless the collateral is serial-numbered property that is consumer property.

68 See Cuming Walsh & Wood, pages 341 to 344.

69 NZ PPS Regs, reg 2(2). For a critique of this, see Gedye Cuming & Wood, para 150.7.

70 Article 9, §9-503.

adopted their spouse's surname, they may still use their unmarried name for work purposes. These sorts of practical realities can lead to considerable confusion in the registration system, as a financing statement might be registered against a grantor under a version of the grantor's name that is not known to a searcher, making the financing statement effectively undiscoverable. It is for this reason that the Regulations specify an external reference point to determine the name that is to be used in a registration. In theory, this enables both registrants and searchers to use the same details.

Even with a single authoritative source for a grantor's details, the registration system is still faced with the challenge of dealing with the fact that a grantor's name may change over time. For example, a grantor may change his or her name by registration, either on marriage or for other reasons.[71] The Act accommodates this to some extent, in s 166. Section 165(b) states that a registration becomes defective if it is no longer made against the grantor's current name (determined under the cascading options set out in the Regulations, as described above), but s 166 allows the secured party a period of up to 60 months to rectify the defect.

A searcher's ability to search for registrations against an individual grantor is compromised by the fact that secured parties with AML/CTF Act data (principally financial institutions) can use whatever details they have on file as their "current data" for the grantor, even if the grantor's name in that data was taken from a source that is different to the one that a searcher would use – for example, if a grantor has a driver's licence, but the financial institution's AML/CTF Act data was compiled using the grantor's passport or birth certificate. In addition, a third-party searcher will not know (and will have no way of knowing) what a financial institution's AML/CTF Act details are for a grantor, but as long as those details continue to be the "current data" in the financial institution's files, it appears that they may continue to be current for the purposes of s 165(b) (at least for that secured party), no matter how out-of-date they may be for other purposes. So if a financial institution has registered a financing statement against the grantor's name from its AML/CTF Act data, that registration may remain effective even if the grantor changes his or her name. If the grantor has a driver's licence with the new name, a searcher will have no way of finding the financial institution's registration, making it effectively undiscoverable.

I have no doubt that it is very convenient for financial institutions to be able to use their AML/CTF Act data to register financing statements against their customers, particularly if their IT systems automatically populate their registrations from that data. However, it does significantly erode the effectiveness of the Register as a whole if the heaviest users of the Register are able to use data for their registrations that can make those registrations invisible to other users.

A number of submissions also recommended that an individual grantor's details should come from their driver's licence, if they have one.[72]

For these reasons, Consultation Paper 4 suggested that we should consider whether financial institutions should be entitled to continue to use their AML/CTF Act data, or whether they should be required to use the other cascading options in clause 1.2 of Schedule 1 to the Regulations instead, in the same way as all other users of the Register. As a practical matter, this might mean that a financial institution would need to update its AML/CTF Act data by reference to

71 For example, under the *Births, Deaths and Marriages Registration Act 1996* (Vic).

72 For example: AFC, S1 page 10; LCA, S2 page 16.

its customer's driver's licence (for example) before it registers a new financing statement against the customer.

6.7.1.2 ***Discussion of stakeholder feedback***

Some responses took the view that financial institutions should continue to be able to use their AML/CTF Act data for registrations. A response on behalf of the Australian banking industry argued for example that the existing rules should continue to apply at least until further analysis had been done on the cost implications of any change.[73] That response also made the point that the change might require banks to use different identification methods for different pieces of legislation, and that this could be at odds with Government's drive to reduce duplication and so cut red tape.

I accept that the cost implications of requiring financial institutions to switch from their AML/CTF Act data may need to be explored more fully. I am firmly of the view, however, that it has the potential to significantly compromise the integrity of the registration system if financial institutions remain able to make valid registrations against grantors with identifiers that may be different to the identifiers used by all other stakeholders.

Admittedly, it is not easy to tell how often the data used by financial institutions is different to the data that they would otherwise have been required to use – that is, how often financial institutions are making registrations which are effective (because they use information from the institution's AML/CTF Act data), but which are invisible to outsiders (because that information is different to the information on the grantor's driver's licence, for example). To the extent that the information sources are inconsistent, though, I do not see why third parties should bear the risk. If banks want to continue to source their registration data from their AML/CTF Act data, then the banks (which are in control of that data) should bear the risk that that data is inconsistent with the data that the Regulations require be used by everyone else.

This view was supported by the great majority of respondents.

I discuss transitional issues in Chapter 10 below. If Government accepts my recommendation on this question, though, it would be desirable to allow an appropriate transitional period for this change, so that financial institutions have adequate time to update their records. It would also be important to ensure that any existing registrations remain effective despite the change. Those points go however to the implementation of the change, rather than the question of whether the change should be made. The existing arrangement has the potential to compromise the Act's objective of increased transparency (by improving a searcher's ability to determine whether personal property might be subject to a security interest), because it allows security interests that are registered by the heaviest users of the Register to remain in effect undiscoverable. In my view, this should be changed.

6.7.1.3 ***Recommendation***

Recommendation 107: *That item 2 of the table in clause 1.2 of Schedule 1 to the Regulations be deleted.*

73 ABA, CP4 page 10.

6.7.2 Is a driver's licence appropriate as the principal source of details for an individual grantor?

6.7.2.1 ***The issue***

One submission queried whether an individual grantor's details should be sourced from a public register (such as the ASIC companies register, or the Electoral Roll), rather than a driver's licence or passport.[74] It is not clear however that this would desirable, or particularly practical.

A substantial benefit of using a document such as a driver's licence or passport is that it contains not only the individual's name, but also their date of birth and photograph. The photograph makes it easier for a registrant or searcher to verify that the identification document belongs to the correct person. In contrast, the ASIC companies register does not contain photographs,[75] and the Electoral Roll contains neither photographs nor dates of birth. In any event, a public register may not be very practicable as a source of identification information for everyday transactions, as it is not readily accessible like a driver's licence or passport, which an individual can carry around with them.

Consultation Paper 4 invited stakeholders to comment.

6.7.2.2 ***Discussion of stakeholder feedback***

One respondent stated that they preferred the more flexible rule under the NZ PPSA, which allows a registrant to take the grantor's details from any official document (see Section 6.7.1 above).[76] One other respondent pointed out that driver's licences are not a perfect identification source, because they are not particularly difficult to change.[77] That response suggested that further thought be given to making birth certificates the primary identification source, rather than driver's licences. As that response also pointed out, however, birth certificates may be a more permanent information source but they are also a less convenient one, as people do not generally carry a copy of their birth certificate around with them. Also, birth certificates do not contain a photo, so it may be more difficult to tell whether a birth certificate being proffered by a person is in fact theirs. Driver's licences in contrast do have a photo, and people do generally keep them on their person.

The overwhelming majority of respondents were of the view that the primary source of identification for a grantor should continue to be their driver's licence, if they have one. I agree.

6.7.2.3 ***Recommendation***

Recommendation 108: *That items 3 to 8 of the table in clause 1.2 of Schedule 1 to the Regulations not be amended.*

74 LCA, S1 page 10.

75 The potential utility of the ASIC companies register also suffers from the fact that not all grantors are company directors.

76 MBA, CP4 page 8.

77 AD, CP4 page 12.

6.7.3 Body corporate grantors

6.7.3.1 *The issue*

Item 2(c) of the table in s 153(1) of the Act provides that a registration against a (non-individual) grantor needs to be made against the details prescribed by the Regulations. Clause 1.3 of Schedule 1 to the Regulations contains a table that sets out a cascade of options that are to be used to source the correct details for a grantor that is a body corporate (if it is not acting as trustee of a trust with an ABN). Leaving migrated security interests to one side, if a body corporate grants security as responsible entity of a registered scheme that has an ARSN, the correct details are the ARSN. If that option does not apply and the body corporate has an ACN, then the appropriate details are the ACN. If the body corporate has no ACN but has an ARBN, then the ARBN should be used. Finally, if none of these options applies, then item 5 of the table says that the registration must be made against:

> Name of body corporate, as provided for in body corporate's constitution or equivalent document.

One submission pointed out two difficulties with this.[78] The first difficulty is that not all bodies corporate have a "constitution or equivalent document". This is apparently the case, for example, for companies incorporated in New Zealand.[79] This makes it difficult to know how to register against a New Zealand company (for example) that does not have an ARBN.

Secondly, even if a body corporate does have a constitution or equivalent document, it will not always be the case that its current name is "provided for" by that document. For example, the constitution could contain its original name, but the name may have subsequently been changed in accordance with a procedure contained in the relevant companies legislation.

It is likely that any jurisdiction with legislation that provides for the creation of bodies corporate will also maintain a register of them. For this reason, the submission suggested it might be preferable to use the name or identifying company number for the body corporate as recorded in that register. Consultation Paper 4 suggested that it could be appropriate to recommend this change.

6.7.3.2 *Discussion of stakeholder feedback*

Almost all responses agreed with this proposal. A number of responses made the point, though, that there are risks involved in using a foreign company's identifying number as its details, as there is a possibility that that number might happen to be the same as the ACN or other number of an Australian grantor. That would be quite a coincidence, but presumably could happen.

The solution suggested by those responses is to use only the foreign company's official name, and not its identifying number. I am comfortable with that approach.

6.7.3.3 *Recommendation*

Recommendation 109: *That item 5 of the table in clause 1.3 of Schedule 1 to the Regulations be amended to provide that the identifying details for a body corporate that is not captured by any of items 1 to 4 of the table be its name under the law under which it is incorporated.*

78 JLF, S1 page 14.

79 See s 26 of the *Companies Act 1993* (NZ).

6.7.4 Trusts

6.7.4.1 The use of ABNs for trusts

6.7.4.1.1 *The issue*

A trust is not a separate legal entity. Rather, a trust is a relationship under which one person (the trustee) holds property for the benefit of one or more other persons (the beneficiaries).

Any liabilities incurred by a trustee are incurred by it personally. If a liability is permitted by the terms of the trust, then the trustee is generally able to meet the liability out of trust property, but the liability is nonetheless incurred by the trustee itself, and not just by "the trust".

Because a trust is not a separate legal entity, the legal position of the trustee, the beneficiaries and any creditors is very different to the legal position that applies where a separate legal entity is involved, such as a company.[80] Despite this, the Regulations treat a trust as if it were a separate legal entity, by requiring in some cases that a trust (rather than the trustee) be identified on the Register as the grantor when the trustee gives security over assets that it holds on trust.

The relevant rules are set out in clauses 1.3 and 1.5 of Schedule 1 to the Regulations. Those rules are not entirely easy to track through, but the effect seems, in summary, to be this:

- If the trustee is a body corporate and has an ARSN – register against that ARSN.
- If the trustee is a body corporate without an ARSN and the trust has an ABN – register against that ABN.
- If the trustee is a body corporate without an ARSN and the trust does not have an ABN – register against the body corporate's ACN (or other details under clause 1.3 of Schedule 1 to the Regulations, as relevant).
- If the trustee is an individual – register against the individual's details under clause 1.2 of Schedule 1 to the Regulations.

The Regulations do not explain what grantor details should be used for a body politic that is trustee of the trust that does not have an ABN. This fact pattern is not likely to arise often in practice, but if it does, the solution is probably to default to the specific rules for bodies politic in clause 1.6 of Schedule 1 to the Regulations.

Trusts are also treated separately for registration purposes under the Canadian PPSAs[81] and the NZ PPSA.[82] Under those regimes, the registration is made against the trust's name, as set out in the document that establishes the trust.[83]

The fact that a financing statement needs to be registered against a trust's ABN if the trustee is a body corporate produces a number of difficulties for both registrants and searchers. For example, it produces problems for registrants in these ways:

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80 For a discussion of this in the context of commercial trusts, see N D'Angelo, *Commercial Trusts* (LexisNexis, 2014).

81 For example *Personal Property Security Regulations* (Sask), reg 11(4).

82 NZ PPS Regs, para 7(h) of Schedule 1.

83 For example NZ PPS Regs, para 6(b) of Schedule 1.

- A secured party may not be able to tell whether the grantor holds property in its own right or as trustee of a trust with an ABN. This can force the secured party to make multiple registrations, adding to cost and to the clutter on the Register.
- A grantor may initially hold collateral in its own right, but then declare that it holds the collateral on trust, and obtain an ABN for the trust.
- A grantor may initially hold collateral on trust for a trust that does not have an ABN, but later obtain an ABN for the trust.

The fact that financing statements must be registered against a trust's ABN if the trustee is a body corporate can also produce difficulties for searchers. A person who wants to determine whether a particular asset of a body corporate could be subject to a security interest needs to know whether the body corporate holds the asset as trustee of a trust with an ABN, or has done so in the past, in order to know how to undertake the searches. If a searcher is not confident of the basis on which the body corporate holds (or has in the past held) the asset, the searcher would need to undertake a search against both the ACN and every ABN of the body corporate, including any past ABNs. This imposes a significant additional burden on searchers, and additional uncertainty.

The use of ABNs for trusts with a body corporate as trustee has simplified the Register for some grantors, in particular for professional trustee companies. However, the use of ABNs does greatly complicate the registration system for everyone else. For this reason, it is worth considering whether the use of ABNs for trusts is desirable, or whether it should be discontinued. If it is discontinued, security interests over assets of a trust would then be perfected by registration against the trustee's details, whether the trustee is a body corporate or an individual.

One submission suggested along these lines that consideration should be given to removing the need to register against the trust as well as the trustee.[84]

As discussed earlier in this report, some submissions suggested that a new collateral class be added to the Register, of "allpap relating to".[85] If this collateral class were added, it would then be open to professional trustee companies to require that any registrations in relation to a particular trust be registered against that collateral class, so that the "relating to" text could be used to identify the particular trust in question. This would go some way to softening the impact of this change, if it is made.

I have decided not to recommend that the range of collateral classes be expanded to include an "allpap relating to" class. See Section 6.3 above. I have however recommended that it be possible for a registration to be made against more than one collateral class, using a common free text field (again, see Section 6.3), and it would be open to a registrant to use the free text field in such a registration in the same way – that is, by identifying in the free text field that the security interest is limited to collateral that is held by the grantor in its capacity as trustee of a particular trust.

Consultation Paper 4 invited stakeholders to comment on whether a registration to perfect a security interest over trust assets should continue to be made against the trust's ABN, if it has one.

84 ABA, S2 page 6.

85 See Section 6.3.

6.7.4.1.2 ***Discussion of stakeholder feedback***

Respondents expressed a range of views on this question. A number were of the view that the current arrangements should be continued, and that registrants and searchers should deal with the uncertainties through added due diligence. One response suggested that the use of ABNs be discontinued, but that it continue to be possible to register against a trust by using the trust's name instead.[86] One response suggested that the due diligence difficulties could perhaps be ameliorated by allowing a registration to be made against any one of a number of identifiers, and having the Register link into other government websites in a way that allowed all those identifiers to be joined on a search result.[87] For varying reasons, however, I am not satisfied that these are desirable (or viable) solutions.

One response queried what happens if a trustee reallocates property from one trust to another, and whether the fact that those trusts have different ABNs would mean that the reallocation is a "transfer" of the property for the purposes of the Act more generally.[88] That is a good example of the conceptual and practical difficulties that flow from treating trusts for some purposes as a separate legal entity, when that is not the case at general law.

Other responses queried what the position would be if the trustee of a trust changes, and whether it would then be necessary to register a financing change statement to reflect the change in the identity of the grantor.

A number of responses were in favour of dropping the use of ABNs for trusts, and requiring instead that a security interest over trust assets be perfected by a registration against the trustee. One response made the point that the concepts of an ABN and the "entity" to which an ABN relates are not well understood outside the tax and accounting professions, and in particular are not well understood by many businesses.[89] As that response noted:

> [T]he need to identify trusts and make a different kind of registration against them is a potent source of error… Hire businesses are simply not attuned to be alert for the existence of trusts and to understand the risks. The true capacity in which an entity is acting is in many cases not clear.[90]

That is my view as well. While the use of ABNs for registrations against trust assets has some attractions, in my view the advantages are clearly outweighed by the disadvantages, particularly if it is possible to identify that a security interest is over trust assets by including a statement to that effect in the free text field. Dropping the use of trust ABNs would increase the number of registrations against corporate grantors that act as trustee of trusts, particularly professional trustee companies, but that inconvenience is outweighed in my view by the far greater inconvenience that the current rules inflict on users in other contexts. It is also worth noting that this would not be a novel outcome for trustee companies, as it would reflect the situation that applied for them under the Corporations Act before the Act commenced.

86 MBA, CP4 page 8.
87 AFC, CP4 page 12.
88 ASF, CP4 page 6.
89 HRIA, CP4 page 8.
90 See the previous footnote.

I acknowledge that this is a question of some controversy. In my view, however, the rules for registrations should not rely on ABNs for trusts, and registrations to perfect a security interest over trust assets should be perfected by a registration against the identification details for the trustee, whether the trustee is an individual or a company.

6.7.4.1.3 ***Recommendation***

> **Recommendation 110:** *That the Regulations be amended so that a registration to perfect a security interest over trust assets should be made against the relevant details for the trustee, rather than the ABN or other identifying details for the trust.*

6.7.4.2 **The name of the trust**

6.7.4.2.1 ***The issue***

One submission suggested that it be made mandatory to include the name of the trust in a registration, if the registration is being made against the trustee's details.[91] The submission appeared to be suggesting that the name of the trust be included in the free text field, rather than as part of the formal identification of the grantor, although this was not clear.

This suggestion is related to the discussion in Section 6.4.3 about the extent to which it should be compulsory to complete the free text field. Consultation Paper 4 invited stakeholders to comment on it.

6.7.4.2.2 ***Discussion of stakeholder feedback***

One response argued that it should be compulsory to include the trust's name in the registration. All other responses, however, were not in favour of making this a requirement.

As one response pointed out, requiring a trust's name to be included in a registration could produce uncertain outcomes, as not all trusts have names, and a trust's name can often be changed very easily.[92] This means that it is unclear just how much benefit would flow from making this compulsory. And as I discussed in Section 6.4.3, I am not in favour of mandating specific requirements for the free text field, if the consequence of failing to comply with the requirement would be that the registration is ineffective. As I also noted in that Section, however, I agree that it is desirable to do something to curtail unnecessarily over-reaching registrations. I will return to that topic in Section 6.10.4 below.

6.7.4.2.3 ***Recommendation***

> **Recommendation 111:** *That a registration relating to assets of a trust not be required to include the name of the trust.*

91 DLA, S2 page 6.

92 AD, CP4 page 13.

6.7.4.3 A trust that has both an ARSN and an ABN

6.7.4.3.1 *The issue*

One submission drew attention to the fact that it is not entirely clear what grantor details are to be used if the grantor is a body corporate which is the responsible entity of a registered scheme that has both an ARSN and an ABN.[93]

The relevant provisions are clauses 1.3(1) and 1.5(1) of Schedule 1 to the Regulations. Clause 1.3(1) says that the table in clause 1.3 applies if the grantor is a body corporate that is a trustee and has an ARSN. Clause 1.5(1) says that the table in item 1.5 applies if the grantor is:

> (a) a body corporate that is a trustee of a trust that:
>
> (i) has an ABN; and
>
> (ii) does not have an ARSN; or
>
> (b) any other trustee of a trust.

The confusion arises because it is not entirely clear what paragraph (b) means when it refers to any "other" trustee. It is referring to any trustee "other than a body corporate that is a trustee", or to any trustee "other than a body corporate that is a trustee of a trust that has an ABN but no ARSN"? If the second interpretation is correct, then both clauses 1.3 and 1.5 would apply if the body corporate is trustee of a trust that has both an ARSN and an ABN.

Consultation Paper 4 suggested that the first interpretation is the better one, and that paragraph (b) is referring to any trustee "other than a body corporate that is a trustee". On that interpretation, paragraph (a) applies to a trustee that is a body corporate, and paragraph (b) applies to a trustee that is not. If a body corporate is a trustee but paragraph (a) does not apply, then the registration rule is found elsewhere, ie in clause 1.3 of the Schedule. Consultation Paper 4 agreed however that paragraph (b) could be amended to make this clearer.

This issue will go away, of course, if the rules are changed so that a registration cannot be made against a trust's ABN (see Section 6.7.4.1 above).

6.7.4.3.2 *Discussion of stakeholder feedback*

All responses were in favour of making this change. In my view, this would be a simple and helpful clarification of the registration rules, and should be made.

On a slightly different but related point, one respondent suggested that a registration should be able to be made against a scheme's ARSN if the security interest is granted by the scheme custodian, rather than the responsible entity.[94] The language of clause 1.4 of Schedule 1 to the Regulations currently does not contemplate this. I have not been able to form a view on this proposal in the time available, but agree that it should be looked into.

93 JLF, S1 page 16.

94 ABA, CP4 page 12.

6.7.4.3.3 ***Recommendations***

Recommendation 112: *If the Regulations continue to require that registrations be made against a trust's ABN, that clause 1.5(1)(b) of Schedule 1 to the Regulations be amended to make it clear that it applies "to any trustee of a trust that is not a body corporate".*

Recommendation 113: *That Government consider whether a registration should be able to be made against a scheme's ARSN if the security interest is granted by the scheme custodian, rather than the responsible entity.*

6.7.5 Partnerships

6.7.5.1 The distinction between a partnership, and the partners in a partnership

6.7.5.1.1 ***The issue***

Similar to a trust, a partnership is also not a separate legal entity, and the assets and liabilities of a partnership are assets and liabilities of the individual partners. Despite this, a partnership is treated by partnership law as being distinct in some respects from the individual partners. In particular, while the partners collectively own the partnership assets, an individual partner's share in the partnership does not give it title to specific property, but rather a right to a proportion of the net assets of the partnership after partnership assets have been realised and all partnership liabilities have been met.[95] This distinction is also encountered frequently in financing transactions, in that the members of a partnership will often jointly grant security over the partnership assets, while at the same time each partner will separately grant security over its (individually held) net interest in the partnership.

The rules for registering a financing statement in relation to a partnership are set out in clause 1.4 of Schedule 1 to the Regulations. The rules are somewhat convoluted, and while they recognise the distinction between the assets of a partnership and a partner's net interest in the partnership, the distinction could be dealt with more clearly.

One submission argued that the rules for registering against partnerships and partners should allow a single registration to be made against both the partnership (for the partnership assets) and the partners (for their respective net interests in the partnership) at the same time.[96] Consultation Paper 4 suggested however that it was preferable to keep those registrations separate.

6.7.5.1.2 ***Discussion of stakeholder feedback***

All responses agreed that it was appropriate to maintain the distinction for registration purposes between a security interest given by a partnership over partnership assets, and a security interest given by a partner over his or her net interest in the partnership.

95 See for example *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd* (1974) 131 CLR 321, at page 327.

96 AFC, S1 att B page 18.

In my view, this is an important distinction, and I agree that it should be maintained. The language of clause 1.4 of Schedule 1 to the Regulations should be recast to draw this distinction more clearly.

6.7.5.1.3 ***Recommendation***

> **Recommendation 114:** *That the current distinction drawn in clause 1.4 of Schedule 1 to the Regulations, between the assets of a partnership and a partner's net interest in the partnership, be maintained and clarified.*

6.7.5.2 **Partnerships that do not have an ABN**

6.7.5.2.1 ***The issue***

Leaving migrated security interests to one side, clause 1.4 of Schedule 1 to the Regulations provides that a financing statement in relation to a security interest granted by a partnership that has been allocated an ABN must be registered against the ABN.

If the partnership has not been allocated an ABN, then the item appears to assume that the partners are all natural persons, and requires the registration to be made against the details for the partners, as individuals, that are set out in clause 1.2 of the Schedule. While the partners in a partnership will usually be individuals, though, this will not always be the case, even for partnerships that have not been allocated an ABN. In my view, clause 1.4 of Schedule 1 should be amended to accommodate the prospect that the partners could be any of:

- an individual;
- a body corporate;
- a body corporate acting as trustee of a trust with an ABN;
- a body politic; or
- another partnership.

Clause 1.4 could achieve this by simply saying that it applies if the grantor is a partnership, and then providing that the registration as against the partnership should be against the partnership's ABN if it has been allocated one, or otherwise against the relevant details of each partner.

The fact that clause 1.4 relies on a partnership's ABN raises some of the same issues as for trusts, as discussed in Section 6.7.4. Here, however, the main risk is that the partnership could acquire an ABN after a financing statement has been registered against the separate partners. I am not aware of any good solutions for this problem, and it may be that a secured party will need to deal with this risk by monitoring its grantor.

One submission suggested that a registration should be made against a partnership's name (and not against the details of the individual partners) if the partnership has not been allocated an ABN.[97] It may be very unlikely for a partnership based in Australia not to have been allocated an ABN. I expect, however, that it would be possible for a partnership based overseas to have assets in Australia but not to have been allocated an ABN, and it may not be

97 JLF, S1 page 17.

practicable in such a case for the registration to be made against the names of all the partners. It would however be undesirable to prescribe different identification conventions for different types of partnerships that have not been allocated an ABN, based on criteria such as the size of the partnership or where it is based. It is also not entirely desirable to use a partnership's name for registration purposes where that name cannot be sourced from a public register, particularly because the unforgiving nature of our exact-match search system leaves no room for variations in spelling.

Consultation Paper 4 invited stakeholders to comment on this.

6.7.5.2.2 ***Discussion of stakeholder feedback***

Respondents had mixed views on this question. A number were of the view that the registration should continue to be made against the individual partners, if the partnership does not have an ABN. The majority were of the view, however, that it should be possible to register against the partnership's name instead.

One response noted that the Canadian rules require that the registration be made against:

- the partnership's registered name, if it has one;
- if the partnership has no registered name, both the name of the partnership and the name of one of the partners; or
- if the partnership has no name, the names of all the partners.[98]

One other response made a similar suggestion.[99] In my view, this approach is a sensible solution for the issue.

6.7.5.2.3 ***Recommendation***

> **Recommendation 115:** *That the Regulations be amended to provide that a registration to perfect a security interest over assets of a partnership be made against the following grantor details;*
>
> - *the partnership's ABN, if it has one;*
> - *failing that, the partnership's registered name in its place of establishment;*
> - *if the partnership has no registered name in its place of establishment, the name of the partnership and the name of at least one of the partners; and*
> - *if the partnership has no name, the names of all partners.*

6.7.6 Multiple grantors

6.7.6.1 ***The issue***

One submission noted that it is not clear when it is appropriate to include more than one person or entity in a registration as the grantor.[100]

98 AD, CP4 page 14.
99 JLF, CP4 page 9.
100 JLF, S1 page 7.

It seems clear that it is appropriate to include multiple persons or entities as grantor in a registration if they are joint owners of the collateral and are jointly giving the security. It is less clear that this is appropriate if each person or entity is giving separate security to the secured party, even if this is being done as part of the same transaction. In this situation, it might be thought to be seriously misleading to use a single registration, a single registration might suggest that the security interest in question was only over jointly-held property.

Consultation Paper 4 invited stakeholders to comment on this.

6.7.6.2 ***Discussion of stakeholder feedback***

The great majority of respondents agreed that a registration that referred to more than one grantor should only perfect a security interest granted by them jointly. A small number of respondents took the opposite view, however, and a number of respondents indicated that they did not think that any change was required, without indicating which view they agreed with.

In my view, a registration that identifies more than one grantor should only be able to perfect a security interest that is granted by them jointly. I also think that it would help to remove an uncertainty from the operation of the registration rules, if this were clarified.

6.7.6.3 ***Recommendation***

Recommendation 116: *That it be made clear that a registration against multiple grantors is only effective to perfect a security interest that is granted by them jointly.*

6.7.7 Foreign names, and exact vs close match searching

6.7.7.1 ***The issue***

The Register operates only in the English language. It only accepts letters in the English alphabet (as well as numbers and a range of punctuation marks), and does not accept foreign characters, or even foreign versions of English letters (such as vowels with umlauts or accents, or consonants with tildes).

It is possible however that the rules for identifying a grantor will require that foreign characters be used. As an example, if an individual grantor does not have Australian identification documents, the rules in clause 1.2 of Schedule 1 to the Regulations may require that the grantor's details be sourced from a non-Australian passport, and that passport may record the grantor's name using characters that are not part of the English alphabet. The same issue can arise for a foreign body corporate that is not registered in Australia, as the rules in clause 1.3 of Schedule 1 to the Regulations will require that its name be entered in the form in which it is recorded in its constitution or equivalent document. The issue will also affect foreign partnerships, if my recommendation in Section 6.7.5.2 is adopted.

This presents registrants with a dilemma, as it means that it may simply not be possible to make an effective registration in these circumstances.

A similar issue can arise where the secured party itself is a foreign entity, as the Regulations apply largely the same rules for the identification of a secured party as they apply for the identification of the corresponding type of grantor.[101]

One solution could be to provide that a grantor's or secured party's details in such a situation can be entered as any reasonable transliteration of the foreign name. That could add to the burden for a searcher against a foreign grantor, but would at least make it possible for a registrant to register a valid financing statement in the first place.

If it were thought that this placed too great a burden on searchers, consideration could be given to making the search functionality on the Register more flexible. Currently, the Register uses an "exact match" search system, under which a search only produces a positive result if the searcher uses the same details in its search as the details that are entered on the Register. It might be easier for a searcher against a grantor with a foreign name to locate the relevant registrations if the search engine used a "close match" system instead – one that returned search results against both exactly the details entered in the search, and similar results as well.

All Canadian PPSA jurisdictions other than Ontario use a close-match system for their searches.[102] Ontario, in contrast, uses an exact-match system. The explanation that has been given for this is that Ontario has significantly larger economy than the other Canadian provinces, so that a close-match search system would produce too many search results.[103] That thinking might suggest that the current exact-match system is more appropriate for Australia as well.

New Zealand also uses an exact-match system, but overlays it with a "wild-card" search option. This option allows a searcher to widen a name search by replacing the third and subsequent letters of any of the name fields (first, middle or last name) with an asterisk (eg "Do* Dinosaur"). The search results will then include all debtors whose name in that field starts with those two letters, and whose name exactly matches the full words entered in the other name fields (eg Dorothy Dinosaur, Donald Dinosaur or Domingo Dinosaur).[104]

The rules that have been developed for identifying a grantor in a registration under the Act have reduced the need for the more flexible close-match searching, because they rely on official registration numbers (such as ACNs or ARBNs) for most corporate grantors, and a formal identification source (particularly a driver's licence) for most individual grantors. I do not believe that the residual circumstances that might benefit from close-match searching are sufficiently important to make it appropriate to change the entire search methodology from the current exact-match searching system.

I also do not think that the New Zealand wild-card option is the answer to the difficulty with foreign names. That option would help if the uncertainty in a transliteration was limited to one word and did not affect that word's first two letters, but would not help in other circumstances.

101 Except that the details do not need to include an individual secured party's date of birth – clause 1.2(4) of Schedule 1 to the Regulations.

102 See Cuming Walsh & Wood, page 365.

103 Duggan & Brown, para 6.32.

104 I am indebted to Gedye Cuming & Wood, para 150.8, for this explanation of the New Zealand "wild-card" search option. The examples, however, are mine.

For these reasons, Consultation Paper 4 proposed that we retain exact-match searching, that a registrant should be able to transliterate foreign names, and that searchers should be left to undertake searches against each possible transliteration of a foreign name, in the relatively limited circumstances where this might be necessary.

6.7.7.2 ***Discussion of stakeholder feedback***

All respondents agreed with this solution.

In my view, this approach makes it possible for a secured party to make valid registrations against foreign entities in a way that is not clearly possible at present, and does so in a way that does not unfairly compromise the position of other users of the Register.

6.7.7.3 ***Recommendations***

Recommendation 117: *That the Register continue to use an exact-match methodology for searches.*

Recommendation 118: *That the Regulations be amended to provide, in circumstances where a grantor's or secured party's name or other identification details would otherwise need to be entered on the Register in letters that are not accepted by the Register, that the registrant be able instead to use any reasonable transliteration of that name or other identifying details for the purposes of the registration.*

6.8 Secured party details

6.8.1 The definition of "secured party"

6.8.1.1 ***The issue***

The Act defines the term "secured party" in s 10, in this way:

> ***secured party:***
>
> (a) means a person who holds a security interest for the person's own benefit or for the benefit of another person (or both); and
>
> (b) if the holders of the obligations issued, guaranteed or provided for under a security agreement are represented by a trustee as the holder of the security interestincludes the trustee; and
>
> (c) in relation to a registration with respect to a security interestincludes a person registered as a secured party in the registration.

Paragraphs (a) and (b) of the definition reflect the definition of "secured party" in the Canadian PPSAs[105] and the NZ PPSA.[106] It is however difficult to see what paragraph (b) adds to paragraph (a), as the trustee referred to in paragraph (b) would seem clearly to be holding the security interest either for itself or for the benefit of others, as described in paragraph (a).

105 For example Sask PPSA, s 2(1)(nn).

106 NZ PPSA, s 16.

For this reason, Consultation Paper 4 suggested that the definition could be simplified without adverse effect by deleting paragraph (b).

6.8.1.2 ***Discussion of stakeholder feedback***

One response suggested that paragraph (b) should not be deleted, for consistency with other jurisdictions. All other responses, however, were in favour of paragraph (b) being removed.

Paragraph (b) of the definition of "secured party" in s 10 adds nothing to paragraph (a), and its presence forces users of the Act to ask themselves unnecessary questions. In my view, it can and should be deleted.

6.8.1.3 ***Recommendation***

> **Recommendation 119:** *That paragraph (b) of the definition "secured party" in s 10 be deleted.*

6.8.2 Nominees

6.8.2.1 ***The issue***

Item 1(b) of the table in s 153(1) of the Act contemplates that a secured party can arrange for another person to be entered on the Register as the secured party, in its stead. It states that the financing statement needs to include the prescribed details of either:

(a) the secured party; or

(b) a person nominated by the secured party who has authority to act on behalf of the secured party.

Consultation Paper 4 suggested that there are two aspects of this that are worthy of discussion. First, it can be argued that this flexibility should be limited to secured parties who "nominate" the registered secured party before the registration is made. Otherwise, a new secured party could artificially improve its security position by nominating an already-registered secured party, rather than making its own (later) registration. Secondly, it is not clear what is encompassed by the requirement that the nominated person "[have] authority to act on behalf of the secured party". Common sense suggests that the nominated person should only need to have the secured party's authority to act on its behalf in relation to matters affecting the registration, but that is not clear.

Consultation Paper 4 suggested that it would make this aspect of the Act more comprehensible if item 1(b) of the table in s 153(1) were amended to clarify these matters, for example so that it reads as follows:

(b) a person nominated by the secured party before the financing statement is registered, who has authority to act on behalf of the secured party in matters relating to the registration.

6.8.2.2 ***Discussion of stakeholder feedback***

One response was not in favour of providing that a secured party can only "nominate" a registered secured party before the registration is made, rather than later.[107] All other responses, however, were in favour of the proposed reworking of item 1(b) of the table in s 153(1).

In my view, this is a sensible proposal. It will also help to clarify the circumstances in which one secured party can rely on another person's registration to perfect their security interest.

6.8.2.3 ***Recommendation***

> **Recommendation 120:** *That item 1(b) of the table in s 153(1) be amended to read:*
>
> *"(b) a person, nominated by the secured party before the financing statement is registered, who has authority to act on behalf of the secured party in matters relating to the registration."*

6.8.3 Multiple secured parties

6.8.3.1 ***The issue***

One submission suggested that it be made easier to include multiple secured parties in a registration.[108]

A registrant who wants to register a financing statement in favour of a secured party must create a "Secured Party Group" on the Register for the secured party, if the secured party does not already have one. A Secured Party Group can contain more than one secured party, so in that sense the Register already allows a registrant to include multiple secured parties in the one registration.

However, the register does not allow secured parties to be added to or removed from a Secured Party Group once it has been established. If the secured parties under the relevant security interest change, then a new Secured Party Group needs to be created, and the registration needs to be transferred to that new Secured Party Group.

The submission did not explain how the process for including multiple secured parties in a registration should be simplified. The concern may have been the fact that the identity of secured parties in a Secured Party Group cannot be changed. Given the relative simplicity of the process involved in creating a new Secured Party Group and transferring the registration, though, it is not immediately clear that the current process needs to be altered.

Consultation Paper 4 invited stakeholders to comment.

6.8.3.2 ***Discussion of stakeholder feedback***

A small number of responses argued that it should be possible to change the identity of members of a Secured Party Group. The great majority of responses, however, did not believe that this functionality was needed. One response also

107 JLF, CP4 page 11.

108 JLF, S1 page 6.

pointed out that a change in the identity of the secured parties for a security interest would not render a registration for that security interest seriously misleading, and that the principal issue for secured parties in relation to their details on the Register is to ensure that the contact details remain current.[109] That suggests that this concern is not a material one.

I can see that the operation of the Register would be more consistent with the Act itself, if it were possible to amend the membership of a Secured Party Group. I also agree, however, that this is not a pressing issue, and if the construct of the Register makes it problematic to permit changes to the membership of a Secured Party Group, then the position should be left unchanged.

6.8.3.3 ***Recommendation***

> **Recommendation 121:** *That the Registrar be asked to explore whether the "Secured Party Group" functionality on the Register could be altered to allow the identity of secured parties in a Secured Party Group to be changed, but that this not be pursued if there are material impediments to doing so.*

6.8.4 GONIs

6.8.4.1 ***The issue***

Item 3(b) of the table in s 153(1) of the Act contemplates that a registration can include an identifier for the giving of notices to the secured party. This "giving of notices identifier" is referred to on the Register, perhaps unsurprisingly, as the "GONI".

A number of submissions suggested that a more intuitive or user-friendly term be used, in order to make its purpose clearer, particularly for the benefit of occasional users of the Register.[110]

Consultation Paper 4 invited stakeholders to comment on this suggestion, and to propose alternative language.

6.8.4.2 ***Discussion of stakeholder feedback***

All responses were in favour of replacing "GONI" with a more user-friendly term. Suggestions included: "secured party identifier", "reference number", "secured party account number", and "SPG file/matter ref".

My preference is something of an amalgam of a number of these suggestions: "secured party internal reference number" (even though the inevitable acronym will become the slightly negative-sounding "SPIRN"). I am not particularly wedded to this suggestion, however, and would be comfortable with any alternative that made its purpose clear to users of the Register.

6.8.4.3 ***Recommendation***

> **Recommendation 122:** *That the expression "GONI" on the Register be replaced with a term that more clearly indicates its purpose, such as: "secured party's internal reference number".*

109 AD, CP4 page 15.

110 For example: AFC, S1 att B page 16; DIFA, S1 att B page 4.

6.9 The registration period

6.9.1 *The issue*

Clutter on the Register

A consistent theme through many of the submissions was that the Register is too cluttered, in that it is difficult to make sense of search results for a grantor because those search results contain information about so many registrations.

I am advised by AFSA that the Register contained a total of 8,417,283 current registrations as at 31 December 2014. Of those registrations, 1,313,629 had been migrated from earlier registers with no end time, and 688,356 had been migrated with an end time of 7 years. Of the other registrations (ie registrations made by secured parties), 4,866,063 have an end time of 7 years or less, 473,018 have an end time of between 7 and 25 years, and 979,029 have no end time. The number of non-migrated registrations with no end time was virtually the same as at the end of the previous quarter (972,213).

According to AFSA, the volume of registrations (including transitional registrations) as against grantors as at 31 December 2014 can be broken down in this way:

Number of registrations	Number of grantors
1,000 or more	12
500 to 999	15
100 to 499	143
50 to 99	388
10 to 49	21,324
Less than 10	723,325

This data suggests that the worst of the "clutter" concern is limited to a relatively small number of grantors.

Should the maximum registration period be shortened, to help reduce the clutter?

Item 5 of the table in s 153(1) of the Act states that a registration against collateral that is neither consumer property nor serial-numbered property can have a duration of either a specified period of up to 25 years, or of an indefinite period. This is consistent with the approach taken in the Canadian PPSAs.[111] In contrast, the NZ PPSA imposes a maximum registration period, for all registrations, of 5 years (with an ability to extend the registration, for a further period of up to 5 years, before the current registration expires).[112]

One submission suggested that one solution to the clutter problem might be to amend the end-time rules to limit the registration period for all registrations to 7 years, along the same lines as in New Zealand (except that the maximum period

111 For example *Personal Property Security Regulations* (Sask), reg 4(2).

112 NZ PPSA, s 153.

in New Zealand is only 5 years, rather than 7).[113] A secured party would then need to renew its registration before the end of the 7-year period, if it wanted its registration to continue to be effective beyond that date.

This would not have an immediate impact on the volume of registrations on the Register, although it would help to manage down the number of current registrations over time. It may also not help to remove the backlog of current "no end time" registrations, including in particular those registrations that were migrated on to the Register from the ASIC charges register.

Imposing a limitation of 7 years would add to the administrative burden for secured parties that have long-term relationships with their grantors, such as manufacturers or distributors that sell goods on retention-of-title terms to long-standing customers. I have been advised by practitioners in New Zealand, however, that this has not been a significant issue in that jurisdiction, particularly as the New Zealand register sends a reminder email to secured parties in advance, to alert them to the fact that their registration is about to expire.

Consultation Paper 4 invited stakeholders to comment on the suggestion that the registration period for all registrations be capped at 7 years.

6.9.2 *Discussion of stakeholder feedback*

A relatively small number of responses were in favour of capping the registration period for all registrations at 7 years. The great majority of responses, however, were not. Respondents argued that secured parties often have long-term secured relationships with grantors, and that it would be unfair to require those secured parties to re-register part way through the term of that relationship. Responses pointed out that this would be an issue not just for banks, but also for commercial parties such as suppliers of goods on retention of title terms. A number of responses also made the point that the most effective way to reduce clutter on the Register may be to allow a registration to be made against more than one collateral class – a change that I have already recommended, in Section 6.3.

I can see that there are some attractions to setting a maximum registration period for all registrations. I accept, however, that this would impose additional burdens on secured parties, and that the objective of the proposed change, which is to reduce clutter on the Register, will be achieved (at least in part) through other changes that I have recommended in this report. It is also apparent that there is no clear case for change. For those reasons, I do not propose to recommend that the Act be amended to impose a maximum registration period for all registrations of 7 years.

6.9.3 *Recommendation*

Recommendation 123: *That the Act not be amended to impose a maximum registration period of 7 years for all registrations.*

113 AFC, S1 att B page 17.

6.10 Effective and ineffective registrations

6.10.1 What are the consequences if a financing statement does not comply with the table in s 153(1)?

6.10.1.1 *The issue*

Section 21 provides that a security interest in particular collateral is perfected if, among other options, a "registration" is "effective" with respect to the collateral. A number of definitions and other sections are relevant to determining whether a registration is effective with respect to collateral.

A "registration" is defined in s 10 to be a "registered financing statement". A "financing statement" is defined in s 10 to be data that is registered pursuant to an application under s 150(1). Section 150(1) then provides (somewhat circularly) that a person may apply to the Registrar to register a financing statement with respect to a security interest.

Section 153(1) states that a financing statement with respect to a security interest consists of data that "complies with" the table set out in that section.

Section 164(1) then provides that a registration with respect to a security interest that describes particular collateral will only be ineffective because of a defect in the Register if there exists:

(a) a seriously misleading defect in any data relating to the registration, other than a defect of a kind prescribed by the regulations; or

(b) a defect mentioned in section 165.

Section 165 says that a registration is defective if, broadly:

- it is required to identify the collateral by serial number, but does not contain the correct serial number;
- in other cases, it does not correctly identify the grantor;
- it indicates that a security interest is a PMSI, but the security interest is not a PMSI to any extent; or
- because of other matters prescribed by the Regulations.[114]

As just noted, s 153(1) suggests that data on the Register will only constitute a "financing statement with respect to a security interest" if the data complies with the table set out in the section. One submission pointed out that this could have the result that a registration is not effective, whether or not it is "seriously misleading" or otherwise engages s 165, if the data does not strictly comply with the requirements in the table.[115] That could be the case, for example, if the details of the secured party are incorrect.

By way of contrast, the corresponding provision in the NZ PPSA merely states that the specified data "must be contained in the financing statement in order to register it".[116]

I do not expect the intention to have been that any error in the data in a registration would stop it from being a financing statement for the purposes of the Act.

114 Currently, no other matters are prescribed.

115 JLF, S1 page 6.

116 NZ PPSA, s 142(1).

I think it would be helpful, however, to clarify that a set of data that is entered in the Register will be a financing statement for the purposes of the Act if the data populates the fields required by the table. Whether the data as so entered gives rise to an "effective" financing statement would then be determined by ss 164 and 165.

Consultation Paper 4 proposed that s 153(1) be amended to clarify this.

6.10.1.2 ***Discussion of stakeholder feedback***

All respondents were of the view that it was appropriate to amend the Act to clarify this point. I am also of the view that it will help to clarify the operation of the Act if this change is made.

6.10.1.3 ***Recommendation***

Recommendation 124: *That s 153(1) be amended to clarify that data entered on the Register will be a financing statement if the data populates the fields referred to in the table in that section, whether or not the data as so entered is accurate.*

6.10.2 When will a financing statement be ineffective?

6.10.2.1 ***The issue***

A number of submissions observed that there is overlap between paragraphs (a) and (b) in s 164(1).[117] By itself, this might not be problematic. However, s 166 provides some qualifications to the operation of s 164(1)(b) but not to s 164(1)(a), so the outcome is unclear if a defect is covered by both ss 164(1)(a) and (b) and a qualification applies. Would the registration be ineffective because it is captured by s 164(1)(a), even though it is sheltered from s 164(1)(b) by the operation of s 166?

Consultation Paper 4 suggested that this was not the intention, but that it should be clarified – for example, by reversing the order of paragraphs (a) and (b), and rewording current paragraph (a), so that s 164(1) read along these lines:

> A registration with respect to a security interest that describes particular collateral is ineffective because of a defect in the register if, and only if, there exists:
>
> (a) a defect mentioned in section 165; or
>
> (b) any other defect in any data relating to the registration, other than a defect of a kind prescribed by the regulations, if the defect is seriously misleading.

The cross-reference in s 165 would of course then need to be updated as well.

6.10.2.2 ***Discussion of stakeholder feedback***

All responses agreed with this proposal.

Section 337A

One response suggested in this context that s 337A should be repealed.[118] That section provides in effect that a registration that indicates that it perfects a security interest under a transitional security agreement will not perfect a security

117 For example: LCA, S2 page 17.

118 HRIA, CP4 page 11.

interest under a different (ie non-transitional) security agreement. The respondent was concerned that uncertainty about what is or is not a transitional security agreement may have caused some businesses wrongly to rely on a "transitional" registration to perfect non-transitional security interests. The respondent suggested that s 337A be repealed in order to allow a "transitional" registration to perfect non-transitional security interests as well.

It is not clear to me that deleting s 337A would necessarily achieve that outcome. More substantively, though, I am not satisfied that it would be desirable. If the Act were amended so that a transitional registration could perfect a non-transitional security interest, then this could adversely affect the priority position of subsequent secured parties who may have taken their security interest in reliance on the fact that the transitional registration perfected only transitional security interests. That could result in a significant reallocation of priority positions, and in my view would not be appropriate.

6.10.2.3 ***Recommendation***

Recommendation 125: *That ss 164(1)(a) and (b) be amended to read:*

"(a) a defect mentioned in section 165; or

(b) any other defect in any data relating to the registration, other than a defect of a kind prescribed by the regulations, if the defect is seriously misleading."

6.10.3 What is "seriously misleading"?

6.10.3.1 Section 164(1)(a)

6.10.3.1.1 *The issue*

The Act does not provide any guidance on when a financing statement will be "seriously misleading" for the purposes of s 164(1)(a). The Canadian PPSAs[119] and the NZ PPSA[120] also provide that a financing statement is ineffective if it is seriously misleading, but similarly do not define the term.

Case law in Canada has held that a defect in a financing statement with respect to a security interest or collateral will make the financing statement seriously misleading if the effect of the defect is that a searcher cannot find the financing statement, or the financing statement does not include the collateral in its collateral description.[121] An Australian court has come to a similar view.[122]

A number of submissions recommended that the Act clarify what it means for a financing statement to be seriously misleading.[123] In particular, submissions were concerned to ensure that a financing statement would not be seriously misleading just because it did not identify the secured party correctly (for example, because

119 For example Sask PPSA, s 43(6).

120 NZ PPSA, s 149.

121 See Cuming Walsh & Wood, pages 363 to 371.

122 *Future Revelation Ltd v Medica Radiology & Nuclear Medicine Pty Ltd* [2013] NSWSC 1741.

123 For example: DIFA, S1 att B page 6; LCA, S1 page 8.

the original secured party had transferred the security interest),[124] or because it did not identify that it perfects a security interest that is a PMSI.[125]

Consultation Paper 4 expressed the view that a defect in a financing statement with respect to a security interest over collateral should only make the financing statement "seriously misleading" if either:

- the effect of the defect is that a properly-formatted search would not disclose the registration; or
- the manner in which the financing statement describes the collateral would cause a searcher to form the view that the registration did not cover the item of collateral in question.

Consultation Paper 4 then invited stakeholders to comment.

6.10.3.1.2 ***Discussion of stakeholder feedback***

The great majority of respondents agreed with the suggested meaning of "seriously misleading" set out above. The great majority also was of the view, however, that this should not be set out in stone in the Act, but rather that the detail of what can be "seriously misleading" should be left to the courts. I am comfortable with that approach.

6.10.3.1.3 ***Recommendation***

Recommendation 126: *That the Act not be amended to include a definition of "seriously misleading".*

6.10.3.2 **Section 165(c)**

6.10.3.2.1 ***The issue***

Section 165(c) provides that a registration is taken to be defective if it indicates that the security interest is a PMSI, but the security insert is in fact not a PMSI to any extent. Two submissions suggested that s 165(c) should be repealed.[126]

6.10.3.2.2 ***Discussion***

I am recommending separately that the "PMSI box" be deleted from the Register – see Section 7.7.8.11 below. Section 165(c) will become irrelevant if that change is made. Even if that change is not made, though, I agree that s 165(c) is draconian and unnecessary, and should be deleted.

6.10.3.2.3 ***Recommendation***

Recommendation 127: *That s 165(c) be deleted.*

124 For example: JLF, S1 page 19; AICM, S1 page 19; LCA, S1 page 8; QLS, S1 page 8; CW, S1 page 5.

125 For example: AFC, S1 att B page 19; LCA, S1 page 8.

126 CW, S1 page 6; AICM, S2 page 30.

6.10.4 Inappropriate or over-reaching registrations

6.10.4.1 Introduction

A person is able as a practical matter to register a financing statement against another person without the other person's consent or even knowledge. However, a person will not want the Register to contain unnecessary or overly-broad registrations against their name or other details, as this could lead others into believing that the person's property was more heavily encumbered than was in fact the case.

The Act responds to this concern in a number of ways:

- First, the Act limits the circumstances in which a person is entitled to make a registration.
- Secondly, it contains rules that require a registrant to remove a registration if the transaction to which it was expected to apply does not eventuate.
- Thirdly, it requires a secured party to remove a registration with respect to certain types of collateral if the security interest "becomes unperfected".
- Finally, the Act contains mechanisms that enable a grantor in some circumstances to challenge a registration, and to require that a registration be removed or narrowed.

6.10.4.2 When should a person be entitled to register a financing statement?

6.10.4.2.1 *The issues*

Even though any person is able as a practical matter to make a registration against any other person, s 151(1) limits the circumstances in which it is proper for them to do so. That section provides as follows:

> (1) A person must not apply to register a financing statement, or a financing change statement, that describes collateral, unless the person believes on reasonable grounds that the person described in the statement as the secured party is, or will become, a secured party in relation to the collateral (otherwise than by virtue of the registration itself).
>
> Civil penalty:
>
> (a) for an individual—50 penalty units;
>
> (b) for a body corporate—250 penalty units.
>
> Note: See Part 6.3 (Civil penalty proceedings).
>
> Example 1: A person applies to register a financing statement that describes collateral as "all present and after-acquired property" of the grantor described in the statement. It is sufficient to comply with this subsection if the applicant believes on reasonable grounds that the secured party described in the statement will take a security interest in a particular class of items of personal property held (or later acquired) by the grantor (see paragraph (b) of the definition of ***description*** in section 10).

Example 2: A person applies to register a financing statement that describes collateral as "fruit". It is sufficient to comply with this subsection if the applicant believes on reasonable grounds that the secured party described in the statement will take a security interest in apples (see paragraph (b) of the definition of ***description*** in section 10).

As can be seen from the quoted text, a breach of s 151(1) carries a civil penalty of 50 penalty units for an individual, and 250 penalty units for body corporate.

There is no equivalent to s 151(1) in any of the Canadian PPSAs or the NZ PPSA.

Should we repeal s 151(1)?

A number of submissions argued that s 151(1) should be repealed.[127] They said that there is no need for it, and that it erodes the value of a secured party's ability to make an advance registration.

I am not convinced that there is no need for the section. While it has been suggested that the experience in Canada and New Zealand is that the risk of frivolous or vexatious registrations is low,[128] there have been a number of Canadian cases in which a person made an unnecessary registration against another party as a means of applying commercial pressure.[129] I have also been advised informally that vexatious registrations are not unknown in New Zealand.

It is also instructive to note that vexatious filings seem to be an unfortunate fact of life in the United States. There, it appears that it is not at all uncommon for a person to register a financing statement against another person for reasons that are entirely unrelated to a financing transaction.[130] Article 9 responds to these so-called "bogus" or "harassment" filings by allowing the debtor (ie grantor) to file an information statement that states that the financing statement should not have been filed, or is overly broad. That information statement becomes part of the financing statement (and so would presumably be revealed by a search), but does not alter the legal effect of the financing statement as filed.[131]

There have also already been a number of reported decisions under the Act in relation to what appear to have been groundless filings,[132] and I am aware of some anecdotal evidence that suggests that these are not isolated examples.

A further reason for retaining 151(1) is that it may also be able to be employed as a tool to deal with concerns that were expressed in submissions regarding the making of overly-broad registrations. See Section 6.10.4.4 below.

For these reasons, Consultation Paper 4 expressed the initial view that s 151(1) should be retained.

127 For example: LCA, S1 page 7; DT, S2 page 11.

128 See Duggan & Brown, para 6.42.

129 See *Myers v Blackman* 2014 ONSC 5226, and *MBNA Canada Bank v Luciani* 2011 ONSC 6347.

130 It appears in particular to have become a tool to harass or intimidate public officials, and corporations – see *State Strategies to Subvert Fraudulent Uniform Commercial Code (UCC) Filings*, available at www.nass.org/news-releases-and-statements.

131 Article 9, §9-518.

132 *Sandhurst Golf Estates Pty Ltd v Coppersmith Pty Ltd* [2014] VSC 217, and *Macquarie Leasing Pty Ltd v DEQMO Pty Ltd* [2014] NSWSC 1466.

Should a registration require the grantor's consent?

As a potential alternative to s 151(1), one submission suggested that a registrant should only be allowed to register a financing statement against a grantor if it has the grantor's consent to do so.[133]

The grantor's consent is not required for a registration under the Canadian PPSAs or the NZ PPSA. The grantor's consent is required for a registration under Article 9, but that consent is deemed to have been given if the grantor enters into the relevant security agreement.[134]

This proposal would have advantages and disadvantages. An advantage is that it would greatly reduce the prospect of a vexatious or inappropriate registration against a grantor. It would also eliminate the need for s 151(1). A disadvantage is that it could add to the administrative burden for secured parties that want to register a financing statement in advance of entering into a security agreement with the grantor.

Consultation Paper 4 invited stakeholders to submit their views on these questions.

6.10.4.2.2 ***Discussion of stakeholder feedback***

A number of responses argued that s 151(1) should be repealed, principally on the basis that it is inconsistent with the notion of advance filing. Doubts were also expressed at the extent to which it could in fact be effective to limit bogus or harassment filings. The great majority of responses, however, were in favour of retaining the section. A similarly strong majority was against amending the Act to require a secured party to obtain its grantor's consent before being allowed to register a financing statement.

I agree that s 151(1) can have a role to play. It also seems that there is no clear case for deleting it, or for requiring a secured party to obtain a grantor's consent before registering.

6.10.4.2.3 ***Recommendation***

> **Recommendation 128:** *That s 151(1) be retained, and that the Act not be amended to require a registrant to obtain a person's consent before registering a financing statement against the person or their property.*

6.10.4.3 **How certain must it be that there is or will be a security interest, before a person may register a financing statement?**

6.10.4.3.1 ***The issue***

Section 151(1) states that a person should only make a registration if they believe on reasonable grounds that the nominated secured party "is" or "will be" a secured party in relation to the described collateral – that is, that the nominated secured party holds or will hold a security interest over the collateral.

133 CCF, S1 page 5.

134 Article 9, §9-509.

This language merges two distinct questions:

- whether the nominated secured party will enter into a transaction with the grantor; and
- whether that transaction, if entered into, will give rise to a security interest.

I have discussed the breadth of the concept of a "security interest" earlier in this report.[135] It can be seen from that discussion that it will sometimes be unclear whether a particular transaction gives rise to a security interest for the purposes of the Act. Because of the adverse consequences that can flow for a secured party if it has a security interest but has not perfected it, a secured party will want to be able to register a financing statement in relation to a transaction if that transaction **might** give rise to a security interest, even if it is not certain that it does so.

It is not clear that s 151(1) currently permits this, as s 151(1) requires that the registrant reasonably consider that the nominated secured party "is" or "will be" a secured party – that is, that it has or will have a security interest over the collateral, not just that it "may have".

My anecdotal understanding is that secured parties generally take the view, in choosing between the prospect of being unperfected and the prospect of breaching s 151(1), that they regard s 151(1) as the lesser of two evils – that is, that secured parties are registering their financing statements, and hoping that s 151(1) does not apply. To my mind, though, this is not particularly satisfactory, and a secured party should be entitled to register a financing statement in circumstances where a transaction might give rise to a security interest, even if it is not clear that it does so, without being at risk of breaching s 151.

Some submissions argued that s 151(1) undermines the fact that the Act permits advance registrations, as the section only allows a person to register a financing statement if they reasonably consider that the nominated secured party **will** enter into a transaction.[136] If this is seen to be too restrictive, an alternative might be to provide that a person can register the financing statement if they reasonably consider that the nominated secured party "may" enter into the transaction. The registrant would then be under an obligation to remove the registration (under ss 151(2) and (3)) if the transaction did not eventuate. (See Section 6.10.4.5 below.)

Consultation Paper 4 agreed that the current formulation of s 151(1) is too restrictive, and suggested (if it is retained) that it be amended to provide that a person may register a financing statement if the person believes on reasonable grounds that the person described in the statement as the secured party is or may be, or may become, a secured party in relation to the collateral.

6.10.4.3.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree with this proposal. The great majority agreed, however, that it was appropriate to amend s 151(1) in this way.

These proposed amendments to s 151(1) will give secured parties greater confidence that they may properly register a financing statement either in advance of entering into a security agreement with a grantor, or where it is not clear that the transaction will give rise to a security agreement. In my view, these are appropriate protections for secured parties, and should be incorporated into the Act.

135 See Chapter 4 above.

136 LCA, S1 page 7; DT, S2 page 11.

6.10.4.3.3 ***Recommendation***

> **Recommendation 129:** *That s 151(1) be amended to provide that a person may register a financing statement if the person believes on reasonable grounds that the person described in the statement as the secured party is or may be, or may become, a secured party in relation to the collateral.*

6.10.4.4 **How precisely must the collateral be described, in a registration?**

6.10.4.4.1 ***The issue***

It is clear that Act allows a person to use a broad description of collateral in a financing statement. This can be seen, for example, in the way that item 4 of the table in s 153(1) describes the manner in which a financing statement must describe the collateral. It can also be seen from the two examples that immediately follow s 151(1), as set out in Section 6.10.4.2 above.

A number of submissions expressed concern about this, in particular about the fact that a registrant can use an overly broad collateral class, and is not obliged (regardless of the breadth of the chosen collateral class) to include any further description of the collateral in the free text field.[137] The submissions argued that this makes the Register very unhelpful for searchers.

This concern was discussed in Section 6.4.3 above. As discussed in that Section, I am not in favour of requiring a registrant to complete the free text field as a condition to the financing statement being effective for the purposes of the Act. It may be however that s 151(1) can be employed as an alternative mechanism to address this concern. While careful consideration would need to be given to the way in which the rule is expressed, it might be possible for s 151(1) to provide that a registrant may only make a registration if it describes the collateral in a manner that is no broader than is reasonably necessary to identify the collateral that the registrant reasonably believes is or may be subject to a security interest in favour of the nominated secured party.

An approach along these lines would allow a secured party to be confident that its security interest is perfected by registration, even if the description of collateral in the registration could be accused of being overly broad. If the description is broader than reasonably necessary, though, the registrant would be in breach of s 151(1) and so exposed to a civil penalty.

Consultation Paper 4 invited stakeholders to comment on this.

6.10.4.4.2 ***Discussion of stakeholder feedback***

Views of respondents were mixed on this question. While a number of responses agreed with the suggested approach, the majority of responses did not. Some of the responses that did not agree pointed to the practical difficulties that a registrant would face with such an approach, particularly for advance registrations. Some of those responses suggested that we should instead adopt the New Zealand approach of requiring that the registration include a "further description" of the collateral, without providing registrants with any further rules to clarify what that might require of them.

137 For example: AFC, S1 att B page 17; AICM, S1 page 23.

This is a difficult question. Many stakeholders have indicated that something should be done to limit over-reaching registrations, and it is not immediately clear why some respondents who were in favour of making the free text field mandatory (see Section 6.4.3 above) are not in favour of rules that explain how a registrant should populate that field. It is also not readily apparent to me whether it greatly assists matters by requiring a registrant to include a "further description" if there are no rules in place that can give a registrant confidence that they have provided a sufficient description to satisfy the requirement.

Some of the respondents indicated that they thought the proposed approach was too complex, and too difficult for registrants to work with. If that is the case and it is still thought to be desirable to do something to curtail unnecessarily broad registrations, an alternative solution would be to require a registrant to include a further description of the collateral in the free text field, using whatever information is reasonably available to the registrant at the time the registration is made, but not as a condition to making the registration an effective one. That would mean that a registration made in advance of the collateral being identified would be allowed to contain less detail than a registration that was made at a later point in time. It would require a registrant to include a further description of the collateral, but would not be prescriptive as to the content of the description. And it would allow a secured party to be confident that its registration was effective to perfect its security interest, whether or not it contained a sufficient "further description" of the collateral.

6.10.4.4.3 ***Recommendation***

> **Recommendation 130:** *That s 151(1) be amended to provide that a registrant must include a further description of the collateral in the free text field, using the information that is reasonably available to the registrant at the time the registration is made, but that the section not specify the level of detail that the further description needs to satisfy.*

6.10.4.5 **When should a secured party be required to remove an advance registration?**

6.10.4.5.1 ***The issue***

As already discussed, the Act allows a secured party to register a financing statement in advance of entering into a security agreement with the grantor.[138] Sections 151(2) and (3) provide some protection for a grantor against the adverse consequences of this, by requiring the registrant of such a financing statement to remove the registration within 5 business days if the nominated secured party does not in fact have a security interest from the grantor over the described collateral, and there are no (or no longer) any reasonable grounds for the belief described in s 151(1).

There is no corresponding provision in any of the Canadian PPSAs or the NZ PPSA. This reflects the fact that they also do not have an equivalent provision to s 151(1).

It might be thought that this mechanism is too prescriptive, particularly given the other mechanisms (discussed below) that allow a grantor to challenge a registration. It could also be argued however that the mechanism is an appropriate counter-balance to the right of a person to make an advance registration, particularly if the advance registration is made on a speculative basis.

138 Section 161 of the Act.

One submission argued that the timeframe of 5 business days to remove a registration is too tight, and that it should be removed.[139]

Consultation Paper 4 invited stakeholders to comment on these questions.

6.10.4.5.2 ***Discussion of stakeholder feedback***

The views of respondents were evenly divided on whether ss 151(2) and (3) should be deleted. Some argued that the provisions are unnecessarily complex, and too difficult for a secured party to work with. Others felt that the provisions were a reasonable counter-balance to a secured party's right to make an advance registration. Views were also evenly divided on whether 5 business days was an adequate timeframe for a secured party to remove a registration.

The language of ss 151(2) and (3) is somewhat unwieldy, but the principle behind them is clear – if a registrant makes an advance registration, then it must later remove the registration if it becomes clear that the transaction will not be proceeding. It is true that a grantor can turn to the "amendment demand" mechanism as an alternative solution to remove such registrations, but that process (as it currently stands) can be a drawn-out one, and will not provide a quick solution for a grantor that wants to use its assets to raise finance, but discovers the existence of a registration against it that had been made some time previously for a transaction that had never proceeded.

The arguments for and against ss 151(2) and (3) are finely balanced. As I see it, though, no clear case has been made for them to be deleted, and on that basis I do not propose to recommend that they be repealed. For similar reasons, I do not propose to recommend that the timeframe in the sections be changed either.

6.10.4.5.3 ***Recommendation***

Recommendation 131: *That ss 151(2) and (3) not be repealed or amended.*

6.10.4.6 **"Unperfected" security interests**

6.10.4.6.1 ***The issue***

Section 167 provides a further protection for a grantor if the collateral described in a registration is either:

- used or intended to be used predominantly for personal, domestic or household purposes; or
- registered with a serial number.

The section requires the secured party to remove the registration from the Register if, broadly, the security interest becomes "unperfected".

The Canadian PPSAs[140] and the NZ PPSA[141] contain a similar concept.

Section 167 raises a number of issues. First, it is not clear why it applies to any collateral that is registered by serial number. This section appears to be intended to be a consumer protection measure, but collateral will often be registered

139 DT, S2 page 12.

140 For example Sask PPSA, s 50(2).

141 NZ PPSA, s 161.

by serial number where the grantor is a body corporate or other commercial enterprise. Consumer protection issues are not relevant in those circumstances. It is also not clear how a secured party is expected to know whether collateral is used or intended to be used for personal, domestic or household purposes, or what happens if the grantor's actual use of the collateral changes over the term of the financing.

If s 167 is to be retained, it would simplify the Act if the section could simply apply to registrations against individuals. That would remove the need to determine how the individual was using or intending to use the collateral, and would mean that s 167 did not apply to other types of grantor just because a financing statement was registered against collateral's serial number.

Secondly, it is unclear what s 167 means when it refers to a security interest becoming "unperfected". It may be intended to refer to a situation where the secured party has released the collateral from its security (for example, because the financing has been repaid). If that is the case, though, it would be preferable for the section to say this, as there could be other circumstances in which a security interest in collateral becomes "unperfected" but it would not be appropriate to require the secured party to discharge its registration. As an example, a secured party's security interest in collateral becomes unperfected if the collateral is sold in a way that allows the buyer to take the collateral free of the security interest. The secured party would want to keep its registration in such a situation, however, because the secured party will need the registration to perfect the security interest that the secured party would instead have in the sale proceeds, under s 32.

Consultation Paper 4 proposed that the Act be amended to address these issues.

6.10.4.6.2 ***Discussion of stakeholder feedback***

All responses were in favour of applying s 167 to individuals, and in favour of redrafting the section along the lines described above.

One response made the point that a secured party may not always immediately know when it ceases to have a security interest that is perfected by the registration.[142] The response suggested for this reason that the timeframe for releasing the registration could be calculated from when the secured party has or should have knowledge of this. That seems to me to be a reasonable proposition, and I am minded to recommend it.

6.10.4.6.3 ***Recommendation***

Recommendation 132: *That s 167 be amended so that:*

- *it applies (and applies only) to registrations against individuals (or to registrations against serial-numbered property that do not include the grantor's details because the grantor is an individual); and*
- *it only requires the secured party to remove a registration from the Register within 5 business days after it becomes aware, or should reasonably have become aware, that it no longer has any security interest over any collateral that is perfected because of the registration.*

142 AFC, CP4 page 15.

6.10.5 Amendment demands

6.10.5.1 The rules

Section 178(1) provides that a person with an interest in collateral that is described in a registration may require the secured party (by means of an *amendment demand*) to amend its registration in either of these ways:

Item	When amendment is authorised	What amendment is authorised
1.	No collateral described in the registration secures any obligation (including a payment) owed by a debtor to the secured party.	Amendment to end effective registration (including an amendment to remove the registration).
2.	The particular collateral in which the person has an interest does not secure any obligation (including a payment) owed by a debtor to the secured party.	Amendment to omit the collateral.

A person who gives an amendment demand can then give a statement in relation to it to the Registrar, under s 180(3). If the person gives the statement to the Registrar in the prescribed manner, then s 180(4) has the effect that the Registrar must give an "amendment notice" to the secured party, inviting the secured party to respond to the amendment demand within 5 business days or any longer period approved by the Registrar. At the end of that period, the Registrar must then amend the registration in accordance with the amendment demand (under s 181(1)), unless the Registrar suspects on reasonable grounds (for example, as a result of information provided by the secured party in response to the amendment notice) that the amendment is not authorised by s 178.

Section 182 provides that a person who gives an amendment demand may instead apply to a court for an order that requires the registration to be amended. A secured party may also apply to court for an order to prevent such an amendment from being made.

These mechanisms raise a number of questions.

6.10.5.2 Who may make an amendment demand?

6.10.5.2.1 *The issue*

Section 178 only allows an amendment demand to be made by a person with an interest in the collateral. If a security interest is registered against the serial number of serialnumbered property and the grantor then sells the collateral free of the security interest, the seller will want to be able to remove the registration against it (or against the serialnumbered property, if it was consumer property). On the current wording of s 178, though, it is not able to do so, because it no longer has an interest in the collateral.

Consultation Paper 4 suggested that this should be corrected.

6.10.5.2.2 *Discussion of stakeholder feedback*

All responses were in favour of this amendment.

6.10.5.2.3 ***Recommendation***

> **Recommendation 133:** *That s 178(1) be amended to allow an amendment demand to be made by a person who is identified as the grantor in the registration, or was otherwise the grantor of the security interest to which the registration related.*

6.10.5.3 **How does s 178 apply to deemed security interests?**

6.10.5.3.1 ***The issue***

A number of submissions noted that s 178 allows a person to demand that a secured party amend or remove a registration if the collateral in question does not secure any obligation owed by a debtor to the secured party.[143] They pointed out that this does not allow for the fact that a registration might perfect a security interest that does not secure an obligation – that is, if it is only a security interest because of the expanded meaning given to that term by s 12(3).

Consultation Paper 4 suggested that this appeared to be a drafting error, and should be corrected.

6.10.5.3.2 ***Discussion of stakeholder feedback***

A small number of respondents thought that this amendment might not be necessary. All respondents accepted, however, that it should be made. That is my view as well.

6.10.5.3.3 ***Recommendation***

> **Recommendation 134:** *That s 178(1) be amended to accommodate the fact that a registration may perfect a security interest that does not secure an obligation because it is deemed to be a security interest by s 12(3).*

6.10.5.4 **Changes to the collateral classes**

6.10.5.4.1 ***The issue***

A number of submissions also pointed out that a secured party's capacity to respond to an amendment demand to omit particular collateral from a registration may be constrained by the functionalities of the Register, and in particular by the fact that the Register does not allow a secured party to amend a registration by changing the collateral class.[144] As an example, if a secured party has registered a financing statement against the collateral class "allpap", it cannot respond to a request to amend its registration to omit particular collateral, because the Register will not allow the secured party to do this. The secured party could respond to the amendment demand by registering a new, narrower financing statement and then releasing the "allpap" registration, but it is not clear that s 178 can require the secured party to do so.

143 For example: JLF, S1 page 20; AICM, S1 page 20.

144 For example: JLF, S1 page 19; LCA, S1 page 9; QLS, S1 page 8; CW, S1 page 5.

Some submissions proposed that the secured party be required to do just that – to make fresh, narrower registrations as required, and then to release the previous, overly–broad one.[145]

Another option would be to amend the functionality of the Register to allow a secured party to amend the collateral class in a registration from a broader class to a narrower (or to a number of narrower) classes. One submission argued that this optionality should be available as a matter of course, and not just as part of the amendment demand process.[146]

Consultation Paper 4 invited stakeholders to comment on this.

6.10.5.4.2 ***Discussion of stakeholder feedback***

All responses favoured the second option, ie that the functionalities of the Register be amended to allow a secured party to amend a collateral class in a registration by replacing it with a narrower one.

I agree that this would be a desirable enhancement, as it would allow the amendment demand process to function more effectively. I have also recommended separately that it be made possible to register a financing statement against more than one collateral class (see Section 6.3). If that change is made, then it would need to be made possible for a secured party to amend its registration by deleting a collateral class, as well.

6.10.5.4.3 ***Recommendation***

Recommendation 135: *That the functionality of the Register allow a registration to be amended by removing a collateral class (if Recommendation 92 is adopted to allow a registration to be made against more than one collateral class), or by replacing a collateral class with a narrower one.*

6.10.5.5 **Security trust instruments**

6.10.5.5.1 ***The issue***

Section 179(3) states that Division 2 of Part 5.6 of the Act does not apply in relation to a security interest, if the security agreement is an instrument or other document:

(a) by which a person issues or guarantees, or provides for the issue or guarantee of, an obligation secured by a security interest; and

(b) in which another person is appointed as trustee for the person to whom the obligation secured by the security interest is owed.

It is not clear why the amendment notice process should not apply to a secured party just because it is a security trustee. There is a similar carve-out in the Canadian PPSAs[147] and the NZ PPSA,[148] and the explanation that has been given is that it is not appropriate to expose the beneficiaries under a security trust

145 LCA, S1 page 9; CW, S1 page 7.

146 ABA, S2 page 6.

147 For example Sask PPSA, s 18(6).

148 NZ PPSA, s 164.

arrangement to the risk that their trustee might negligently allow a registration to be removed.[149] It could also be argued, however, if investors have appointed a person to act as their trustee, that those investors, and not third parties, should bear the risk that their trustee might not do its job properly. There are many ways in which a security trustee could negligently do something that adversely affected its investors, and it is not clear to me why this particular risk should be isolated and dealt with in this way.

Consultation Paper 4 suggested that s 179(3) could be deleted. This change would simplify the Act and increase the consistency in the way in which its rules are applied.

6.10.5.5.2 ***Discussion of stakeholder feedback***

One response did not agree with this proposal. One other response suggested that it did not need to apply in relation to at least some securitisation trusts, because the security trustee in those transactions typically is engaged by the grantor itself.[150] I do not see, however, why that should mean that the amendment demand process should not be able to apply if needed.

All other responses were in favour of deleting s 179(3).

6.10.5.5.3 ***Recommendation***

Recommendation 136: *That s 179(3) be deleted.*

6.10.5.6 **The contents of an "amendment statement"**

6.10.5.6.1 ***The issue***

A person who gives a statement to the Registrar under s 180(3) (in order to trigger the obligation of the Registrar to give an amendment notice to the secured party under s 180(4)) must give the statement in the required form.

The required contents of the statement are set out in reg 5.9 of the Regulations. The list of requirements in reg 5.9 would be quite daunting for a person who is unfamiliar with the Act (as is likely to be the case for many grantors), and it would be desirable to simplify them.

As an example, reg 5.9(g) requires the person to make the following statement:

> (g) that the security agreement providing for the security interest is not an instrument or other document:
>
> (i) by which a person issues or guarantees, or provides for the issue or guarantee of, an obligation secured by a security interest; or
>
> (ii) in which another person is appointed as trustee for the person to whom the obligation secured by the security interest is owed.

A person making the statement may not be in a position to know these matters. In any event, this language appears to have been included in reg 5.9 because of the existence of s 179(3), and I have recommended that s 179(3) be deleted.[151]

149 Gedye Cuming & Wood, para 164.1.

150 ASF, CP4 page 11.

151 See Section 6.10.5.5.

For these reasons, Consultation Paper 4 expressed the view that reg 5.9(g) should be deleted as well, and that the balance of reg 5.9 should be simplified.[152]

6.10.5.6.2 ***Discussion of stakeholder feedback***

All respondents supported these proposals.

6.10.5.6.3 ***Recommendation***

> **Recommendation 137:** *That reg 5.9(g) of the Regulations be deleted, and that the balance of reg 5.9 be simplified.*

6.10.5.7 **Terminating the Registrar's administrative process – when does a proceeding "come before a court"?**

6.10.5.7.1 ***The issue***

The provisions regarding amendment demands, the consequent giving of amendment notices by the Registrar and the Registrar's obligations in relation to amending registrations after it has given an amendment notice, are located in Subdivision A of Division 2 of Part 5.6 of the Act.

Section 179(2) says that this Subdivision stops applying in relation to an amendment demand if "proceedings come before a court" under s 182. The section does not explain however when proceedings will be regarded as having "come before a court" for this purpose. Proceedings could be regarded as having come before a court when an originating process is filed, or potentially only at some later point in time such as the hearing itself.

I expect the intention was that proceedings would "come before a court" for these purposes when a party files an originating process in relation to the matter with the court. It also makes sense, in my view, for the Registrar's administrative process to be switched off at that point in time, rather than later – it would otherwise be a waste of the Registrar's resources to continue the administrative process, as any further work undertaken by the Registrar would be rendered irrelevant in due course by the outcome of the court process.

Consultation Paper 4 proposed that this Act be amended to clarify this.

6.10.5.7.2 ***Discussion of stakeholder feedback***

All respondents supported this proposal.

6.10.5.7.3 ***Recommendation***

> **Recommendation 138:** *That it be made clear that a proceeding "comes before a court" for the purposes of s 179 when a party first files an originating process with the court.*

152 As an aside, if reg 5.9(g) is retained, it should say "and" at the end of paragraph (g)(i), not "or". See Section 179(3).

6.10.5.8 Should the whole "amendment demand" process be replaced?

6.10.5.8.1 *The issue*

A broader question is whether the Registrar's administrative decision-making process in relation to amendment demands should even be retained. The process effectively requires the Registrar to operate in a quasi-judicial capacity, on the basis of potentially very limited information. I am advised that the Registrar is being called on to issue amendment notices and to make decisions under s 181 very frequently – over the 6 months to 31 December 2014, for example, the Registrar received more than two requests per working day to issue an amendment notice. This is placing a considerable strain on the Registrar's resources.

The amendment notice process is arguably also not a particularly effective use of the Registrar's resources, as I am advised that most secured parties that receive an amendment notice either remove or amend the registration themselves as a result of receiving the amendment notice, or simply do not bother responding (in which case the Registrar is likely to remove or amend the registration itself). AFSA advises me that the outcome of the valid amendment notices issued over the 6 months to 31 December 2014 was that just under 90% of the relevant registrations ended up being removed or amended.

The strain on the Registrar's resources becomes even more acute if the applicant or secured party wants to object to the Registrar's decision, because the secured party may decide, rather than taking the matter to court, to challenge the Registrar's decision before the Administrative Appeals Tribunal under s 191 of the Act. I am advised that this has led to the Registrar's legal representative cross-examining an applicant in proceedings to which the secured party was not even a party, and where the grantor and the secured party have been effectively conducting their commercial litigation through the Administrative Appeals Tribunal review process, via the office of the Registrar. The Registrar has made the point to me that while the Administrative Appeals Tribunal is an appropriate forum for reviewing administrative decisions that affect an individual, it is a less suitable forum for decisions that involve multiple parties and that determine the rights as between them.

The mechanisms under the NZ PPSA operate quite differently. In New Zealand the onus is reversed, in that a person who gives an amendment demand can themselves procure that the Register be amended in accordance with the demand, unless the secured party is able to produce a court order within 15 working days to the contrary.[153] Most of the Canadian PPSAs take a similar approach.[154]

This approach clearly favours the grantor over the person who is entered in a registration as the secured party. It would only be appropriate to consider this approach if it is clearly possible for a secured party to obtain an appropriate court order within the specified time frame. If this approach were otherwise thought to be appropriate, for example, it might be desirable to allow a secured party a longer period than 15 business days to respond, if that period were thought to be too short. One option might be to follow the approach that applies to an application for removal of a caveat under real property legislation, as that is more likely to be tailored to the practicalities of obtaining orders under our court system.[155]

153 NZ PPSA, s 165.

154 For example Sask PPSA, s 50(5).

155 That approach varies however as between jurisdictions. See for example s 90 of the *Transfer of Land Act 1958* (Vic), and s 74J of the *Real Property Act 1900* (NSW).

As noted earlier, the Registrar's experience so far has been that almost all amendment demand processes end up with the registration in question being removed or amended in accordance with the amendment demand. This suggests that the practical outcome of reversing the onus in this way would not be as severe as might otherwise be thought to be the case. This approach would also help the grantors to defend themselves against bogus filings, as discussed in Section 6.10.4.2 above.

Another option might be to reserve the New Zealand approach for registrations against individuals or their serial-numbered property, and to require that challenges to all other registrations be taken to court.

Consultation Paper 4 invited stakeholders to comment on these issues.

6.10.5.8.2 ***Discussion of stakeholder feedback***

A number of responses did not agree with the suggestion that the onus of the amendment demand process should be reversed along the lines of the approach taken in New Zealand. Some of those responses argued that this tilted the playing field too heavily in favour of grantors, at the expense of secured parties.

The majority of responses took the opposite view, however, and agreed that we should move to the New Zealand approach, and provide that a grantor can remove a registration from the Register unless the secured party produces a court order to the contrary within a specified period of time. The timeframes suggested for this purpose ranged from 15 business days to one month.

A move to the New Zealand approach does seem to be a significant shift, particularly relative to the way security registration systems have worked in Australia in the past. It does however have parallels with the system that currently operates around Australia for the removal of caveats over land. I am also advised that any concerns that may have been harboured in Canada (in the provinces that have it) and New Zealand about the risk that grantors might make improper use of this mechanism have not materialised, and that debtors are not making inappropriate use of the amendment demand mechanism. That suggests that the significance of the change may not be as great in practice as it might seem in principle (particularly as the result under the current rules seems to be that almost all challenged registrations end up being removed, albeit in a more cumbersome way). It might also help to reduce the risk of grantors making inappropriate challenges under the New Zealand approach if it were made clear that the court could decide that the secured party's costs were to be added to the amount secured, if the secured party succeeded in obtaining a court order.

There are clearly good arguments for and against the current amendment demand rules. In my view, though, there is merit in moving to the New Zealand approach to amendment demands, particularly if a court can add the secured party's costs to the amount secured as suggested in the previous paragraph. It is clear to me that the office of the Registrar is not the appropriate forum for the conduct of disputes between secured parties and grantors about the appropriateness of a secured party's registration, and the Canadian and New Zealand experience suggests that their approach is unlikely to be the subject of significant abuse.

6.10.5.8.3 ***Recommendation***

> **Recommendation 139:** *That the amendment demand process in Part 5.6 of the Act be recast along the lines of the approach taken in New Zealand, under s 165 of the NZ PPSA.*

6.10.5.9 **Contracting out of amendment demands**

6.10.5.9.1 ***The issue***

One submission expressed concern at the fact that some secured parties are apparently including in their documents an obligation on the grantor not to make an amendment demand.[156] The submission proposed that the Act be amended to prohibit this practice.

Consultation Paper 4 invited stakeholders to submit their views on this.

6.10.5.9.2 ***Discussion of stakeholder feedback***

A number of responses agreed with the submission, ie that the Act should be amended to prohibit a secured party from requiring that its grantor agree not to make amendment demands. An equivalent number of responses took the opposite view, however, and argued that the Act should not be amended in this way.

I have discussed elsewhere that I am not in favour of complicating the Act by amending it to prohibit specific practices, unless the need to do so is clear and there are no other ways to address the concern. I am not satisfied that there is a clear need to prohibit this practice, and so do not propose that the Act be amended to do so.

6.10.5.9.3 ***Recommendation***

> **Recommendation 140:** *That the Act not be amended to prohibit a secured party from obliging its grantor not to make amendment demands.*

6.10.6 Expired registrations

6.10.6.1 ***The issue***

Two submissions said that more should be done to remove expired registrations from the Register.[157]

A registration that reaches its end time is removed from the Register, in the sense that a search for current registrations will no longer reveal it. For this reason, I anticipate that the submissions were proposing that more be done to remove a registration from the Register if the security interest to which it relates has expired.

156 LCA, S2 page 19.

157 AFC, S1 att B page 17; DIFA, S1 att B page 4.

The Act already contains a number of mechanisms to remove registrations, as discussed earlier in this Chapter.

Consultation Paper 4 suggested that the recommendations earlier in this Chapter might respond sufficiently to the concern expressed in the submission.

6.10.6.2 ***Discussion of stakeholder feedback***

All respondents agreed that no additional mechanisms need to be included in the Act to deal with expired registrations.

6.10.6.3 ***Recommendation***

> **Recommendation 141:** *That no additional mechanisms need to be included in the Act to facilitate the removal of registrations.*

6.11 Other proposals relating to the operation of the Register

6.11.1 Modes of access to the Register

6.11.1.1 ***The issue***

The Register is maintained in electronic form, and is accessible over the internet on the Registrar's website at www.ppsr.gov.au. Large users of the Register are also able to access the Register via a direct business-to-government feed, by making appropriate arrangements with the Registrar. In addition to direct online access, registrants and searchers can access the Register indirectly, via a third-party information provider or broker. Searchers can also undertake searches through the National Service Centre.

One submission suggested that the Registrar should make it possible for users to access the Register in other ways as well.[158]

Initially, the Registrar also provided a facility for manual registrations through the National Service Centre. Only very limited use was made of this facility, however, as only 21 registrations were made in this way over the first year of operations, out of a total of 1,446,308. I am advised that it was not evident from those registrations that the registrant would not have been capable of registering online, and the Registrar discontinued this service in July 2013. The Registrar has not been asked to reconsider that decision.

The submission did not suggest how it should be possible to access the Register beyond the methods that are available at present.

Consultation Paper 4 invited stakeholders to comment on whether the current modes of access to the Register are sufficient.

6.11.1.2 ***Discussion of stakeholder feedback***

All responses agreed that the current modes of access to the Register are adequate. I have no information before me that suggests otherwise.

158 NSWBC, S1 page 3.

6.11.1.3 ***Recommendation***

Recommendation 142: *That no steps need to be taken at this time to expand the ways in which users can access the Register.*

6.11.2 Should a secured party be required to include a copy of its security agreement with its registration?

6.11.2.1 ***The issue***

Some submissions suggested that it would improve the quality of the information on the Register if a registration were required to include a copy of the security agreement to which it relates.[159] This would be consistent with the mechanisms for the registration of company charges that applied under the Corporations Act before the Act came into effect.

It is open to a secured party to include a copy of its security agreement as an attachment to its registration, if it so wishes. The Register is structured however as a "notice filing" system, in that it is simply designed to warn searchers that a grantor's personal property may be subject to a security interest, and not to provide a complete picture of what the security is, or what property it applies to. This approach is consistent with the regimes under all the Canadian PPSAs, the NZ PPSA and Article 9.

I am not in favour of changing that general approach by making it mandatory for a registrant to include a copy of the relevant security agreement. There are several reasons for this. First, it would impose an additional burden on secured parties, as the obligation would be of little value to searchers unless the secured party was also obliged to file amendments to the security agreement over time, and to file new security agreements as they are entered into. Secondly, the copy of the security agreement as filed would not necessarily disclose exactly what collateral it covers, so making a copy of the security agreement available to searchers may not help to inform them of exactly what personal property is subject to the security interest. Finally, a secured party may not want the commercial contents of its security agreement to be available for review by anyone who is entitled to undertake a search against the grantor.

Consultation Paper 4 invited stakeholders to comment on this proposal.

6.11.2.2 ***Discussion of stakeholder feedback***

One response supported including an extract or abbreviated version of the security agreement with a registration. One other response indicated that it had mixed views internally on the question. All other responses were of the view, however, that a secured party should not be required to include a copy of the security agreement in its registration.

It would be inconsistent with the "notice filing" principle to require a secured party to include a copy of its security agreement with its registration. Such a requirement would also produce a number of logistical problems for secured parties. In my view, there is no clear case for making this change.

159 For example: DIFA, S2 att A page 6.

6.11.2.3 ***Recommendation***

> **Recommendation 143:** *That the Act not be amended to require a secured party to file a copy of its security agreement as part of its registration.*

6.11.3 Should a registration be required to specify a maximum secured amount?

6.11.3.1 ***The issue***

One submission suggested that a financing statement should be required to disclose a maximum amount secured, so that it would only take priority over otherwise-junior security interests up to that amount.[160] This would again be consistent with the operation of the previous charges register under the Corporations Act, which allowed a registration of a charge to specify a "maximum prospective liability" for the charge.

There is no requirement along these lines in the Canadian PPSAs or the NZ PPSA.

The "maximum prospective liability" mechanism under the Corporations Act was something of a toothless tiger, as chargees routinely required the chargor to specify an amount that was several multiples of the amount that they expected to be secured. This was done principally to allow for contingencies. If a similar functionality were to be built into the Register, then I expect that the same practice would quickly develop under the Register as well. That could then make the Register misleading, as it would suggest that the affected grantor was in fact more deeply indebted to its secured parties than was actually the case.

For these reasons, Consultation Paper 4 expressed the view that it would not be appropriate to make such a change.

6.11.3.2 ***Discussion of stakeholder feedback***

All the responses agreed that it would not be appropriate to require a secured party to specify a maximum secured amount in its registration.

One response indicated in this context that there may be some residual uncertainties regarding the priority position for migrated security interests.[161] I expect that this may be a reference to charges that were migrated from the ASIC charges register and that had a "maximum prospective liability" for the purposes of the priority rules that applied under the Corporations Act. I do not have enough information on this issue, however, to be able to make a recommendation in relation to it.

6.11.3.3 ***Recommendation***

> **Recommendation 144:** *That the Act not be amended to provide that a registration be required to specify a maximum amount secured.*

160 NSWYL, S1 page 7.

161 ABA, CP4 page 19.

6.11.4 Linking of registrations

6.11.4.1 The legal implications of linking registrations

6.11.4.1.1 *The issue*

The Register includes an "Earlier Registration Number" field that enables a registrant to indicate that its registration relates to an earlier registration. The purpose of this field is to allow for the possibility that a security interest might be perfected over time by more than one registration, and to enable a registrant to indicate to a searcher that a security interest's priority time may be earlier than the registration time for the current registration (because it runs from the registration time for the earlier registration that it replaced).

This ability to link registrations is not contemplated by the Act or the Regulations. As a matter of application of the Act, a security interest's priority time will run from the registration time of the first registration to perfect it, as long as it has been continuously perfected since that time, whether or not the secured party uses the linking functionality.

Some submissions suggested that the Act be amended to formalise the linking functionality, and to provide that a security interest will only be continuously perfected by a series of registrations over time if those registrations are "linked" on the Register.[162] One submission took the opposite view, however, and suggested that it be confirmed in the Act or the Regulations that the linking functionality is for information only, and has no legal effect.[163]

To my knowledge, a similar functionality is not available on the registers under the Canadian PPSAs or the NZ PPSA.

Consultation Paper 4 indicated that I was not inclined to recommend that the linking of registrations be elevated to a formal requirement for continuous perfection of a security interest. Even if this change were made, a searcher would not be able to assume with confidence that a security interest's priority time was the registration time of the earlier linked registration, as the security interest could have been perfected from an earlier time in some other way that is not apparent from the Register – for example by possession or control, or by being temporarily perfected by force of the Act. So if a searcher needs to determine a security interest's priority time, it will always need to undertake further investigations. I would also be concerned that the need to accurately link a registration to an earlier registration could be another trap for the unwary secured party, and add further complexity to the registration process.

6.11.4.1.2 *Discussion of stakeholder feedback*

A small number of responses argued that linking should be required in order to establish continuous perfection through a series of financing statements. All other responses were of the view, however, that this was not appropriate. That is my view as well, for the reasons given above.

162 For example: AICM, S1 page 15; LCA, S1 page 6; QLS, S1 page 6; CW, S1 page 4.

163 JLF, S1 page 18.

6.11.4.1.3 ***Recommendation***

> **Recommendation 145:** *That the Act and the Regulations not be amended to provide that a security interest will only be continuously perfected by a series of registrations if those registrations are linked using the "Earlier Registration Number" field on the Register.*

6.11.4.2 **The mechanics of linking**

6.11.4.2.1 ***The issue***

The "Earlier Registration Number" field on the Register currently allows only one earlier registration number to be entered in the field. As one submission noted, however, a secured party may want to link a new registration to a number of earlier registrations.[164]

Consultation Paper 4 agreed with the submission that it would be desirable for the Register to allow this.

6.11.4.2.2 ***Discussion of stakeholder feedback***

A small number of responses disagreed with this proposition. The reason given by one of those responses was that the respondent thought that the whole concept of "linking" should be dropped. All other responses agreed, however, that this change should be made.

The limited role played by linking does make the concept one of very limited value. If it is to be retained, however, it should be allowed to work properly, and this proposed amendment will assist to achieve that outcome.

6.11.4.2.3 ***Recommendation***

> **Recommendation 146:** *That the Register be amended to allow multiple registration numbers to be entered in the "Earlier Registration Number" field on the Register.*

6.11.5 Only one registration per asset?

6.11.5.1 ***The issue***

Some submissions suggested that it should only be necessary to make one registration per asset.[165] The submissions argued that this would assist small businesses in the context of a chain of leases, as a head lessor's registration against the asset would perfect the security interests under the subleases as well.

The Register operates principally as a grantor-based registration system. If a searcher wants to determine whether an asset could be encumbered, the searcher generally needs to determine who the grantor of such an encumbrance could be, and then search against that grantor's details.

164 JLF, S1 page 21.

165 For example: ABA, S1 page 2 and att B page 10; CCF, S1 page 5; DIFA, S1 att B page 1.

The Register also operates in part as an asset-based registration system, in that it is possible to register against the collateral's details as well, if it is serial-numbered property. If a grantor is an individual and the collateral is both consumer property and serial-numbered property, then the Register is solely an asset-based system, as a registration can only be made against the serial number. In the case of other serial-numbered property, the Register straddles both approaches.

A system that only required one registration per asset would only be practicable for serial-numbered property. Such a system would also significantly cut across the basic premise of the Register as being primarily a grantor-based registration system, and would be likely to have substantial consequences for other aspects of the Act.

For these reasons, Consultation Paper 4 expressed the view that such a change would not be appropriate.

6.11.5.2 ***Discussion of stakeholder feedback***

One response argued that this change should be made, because it would assist in "the efficient and effective management of PPSA risks arising in the context of sub-leasing".[166] All other responses agreed, however, that this change was not appropriate.

I expect that at least some of the risks that arise in the context of sub-leasing will be dealt with by other changes that I am recommending be made to the Act. Even if that is not the case, though, this would not be an appropriate change to make, for the reasons given above.

6.11.5.3 ***Recommendation***

Recommendation 147: *That the current structure of the Register as principally a grantor-based registration system be retained, and that the Act not be amended to allow one registration to perfect all security interests over an asset, regardless of the identity of the grantor.*

6.11.6 Separate registers for specific security interests?

6.11.6.1 ***The issue***

A number of submissions suggested that a separate register be maintained for certain types of security interests, such as leases.[167]

It is not clear to me what this would achieve. Unless the Act is restructured so that the legal consequences for some security interests such as leases are different to the legal consequences for other types of security interests, I do not see what would be gained by recording them separately.

Consultation Paper 4 invited stakeholders to indicate whether they saw any benefit in maintaining such separate registers.

166 AFC, CP4 page 19.

167 For example: ABA, S2 page 10.

6.11.6.2 ***Discussion of stakeholder feedback***

All respondents were of the view that it would not be appropriate to maintain separate registers for specific types of security interests. One response observed that this would be a backwards step, and would be inconsistent with the unitary principle that underpins the Act.[168] I agree this would involve a partial reversion to the "form over substance" philosophy that the Act has sought to overcome, and do not propose to recommend it.

6.11.6.3 ***Recommendation***

> **Recommendation 148:** *That the Act not be amended to provide for separate registers for security interests that arise from different types of transactions.*

6.11.7 Separate registers for specific types of collateral?

6.11.7.1 ***The issue***

One submission suggested that consideration be given to establishing a separate register of construction and heavy industry machines.[169] The submission argued that yellow goods are not easy to store securely, and lack a central registry of identifying information such as a VIN. It argued that yellow goods, because they are stored commonly on construction and industrial sites, are an easy target for theft, and that their accessibility and high unit value make them a profitable target for thieves to resell on the black market.

The submission noted that industry has explored options to respond to this risk. Those options include a system under which each item of yellow goods is allocated a serial number, and that number is then micro-sprayed on to the unit for identification purposes. The submission noted that this initiative would require a register that linked the serial number with relevant manufacturer information such as the chassis and engine number. The submission recommended that this initiative be pursued.

6.11.7.2 ***Discussion***

I do not have sufficient information before me to express a view on the merits of this proposal. In any event, the proposal falls outside the remit of this review, as my task is to consider the operation of the Act and the Register established by the Act, and not to consider the desirability or otherwise of setting up other registers. I am however comfortable with recommending to Government that it give separate consideration to this suggestion.

6.11.7.3 ***Recommendation***

> **Recommendation 149:** *That Government separately consider whether it wishes to facilitate the establishment of a register of construction and heavy industry machines.*

168 AD, CP4 page 23.

169 Veda, S2 page 8.

6.11.8 Should the Register be free?

One submission recommended that transactions on the Register be free of charge.[170]

Section 190 of the Act provides that the responsible Minister can set fees for the purposes of the Act. Section 190(5) states that the fees may not be such as to amount to taxation.

The fees are set on a cost recovery basis, in that they enable Government over time to recover the cost of establishing, maintaining and upgrading the Register, as well as the cost of maintaining the Registrar's office and supporting arrangements.

It would clearly be attractive for users of the Register to be able to do so free of charge. If Government is not able to recover the costs of the Register and the Registrar from fees, however, then they would need to be funded from other sources.

This is not an issue on which it is appropriate for me to express a view. I have instead referred the comment to Government for its consideration.

6.11.9 Supporting functionalities

6.11.9.1 ***The issue***

A number of submissions made valuable suggestions regarding what might be called the supporting functionalities of the Register – aspects of the operation of the Register that do not derive from the language of the Act or the Regulations, but rather have been incorporated into the Register's capabilities in order to assist secured parties, particularly secured parties that are regular users of the Register.[171] A number of those comments were quite technical in nature.

AFSA is constantly reviewing proposals to enhance the supporting functionalities of the Register, in consultation with AFSA's consultative forums. AFSA assesses and prioritises proposals on the basis of a number of factors, including the level of net benefit that would flow from a proposal relative to its complexity and implementation cost.

I noted in Consultation Paper 4 that I am not well-placed to comment on the technical aspects of proposals of this nature. Instead, I have asked AFSA to incorporate them as appropriate into its planning processes, and to discuss them with AFSA's consultative forums as needed.

6.11.9.2 ***Discussion of stakeholder feedback***

All respondents supported this proposal. Two of those respondents observed that AFSA's consultative forums have been working well, and are allowing for an appropriate level of consultation regarding proposed changes to Register functionalities.[172] In my view, they are the best forum for progressing issues of this more technical nature.

170 CCF, S1 page 5.

171 For example: JLF, S1 page 21; AFC, S2 att A page 7; AICM, S2 page 30; DIFA, S2 att A page 9; DLA, S2 page 9; Veda, S2 page 6.

172 AFC, CP4 page 20; DIFA, CP4 page 17.

One submission[173] also proposed that Government allow data analytics to be performed on data on the Register, subject to appropriate safeguards. The submission suggested that this would be consistent with the Australian Government Information Management Office's Big Data Strategy of 2013.

I am not in a position to assess the desirability of this. In any event, this goes not to the operation of the Act and the Register, but rather to whether data on the Register can or should be used for unrelated (or only partly related) purposes, and it is not clear to me that this falls within the remit of this review. I am however prepared to recommend that Government give separate consideration to the proposal.

6.11.9.3 ***Recommendations***

Recommendation 150: *That AFSA be asked to incorporate suggestions in the submissions that go to the supporting functionalities of the Register into its current planning processes, and to discuss them with AFSA's consultative forums, as appropriate.*

Recommendation 151: *That Government consider separately whether it wishes to facilitate data analytics being undertaken on data in the Register.*

6.11.10 Notices of verification statement

6.11.10.1 Should a notice be required for a registration against serial-numbered property that is consumer property?

6.11.10.1.1 ***The issue***

The Act allows a registrant to register a financing statement in relation to a security interest without the grantor's knowledge or consent.

Section 156 of the Act provides that the Registrar must ensure that a notice of the registration of a financing statement or financing change statement (a *verification statement*) is given to the person who is registered in the registration as the secured party. Section 157(1) then counters the fact that the registration could have been made without the grantor's knowledge or consent, by requiring the secured party to give a notice of the verification statement in the approved form (typically, by simply providing a copy of the verification statement itself) to "a person registered as the grantor in the registration".

A number of submissions pointed out that s 157 does not seem to accommodate a registration that is made against serial-numbered property that is consumer property, because s 153(1) requires that such a registration be made against the serial number only, and may not identify the grantor.[174] In this situation, there is no "person registered as the grantor in the registration", with the apparent result that the secured party is not required to give the notice.

This gap appears to be inadvertent. That gap could also widen somewhat, if the distinction between consumer property and commercial property is removed and the registration rules are amended so that any registration against serial-numbered

173 Veda, S4 page 4.

174 For example: AICM, S1 page 18; LCA, S1 page 8; QLS, S1 page 8; CW, S1 page 5.

property needs to be made against the serial number only, without the grantor's details, if the grantor is an individual.[175]

Consultation Paper 4 expressed the view that this gap should be closed, as a person whose serial-numbered property is identified as collateral in a registration will be concerned to be made aware of the registration, whether or not their name appears in the registration as well. If a secured party has already entered into the security agreement, it should give the notice to the grantor under the security agreement. If the secured party has not yet entered into the security agreement with the grantor, it should give the notice to the person who it anticipates will be the grantor (and then re-issue the notice when the security agreement has been entered into, if the actual grantor is someone else).

6.11.10.1.2 *Discussion of stakeholder feedback*

A small number of respondents did not agree with this proposal. One of those respondents argued that this was not an inadvertent gap, but a considered policy choice.[176] It took the position that a grantor did not need to receive a notice of verification statement in these circumstances, because it could always rely on the amendment demand process to remove the registration if it is unwarranted. I would be concerned, however, that the grantor may not be aware of the existence of the registration (and so not able as a practical matter to engage the amendment demand process) if it does not receive a notice of verification statement after the registration is made. The response also argued that the purpose behind s 157 more generally is to protect the privacy of individuals, and that an individual's privacy is not exposed if the registration does not include their details. I am not satisfied, however, that privacy concerns are a complete explanation for obliging a secured party to provide a grantor with the notice.

One other response expressed similar views.[177] All other respondents, however, were in favour of the proposed change. I agree with the majority view.

6.11.10.1.3 *Recommendation*

Recommendation 152: *That s 157(1) be amended to require a secured party to give a notice of a verification statement to the grantor, where the grantor's details are not included in the registration, on the following basis:*

1. *If the secured party has already entered into the security agreement, it should give the notice to the grantor under the security agreement.*
2. *If the secured party has not yet entered into the security agreement with the grantor, it should give the notice to the person who it anticipates will be the grantor, and then re-issue the notice when the security agreement has been entered into, if the actual grantor is not the same person.*

175 See Section 6.2.1.1 above.

176 AFC, CP4 page 21.

177 ABA, CP4 page 23.

6.11.10.2 **When should a notice be required for a change to a registration?**

6.11.10.2.1 ***The issue***

Sections 156 and 157 have the combined effect that a secured party must give notice of a verification statement to the grantor on the occurrence of a "registration event". This is defined in s 155(8) to be the registration of a financing statement or a financing change statement.

Section 10 defines a "financing change statement" to be "data amending a registered financing statement". This suggests that any change to the data in a financing statement could be a financing change statement, and so trigger an obligation to issue a notice of verification statement to the grantor, no matter how trivial the change might be.

One submission queried whether it should always be necessary to issue a notice of verification statement in response to a financing change statement.[178] The submission suggested that a notice of verification statement should not be required where there is a bulk transfer of security interests from one secured party to another, presumably because of the administrative burden that would otherwise be involved in issuing the notices. The submission also suggested that the Registrar be able to issue a single verification statement in such a circumstance, rather than separate ones which each secured party would then need to send separately to each affected grantor.

I can see that it would be an unnecessary administrative burden to require a secured party to notify its grantor of minor changes to the registration that do not impact on the grantor (such as a change to the secured party's Secured Party Group, or its email address). I think it is important however that a grantor be notified of material changes to the registration, such as changes to the way in which the registration identifies the grantor, the secured party or the collateral, and that a secured party should not be exempted from the need to give notice of such a change just because it is part of a bulk dealing.

I am advised that the Register does already generate a bulk verification statement in relation to some bulk changes. I am also advised that AFSA is considering these issues as part of its current work on enhancing the Register.

Based on these considerations, Consultation Paper 4 proposed as a recommendation that the Act be amended to provide that a secured party is only required to give a notice of verification statement to the grantor in relation to a financing change statement if the relevant change affects the way in which the registration identifies the grantor, the secured party or the collateral, but that the Act not be amended to exempt a secured party from the obligation to give a notice of verification statement just because it is part of a bulk transfer.

6.11.10.2.2 ***Discussion of stakeholder feedback***

The majority of responses agreed with this proposal. A number, however, did not. One response made the fair point that there is a risk in being too prescriptive, and that there could be other changes to a registration (for example, a change to the registration period) that would be of interest to the grantor as well.[179] Other responses suggested that the current provisions are appropriate, and should not be changed.

178 AFC, S2 att A page 7.

179 AD, CP4 page 26.

One response suggested that the whole "notice of verification statement" mechanism in the Act should be deleted.[180] I would not be in favour of recommending this, however, without further consultation with stakeholders.

I am persuaded that it could be too prescriptive to amend the Act so that it lists exhaustively the events that will trigger an obligation on a secured party to provide a notice of verification statement to a grantor. As an alternative, I propose to recommend that the provisions remain as they are, but that Government be empowered by the Regulations to identify events for which a secured party does not need to do so. Industry and Government can then resolve separately the types of events that should be excluded by the Regulations.

6.11.10.2.3 *Recommendations*

Recommendation 153: *That the Act be amended to provide Government with the power to make regulations that excuse a secured party from the obligation to give a notice of verification statement to the grantor in relation to events of the type listed in those regulations.*

Recommendation 154: *That the Act not be amended to exempt a secured party from the obligation to give a notice of verification statement just because it is part of a bulk transfer.*

6.11.10.3 Should a notice of verification statement be optional for commercial transactions?

6.11.10.3.1 *The issue*

Section 157(3) provides that a secured party does not need to provide its grantor with a notice of verification statement if the collateral is commercial property and the grantor has waived in writing its right to receive the notice. Secured parties routinely rely on this, and require their grantors to waive the right to receive the notice. This will generally not adversely affect grantors in commercial transactions, because they will be aware of the fact that the registration is being made.

One submission noted however that some grantors resist giving the waiver, and that this can lead to lengthy negotiations which either result in the grantor agreeing to give the waiver after all, or end up requiring the secured party to override its systems and give the notice to the grantor.[181] This was described in the submission as being an "untenable position". The submission suggested for this reason that the rule in s 157 be reversed for commercial property, and that the secured party not be obliged to give a notice of verification statement unless it has agreed with its grantor that it will do so.

I can understand why secured parties with highly-automated lending systems would want to avoid any transaction that did not fit into the system's standard parameters. Despite this, I am not in favour of this change. Most grantors will not be aware of the fact that they are entitled to receive a notice of verification statement, and so are unlikely to ask for it. The *de facto* effect of such a change would be that notices of verification statement would almost never be given.

180 AFC, CP4 page 21.

181 AFC, S2 att A page 9.

The proposal would also be difficult to implement fairly when a secured party registers a financing statement in advance of entering into a security agreement with the grantor, as the grantor in such a situation may genuinely not be aware of the registration, and will have no way of becoming aware of it unless the secured party gives it the notice of verification statement.

Consultation Paper 4 provided stakeholders with the opportunity to comment on this.

6.11.10.3.2 ***Discussion of stakeholder feedback***

One respondent repeated its proposal that the whole "notice of verification statement" mechanism should be repealed.[182] As I have already indicated, however, I do not propose to recommend this.

All other responses agreed with the position put in the Consultation Paper, which is that it would not be appropriate to reverse the position under s 153 so that a secured party is only required to provide a notice of verification statement if it has agreed to do so. In my view, the current position under the Act strikes the right balance, and should not be changed.

6.11.10.3.3 ***Recommendation***

Recommendation 155: *That s 157 not be amended to provide that a secured party need only give a notice of verification statement to a grantor in relation to commercial property if it agrees with the grantor that it will do so.*

6.11.11 Constructive notice of the contents of the Register

6.11.11.1 ***The issue***

Section 300 of the Act provides that a person is not deemed to be aware of the existence or contents of a registration, just because it is on the Register. Section 300 says this:

> A person does not have notice, or actual or constructive knowledge, about the existence or contents of a registration merely because data in the registration is available for search in the register.

One submission expressed concern that a person could be taken to have constructive knowledge of the contents of the Register, despite s 300, if a prudent person in their position would have undertaken a search.[183] While the submission did not explain the basis for the concern, it is likely to be based on the fact that s 300 only says that the existence of data on the Register does not automatically deem others to be aware of the data. The section appears to leave open the prospect that a person could be deemed to have knowledge of the contents of the Register on general legal principles.

182 AFC, CP4 page 22.

183 ABA, S2 page 9.

One such principle is that a person may be taken to have knowledge of a matter if they wilfully and recklessly fail to make such enquiries as an honest and reasonable man would make.[184]

I am not satisfied that I should recommend that the Act be amended to overrule the general law principles in relation to constructive notice. Those principles are of general application, and have been developed by the courts as a means of striking a balance between the interests of a person who was in a position to make themselves aware of something but did not, and the interests of a third party who might be adversely affected by this. It is not clear to me why the general law principles should not apply to the Act in the same way as they do in other areas.

Consultation Paper 4 provided stakeholders with the opportunity to comment on this.

6.11.11.2 ***Discussion of stakeholder feedback***

One respondent disagreed with the position put in the Consultation Paper. All other respondents, however, did agree. In my view, no clear case has been made for altering the way questions of constructive notice apply in the context of the Act. I do not propose to recommend any change.

6.11.11.3 ***Recommendation***

> **Recommendation 156:** *That the Act not be amended to provide that a person should not be taken to have knowledge of the contents of the Register where the general law would hold otherwise.*

6.11.12 Residual references to the Register as a collateral register

6.11.12.1 ***The issue***

Early drafts of the Act emphasised the character of the Register as a register of collateral, rather than a register of financing statements.[185] That approach was modified in later drafts, and then in the Act itself, but the Act still contains provisions that emphasise the collateral in a way that makes the drafting more complicated than it perhaps needs to be.

Section 160 of the Act appears to be such a provision. It says this:

> A description of collateral starts to be registered in a registration with respect to a security interest, in relation to a particular secured party, at the moment (the ***registration time***) when the description becomes available for search in the register in relation to that secured party.

Section 160 would be much easier to follow if it simply said that a financing statement starts to be registered at the moment when data in the financing statement becomes available for search in the register. A formulation along these lines would also sit more comfortably with the language that is used, for example, in s 153.

184 See *Baden Delvaux & Lecuit v Societe Generale pour Favoriser le Development du Commerce* [1992] 4 All ER 161; [1993] 1 WLR 509.

185 See for example the *Personal Property Securities Bill 2008*, May 2008 Consultation Draft.

This formulation would also remove the references in the current language to the identity of the secured party. Those references do not seem to be necessary, and can produce problems for a secured party under s 588FL of the Corporations Act if a security interest is transferred to a new secured party, as the financing statement would only be registered in relation to the new secured party when its name is included in the registration. That is likely to happen outside the 20 business day timeframe required by that section.[186]

The language of the Act as a whole could also be simplified by making corresponding changes to other relevant sections.

Consultation Paper 4 proposed to recommend that these changes be made.

6.11.12.2 ***Discussion of stakeholder feedback***

All respondents agreed with this proposal. In my view these changes would simplify the drafting of the Act and make it easier for users to understand and work with, and should be made.

6.11.12.3 ***Recommendation***

Recommendation 157: *That:*

- *s 160 be amended to provide that a financing statement (rather than a description of collateral) starts to be registered when data in the financing statement becomes available for search in the register; and*
- *corresponding simplifications be made where possible to other sections of the Act.*

6.11.13 Court power to rectify errors in registrations?

6.11.13.1 ***The issue***

One submission suggested that the Act give courts a general power to provide relief for errors in a registration.[187] The submission proposed this in response to the fact that the design of the Register and the complexity of the Act make it easy to make an error in a registration. The submission suggested that it would be appropriate to enable a court to order that a registration be corrected, or otherwise to deem a registration to be effective, if this could be done in a way that did not prejudice other parties.

It may be that the need for such court powers will be reduced if the Act and the Register are simplified in the ways that I have recommended elsewhere in this report. It may also be unlikely that the options that would be open to a court to correct a registration in a way that did not prejudice third parties would be any different to the options that were available to the secured party itself, for example by registering a financing change statement or a fresh financing statement.

This proposal was discussed in Consultation Paper 4. Consultation Paper 4 noted that care would also need to be taken, if this change were made, to ensure that the court did not order the Registrar to amend the Register in a way that the Register's functionality did not permit, and that thought would need to be given to

186 This issue would go away, of course, if s 588FL of the Corporations Act is repealed. See Section 9.2.1.1 below.

187 JLF, S1 page 19.

the manner in which any court-ordered "deemed effectiveness" of a registration could itself be recorded on the Register. For example, it might be necessary to amend the functionality of the Register to allow a "flag" to be entered against the affected registration, in order to draw a searcher's attention to the existence of the court order.

6.11.13.2 ***Discussion of stakeholder feedback***

Views of respondents were evenly divided on this suggestion. A number of responses were in favour of vesting a power of this nature in courts, but a similar number did not agree. One of those respondents made the point that this change would produce further uncertainty under the Act, and would have the potential to increase the amount of litigation.[188]

I can see that there are arguments both for and against this suggestion. On balance, however, I do not think that this change should be made. It is also clear, in my view, that no clear case has been made in its favour.

6.11.13.3 ***Recommendation***

> **Recommendation 158:** *That the Act not be amended to give courts a power to rectify ineffective registrations.*

6.11.14 Registrar's power to correct errors on the Register

6.11.14.1 ***The issue***

Section 186 of the Act gives the Registrar a power to amend the Register by restoring data that had been incorrectly removed. Section 186 says this:

> (1) The Registrar may (at his or her initiative) register a financing change statement to restore data to the register (including an entire registration) if it appears to the Registrar that the data was incorrectly removed from the register under this Act.
>
> (2) If data is restored to the register under subsection (1), for the purposes of this Act the data is taken never to have been removed from the register.

The view taken by the Registrar (which also reflects my understanding) is that s 186 is intended to allow the Registrar to restore data that the Registrar himself or herself had removed incorrectly, for example pursuant to the Registrar's power to remove data under s 184 or 185. The Federal Court has however taken a more expansive view of s 186, as it held recently that a secured party can use that section to require the Registrar to restore a registration that the secured party itself (or more correctly, that a person acting on behalf of the secured party) had removed in error.[189]

Consultation Paper 4 expressed the view that the Registrar is not the appropriate person to adjudicate on questions such as whether a secured party has removed data in error, or whether it is appropriate to restore data in such a circumstance (given the effect that doing so could have on third parties). Section 186 should only deal with the restoration of data that had been removed from the Register in error by the Registrar himself or herself.

188 AD, CP4 page 28.

189 *SFS Projects Australia Pty Ltd v Registrar of Personal Property Securities* [2014] FCA 846.

6.11.14.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal, and it was not clear from a number of other responses whether they were in support or not. The great majority of respondents agreed, however, that the Registrar's power under s 186 should be limited to restoring data that had been removed by the Registrar. In my view that was the original intent of the section, and I agree that it will assist the operation of the Act if this is made clear.

6.11.14.3 ***Recommendation***

> **Recommendation 159:** *That s 186 be amended to make it clear that it applies only to data that was removed from the Register by the Registrar.*

6.11.15 Residual issues with migrated security interests

6.11.15.1 **Background**

The Register replaced a range of Commonwealth, State and Territory registers when the Act commenced practical operation at the registration commencement time on 30 January 2012. To assist with the commencement process, data from a number of those registers was migrated onto the Register, so that the security interests to which they related were perfected by registration from the registration commencement time. The mechanisms for this are set out in Division 6 of Part 9.4 of the Act.

Unsurprisingly, the data on the source registers did not always match all the requirements for registrations that are set out in the table in s 153(1). The Act and the Regulations address this in a number of ways. For example, the Regulations provide that the required details for the identification of a grantor or secured party for a migrated registration are the details that came from that register, whether or not they reflect the identification details that the Regulations require for other registrations.[190]

Section 337 also provides that the Registrar may determine that a migrated registration is effective for the purposes of the Act, even if it contains a defect that would otherwise cause it to be ineffective because of s 164 or 165, for a period of up to 5 years from the registration commencement time. The Registrar has made such a determination, under the *Personal Property Securities (Migrated Security Interests and Effective Registration) Determination 2011*. That determination states that a migrated registration will not be ineffective because of a defect, to the extent that the defect arises from the fact that the financing statement (as registered by the Registrar) included or omitted particular data. It will not protect a migrated registration, however, if the data on the source register was incorrect to start with.

The migration process itself also produced a number of challenges. Many registrations against companies were migrated from the ASIC charges register by reference to the company's ABN, rather than its ACN. AFSA has advised that this has since been corrected, by amending the data on the Register to use the company's ACN instead. Also, a small number of company charges from the ASIC charges register were registered on the Register against the company's name rather than against an ACN, apparently because the company in question was deregistered at the registration commencement time.

190 See item 1 of the table in each of clauses 1.2 to 1.6 of Schedule 1 to the Regulations.

The challenges were not confined to the ASIC charges register. In particular, one submission pointed out that grantor names for registrations against motor vehicle serial numbers (ie the vehicle registration number, or VIN) may have been migrated from some State and Territory motor vehicle securities registers into the "organisation" field for the grantor's details, even where the original registration was in the name of an individual.[191] The same submission suggested that some interests relating to yellow goods were migrated under a product identification number, rather than a prescribed serial number such as a VIN. While the effect of these sorts of transitional issues should diminish with time, it appears that they are still causing concern.

6.11.15.2 Registrations migrated from the ASIC charges register

6.11.15.2.1 *The issues*

AFSA has published a fact sheet to assist a searcher of the Register to determine how it might want to search against a corporate grantor.[192] The fact sheet suggests that a searcher might want to conduct multiple searches, in the case of a grantor that is incorporated under the Corporations Act, against any or all of:

- the company's correct details (ie its ACN);
- alternative possible identifiers (such as an ARSN or ABN); and
- its name.

This has also become the customary market practice.

One submission expressed concern at the fact that the Registrar is continuing to suggest that searchers consider making multiple searches in these circumstances, and in particular that searchers consider making searches against a company's ABN, even though the initially incorrect migration of registrations to a company's ABN has been addressed.[193] That submission also suggested that steps be taken to deal with the "deregistered company" problem, particularly as it should represent only a relatively small number of registrations.[194]

<u>The "migration by ABN" problem</u>

As noted earlier, the incorrect migration of charges from the ASIC charges register by reference to a company's ABN has been resolved, in that the registrations for migrated charges that were made against a company's ABN in the ABN field have been corrected, by removing the company's ABN from the ABN field and inserting its ACN into the ACN field instead. AFSA has advised me that it will also conduct a reconciliation of the Register against ASIC's records, for migrations that were made by inserting the chargor's details into the (correct) ACN field, to ensure that those details were in fact the company's ACN, and not part of its ABN instead. I am advised, once that reconciliation is complete, that AFSA will look to revise its guidance to searchers on this point.

191 LIV, S2 page 3.

192 Available at www.ppsr.gov.au.

193 NSWYL, S1 page 8.

194 NSWYL, S1 page 11.

The "deregistered grantor" problem

One submission proposed a solution to this problem.[195] The submission suggested that the organisation name be matched to an ACN in ASIC's records, and that the Registrar then process a bulk data change to amend the relevant "deregistered grantor" registrations. The amendment would replace the organisation name with the matched ACN. This is a valuable suggestion, and should solve the problem. I understand that AFSA also agrees with this suggestion in principle, subject to confirming that it is technically possible to implement it.

Consultation Paper 4 provided stakeholders with the opportunity to comment on these matters.

6.11.15.2.2 *Discussion of stakeholder feedback*

All respondents indicated that it would be desirable to fix the "deregistered company" issue, in the manner described above. I agree with that view as well, if the proposed solution is technically feasible.

6.11.15.2.3 *Recommendation*

Recommendation 160: *That residual issues with registrations that were migrated from the ASIC charges register be addressed, if technically feasible, by:*

- *matching organisation names for grantors on the Register to ACNs in ASIC's register; and*
- *then processing a bulk data change to amend the relevant "deregistered grantor" registrations by replacing the organisation name with the matched ACN.*

6.11.15.3 Registrations migrated from State and Territory motor vehicle or similar securities registers

6.11.15.3.1 *The issue*

I noted in Section 6.11.15.1 that one submission had identified some residual issues with the manner in which data was migrated from some State and Territory registers.[196] I was not aware that these were ongoing issues, and have asked AFSA to discuss them directly with the authors of that submission.

6.11.15.3.2 *Discussion of stakeholder feedback*

A number of responses identified a further residual issue with migrated data, relating to registrations that were migrated from bills of sale registers. I will recommend that AFSA look into this issue as well, in collaboration with its consultative forums.

195 NSWYL, S1 page 11.

196 LIV, S2 page 3.

6.11.15.3.3 ***Recommendation***

> **Recommendation 161:** *That AFSA investigate identified instances of incorrect migrations from State or Territory registers and then develop and implement solutions, where appropriate, in consultation with its relevant consultative forums.*

6.11.15.4 **Registrar's power to amend the Register**

6.11.15.4.1 ***The issue***

One challenge that has faced the Registrar in dealing with issues affecting migrated registrations is that the Registrar has only limited powers to amend the Register. It would assist the Registrar to deal with challenges affecting migrated data if the Registrar had additional powers to improve the integrity of migrated data. This would assist the Registrar, for example, to implement the solution discussed in Section 6.11.15.2 above in relation to registrations that identify a deregistered company as the grantor.

For this reason, Consultation Paper 4 proposed to recommend that the Act be amended to empower the Registrar to amend migrated data on the Register as the Registrar considers necessary to correct errors in the migration process.

6.11.15.4.2 ***Discussion of stakeholder feedback***

All respondents were in favour of giving the Registrar this power. I agree that this would be a useful enhancement of the Act, and would make it easier to finalise the transition of pre-Act security interests into the new regime.

6.11.15.4.3 ***Recommendation***

> **Recommendation 162:** *That the Act be amended to empower the Registrar to amend migrated data on the Register as the Registrar considers necessary to correct errors arising from the migration process.*

6.12 Other matters affecting the Registrar

6.12.1 Registrar's discretion to refuse to register a financing statement

6.12.1.1 ***The issue***

Sections 150(3)(c) and (d) provide that the Registrar must register a financing statement or financing change statement if, among other things:

(c) the Registrar is not satisfied that the application is:

(i) frivolous, vexatious or offensive, or contrary to the public interest; or

(ii) made in contravention of section 151 (belief about security interest); and

(d) the registration would not be prohibited by the regulations.

The Register is a publicly-accessible, real-time register. The manner in which registrants can register a financing statement online makes it impracticable for the Registrar to exercise the power given to it to refuse a registration.

For these reasons, Consultation Paper 4 expressed the view that ss 150(3)(c) and (d) are not appropriate, and should be removed.

6.12.1.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree that ss 150(3)(c) and (d) should be deleted. The great majority, however, were in favour. In my view, it is inappropriate for the Act to vest powers in the Registrar that the mechanisms of the Act and the Register make it impossible for the Registrar to use, and I agree that these provisions should be deleted.

6.12.1.3 ***Recommendation***

Recommendation 163: *That ss 150(3)(c) and (d) be deleted.*

6.12.2 Amendment of the Register in accordance with a court order – procedural fairness

6.12.2.1 ***The issue***

The Registrar may be required to amend or remove a registration by court order. The effect of s 184(1)(e)(ii), in conjunction with reg 5.10(2), is that the Registrar may remove data from the Register if the removal is required by a court order to be done urgently, and in this case the Registrar is not required to exercise procedural fairness. This is because s 184(1)(c) is not listed in s 191 as a provision that is subject to review by the Administrative Appeals Tribunal.

It is less clear whether the Registrar is required to exercise procedural fairness if he or she amends the Register in response to a court order that does not require the Registrar to act urgently. If the court order spells out exactly what needs to be done, of course, then this should not matter. If the court's directions are more general, however, and the Registrar could give effect to the order in more than one way, then it may be necessary for procedural fairness to be addressed.

It has been put to me that the Registrar should not be expected to exercise procedural fairness when giving effect to a court order, and instead that any issues as to the way in which the Registrar should implement a court order should be resolved as part of the legal proceedings that resulted in the court order, and so included in the terms of the court order itself. That would ensure that any disagreements between the parties as to the way in which the court's decision should be implemented would be resolved in a proper judicial forum, and that the court's wishes would be given proper effect.

If necessary, the Registrar should also be able to seek further directions from the court.

For these reasons, Consultation Paper 4 proposed that the Act be amended to provide that the Registrar does not need to exercise procedural fairness when giving effect to a court order, and that the Registrar instead be able to seek further directions from the court before giving effect to the court's order.

6.12.2.2 ***Discussion of stakeholder feedback***

All respondents were of the view that this was appropriate.

6.12.2.3 ***Recommendation***

> **Recommendation 164:** *That the Act be amended to provide that the Registrar does not need to exercise procedural fairness when giving effect to a court order, and that the Registrar instead be able to seek further directions from the court as to the way in which the Registrar should give effect to the order.*

6.12.3 Registrar's investigative powers

6.12.3.1 ***The issue***

Section 195A provides that the Registrar may conduct an investigation into any matter for the purpose of performing his or her functions. It has been suggested to me that it should be made clearer that this also allows the Registrar to conduct an investigation into a breach of the Act in order to pursue the enforcement of civil penalties. This would support the Registrar's power to apply to court under s 222 to require payment of a civil penalty by a person who has contravened a civil penalty provision.

Consultation Paper 4 agreed that this would be a worthwhile clarification.

6.12.3.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal. All other respondents were of the view, however, that the change was appropriate, or at least did not object to it.

In my view, this would be a useful clarification. It would assist the office of the Registrar to perform its functions more effectively, and should be made.

6.12.3.3 ***Recommendation***

> **Recommendation 165:** *That s 195A be amended to confirm that the Registrar's power to conduct investigations extends to investigations that are conducted for purposes that may include pursuing the enforcement of civil penalties.*

6.12.4 A business day calendar

6.12.4.1 ***The issue***

The Act uses a concept of "business day" in a number of contexts. The term "business day" is defined in s 10 in this way:

> **business day** means a day other than:
>
> (a) a Saturday or a Sunday; or
>
> (b) a day which is a public holiday for the whole of:
>
> (i) any State; or
>
> (ii) the Australian Capital Territory; or
>
> (iii) the Northern Territory; or

(c) a day that falls between Christmas Day and New Year's Day; or

(d) a day on which the Registrar has refused access to the register, or otherwise suspended the operation of the register, in whole or in part (see subsection 147(5)); or

(e) a day that is prescribed by the regulations for the purposes of this definition.

This is quite a difficult definition to apply in practice.

One solution might be to replace the definition. One possibility would be to replace it with the definition in the Corporations Act, which reads:

> **business day** means a day that is not a Saturday, a Sunday or a public holiday or bank holiday in the place concerned.

That definition would raise its own set of difficulties, however, for example because it would then be necessary to determine what the "place concerned" is on each occasion on which the definition is used. It could also have the result that time periods under the Act would become inconsistent, because of State or Territory variations in public or bank holidays.

Another option might be to define "business day" by reference to days that are not public or bank holidays in one particular jurisdiction, such as Canberra. That would simplify the definition, but might not be attractive to some States or Territories for parochial reasons.

As an alternative to amending the definition, a number of submissions suggested that the Registrar simply be asked to maintain a "business day calendar" on its website.[197]

Consultation Paper 4 provided stakeholders with the opportunity to comment on these suggestions.

6.12.4.2 *Discussion of stakeholder feedback*

Only a relatively small number of respondents commented on this issue, and their views were mixed. A number of respondents suggested that the definition should be simplified, but an equivalent number did not agree. To the extent that it is possible to extract a consensus from the responses, that consensus appears to be in favour of keeping the definition in its current form, and asking the Registrar to maintain a business day calendar on its website. I agree that this is the best way forward.

6.12.4.3 *Recommendation*

Recommendation 166: *That:*

- *the definition of "business day" in s 10 not be amended; and*
- *the Registrar be asked to maintain a "business day calendar" on the Registrar's website.*

197 For example: DIFA, S1 att B page 6; AFC, S2 att A page 8.

6.12.5 Notices to secured parties that cannot be located

6.12.5.1 ***The issue***

There are a number of situations in which the Act may require the Registrar to contact a secured party. For example, the Registrar may need to issue the secured party with an amendment notice under s 180 of the Act. This is not possible, however, if the Registrar has no valid contact details for the secured party – for example, if the registration is a migrated registration, and the migrated data does not include the necessary information.

It has been suggested to me that the Registrar should be able to issue a notice in these circumstances by publishing the notice on the Registrar's website. That is clearly less desirable from the secured party's perspective than having the notice issued to the secured party directly, but would be preferable in my view to the Registrar not being able to issue the notice at all.

If a notice is issued by publication on the Registrar's website, then it would be appropriate to allow a longer notice period than the period that would otherwise apply, so that the secured party has some opportunity to become aware of the notice in time to respond.

For these reasons, Consultation Paper 4 proposed that the Registrar be empowered to issue a notice to a secured party by publication on the Registrar's website, if the Registrar has no other valid notice details for a secured party, and that the associated notice period required by the Act be extended in these circumstances.

6.12.5.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal. All other responses, however, did agree with it.

In my view, this is an appropriate solution to an otherwise-insoluble problem. The Act should be amended to provide the Registrar with this flexibility.

6.12.5.3 ***Recommendation***

Recommendation 167: *That:*

- *the Registrar be empowered to issue a notice to a secured party by publication on the Registrar's website, if the Registrar has no other valid notice details for a secured party; and*
- *any notice period required by the Act in relation to such a notice be extended by an appropriate additional period.*

Chapter 7
Dealings in collateral

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7.1 Terminology

7.1.1 *The issue*

The Act uses a number of different terms to refer to what might loosely be described as a dealing with property. For example, s 12(2) refers to an "assignment" and a "transfer" as distinct concepts. Section 31(1)(a) talks of a "dealing" in collateral, and s 32(1)(a) refers separately to both a "dealing" and a "disposal". A large number of provisions refer to a "transfer" of collateral.

It is not clear to what extent these terms are intended to embody different meanings, or are just being used as alternative expressions for the same concept. This uncertainty makes it difficult for secured parties to be confident that they understand the implications for their security interest, if the grantor deals with the collateral in different ways.

The Act will be much easier to understand if it can be amended to use terminology more consistently than it does at present. For these reasons, Consultation Paper 2 suggested that the Act be amended to ensure that it uses consistent terminology, and to clarify the distinctions in meanings between similar terms.

7.1.2 *Discussion of stakeholder feedback*

All respondents agreed that this would be a valuable improvement to the Act.

7.1.3 *Recommendation*

Recommendation 168: *That the Act be amended to ensure that it uses consistent terminology when it refers to dealings in collateral, and if different terms are used to describe particular types of dealings, that it be made clear what the differences in meaning are as between those different terms.*

7.2 Should a transfer of collateral change the identity of the grantor of the security interest?

7.2.1 *The issue*

This Chapter 7 looks at the rules in the Act that regulate what happens to a security interest, if the collateral is dealt with in different ways.

The Act recognises that a security interest can remain attached to collateral after the collateral is transferred. Even if a security interest remains attached to collateral after it has been transferred, however, the security interest will not necessarily continue to be perfected. A security interest will only be perfected if, in addition to being attached to the collateral, the security interest is also enforceable against third parties under s 20, and the secured party has taken a perfecting step of registering an effective financing statement, or taking possession or control of the collateral, under s 21. In most cases, a secured party will not have possession or control of the collateral, and will need to have a security agreement with the grantor that "covers the collateral" under s 20, and to have an effective registration.

A transfer of collateral subject to a security interest has the result of making the transferee the grantor of the security interest over the collateral, in place of the transferor. This is implicit, for example, in s 34, and is made explicit by

paragraph (e) of the definition of "grantor" in s 10, and by the Note to s 166. In this respect, the Act has taken a different path to its overseas counterparts. Under the Canadian PPSAs and the NZ PPSA, a person who transfers collateral subject to a security interest will continue to be the grantor of the security interest for most purposes. This means, in Canada and New Zealand, that the security agreement with the transferor will continue to make the security interest enforceable against third parties, and that the security interest will continue to be perfected by the original registration against the transferor.

Under the Act, in contrast, it is not entirely clear that the original security agreement will be sufficient for the security interest to continue to be enforceable against third parties, because the new grantor is not a party to it. This is discussed in Section 5.2.3. Perhaps more significantly, however, the security interest will no longer be perfected by the registration against the transferor, because the transferor is no longer the grantor. This means that the registration is now ineffective because of a defect, under s 164.

The security interest will instead be temporarily perfected for up to 2 years, under s 34. That temporary perfection will protect the secured party in a priority competition with other secured parties, and will protect the secured party from the risk that the security interest could otherwise vest in the transferee under s 267, if the transferee becomes insolvent (see Section 8.7 below).

However, the security interest will be exposed to the taking free rule in s 52. Section 52 provides that a buyer or lessee of collateral for new value will take the collateral free of a security interest if it is only temporarily perfected, unless the buyer or lessee had knowledge that the sale or lease was in breach of the security agreement. So if the transferee on-sells the collateral, for example, to a buyer for new value who did not know that the sale was a breach of the security agreement, then that buyer will take the collateral free of the security interest.

7.2.2 *Discussion*

The Act produces a harsher outcome for the secured party than a Canadian PPSAs and the NZ PPSA. Under that legislation, the security interest continues to be perfected by the registration against the original transferor. For as long as the security interest remains attached to the collateral and no other taking free rule applies, the security interest will travel with the collateral, and will continue to be perfected over it. Under the Act, in contrast, the security interest will remain temporarily perfected for up to 2 years after the first transfer, but will become unperfected if the collateral is transferred a second time.

The Canadian/New Zealand approach clearly provides a better outcome for a secured party than the Act. However, it provides a less attractive result for later buyers or lessees, or for secured parties to later buyers or lessees, as they will have no way of being able to discover the existence of the transferor–granted security interest, unless they investigate the ownership history of the collateral and conduct searches against all the previous owners.

One respondent recommended that the Act be amended to adopt the Canadian/New Zealand approach.[1] That would tilt the balance back in favour of the secured party (if that was thought to be appropriate), and would also deal with the concerns discussed in Sections 5.2.3 and 7.4.1.1 about how ss 20(2) and

1 LW, CP2 page 17.

31(3) function where a transfer of collateral has changed the identity of the grantor. I am not prepared to recommend that we do this, however, for a number of reasons. First, I would not want to recommend the change until I was confident that all the consequential effects of the change had been identified and found to be appropriate. Secondly, I would not want to recommend it until stakeholders had been given an opportunity to comment. And thirdly, if the only substantive difference between the two approaches is the fact that the secured party is vulnerable to subsequent transfers under the Act because of s 52, a simpler solution might be to amend s 52 instead (if it were thought appropriate as a policy matter to prefer the secured party over other third parties). I am however comfortable with recommending that this be investigated further.

I will return to s 52 in Section 7.6.11 below.

7.2.3 *Recommendation*

> **Recommendation 169:** *That Government consider further whether the Act should continue to provide that a transfer of collateral subject to a security interest will cause the transferee to become the grantor of that security interest, or whether the Act should be amended to reflect the alternative approach taken under the Canadian PPSAs and the NZ PPSA.*

7.3 Leases

7.3.1 Can a lease of goods be a transfer of the goods for the purposes of the Act?

7.3.1.1 *The issue*

One of the most challenging questions raised in the submissions related to the effect that a lease of goods might have on a security interest that had previously been granted over the goods by the lessor. A number of submissions raised this issue,[2] including in the context of lease/sublease chains, where it was said to be unclear what effect a sublease could have on the interest of a lessor further up the lease chain. Submissions noted that it is unclear whether the interest of such a lessor would be compromised if the sublessee sold or granted security over the goods, or if the sublessee became insolvent in a way that engaged the "vesting on insolvency" rule in s 267.

The Act does not provide clear guidance on this important question. In my view, though, the answer to the question is found in the discussion in Section 5.1.2 above of the way in which the Act approaches the concept of "rights in the collateral". It can be seen from that discussion that there are two schools of thought. One school of thought (the "possession" model) argues that a person's rights in collateral, at least in the case of physical collateral, are bounded by the rights that the general law affords to a person in possession of the collateral. The other school of thought (the "unitary" model) argues that a consequence of the unitary approach that the Act takes to security interests is that the Act treats the grantor of a security interest as if it were the owner of the collateral, whether or not that is the case at general law.

2 For example: JLF, S1 page 28; Avis, S1; AFC, S1 page 3; AICM, S1 page 10.

If the possession model is correct, then a lease of collateral, even if it gives rise to a security interest under the Act, will not affect the lessor's status as the owner of the collateral for the purposes of the Act. This would mean that any security interest granted by the lessor would remain attached to the goods despite the lease, even if a taking free rule allows the lessee to take the leased goods free of the security interest. If a taking free rule applies, then the secured party will not be able to enforce its security interest in a manner that would interfere with the lessee's possession of the goods for the term of the lease, but the secured party would nonetheless continue to have security over the goods themselves.

If the unitary model is correct, however, then a different set of consequences follows. Under this model, the lessee under a lease that gives rise to a security interest is treated by the Act as if it were the owner of the goods. The logical consequence of this is that the Act operates as if the lessor had sold the goods to the lessee, and taken security back for the unpaid purchase price – in other words, as if the lessor had transferred the goods to the lessee. This would mean that a security interest granted by the lessor over the goods might cease to be attached to the goods – for example, if the secured party had consented to the lease, or if a taking free rule applied. If that is the case, then the security interest would attach instead to the lessor's rights under the lease (including the lessor's rights to the return of the goods at the end of the lease), as proceeds.

Under the unitary model, if the security interest did remain attached to the goods despite the lease, then the secured party would be in the same position as any secured party with a security interest over collateral that had been transferred, as just discussed in Section 7.2.1. Its security interest would be temporarily perfected under s 34, but would be exposed to the risk that the security interest could cease to be attached to the collateral if the lessee sells the collateral, or if the lessee sub-leases it under another lease that the Act also characterises as a security interest, because of the effect of the taking free rule in s 52.

The possession model is more in line with traditional legal thinking, and favours the secured party. The unitary model is more consistent with the unitary principle that underpins the Act, and favours third parties.

Consultation Paper 2 invited stakeholders to comment on these issues.

7.3.1.2 ***Discussion of stakeholder feedback***

Respondents had a range of views on this question. Some respondents emphasised the need to protect the position of the lessor, and to ensure that its position could not be prejudiced by unauthorised actions by a lessee or sublessee. Other respondents focussed more on the need to recognise and give effect to the unitary nature of security interests under the Act, and took the view that an approach that singled leases out for special treatment would involve a return to the "form over substance" approach of the prior law that the Act was intended to replace.

I do not think it appropriate that the Act provide complete protection for a lessor (or other secured party) from any adverse consequences that could flow from an unauthorised dealing in the collateral. As I explain in Section 7.5.1 below, not even the prior law went that far, as there were circumstances under prior law in which a secured party (such as a chargee) could lose its security interest as a result of an unauthorised dealing in the collateral by the grantor. Admittedly, this was less of a risk previously for lessors, but the Act has now assimilated the position of a finance

lessor with the position of other in-substance secured parties, and I do not think that the fact that prior law distinguished between different types of secured party is justification for continuing the distinction under the Act.

In any event, the position of a lessor under the unitary model is not as exposed as might initially be thought. If a lessee subleases collateral under a finance lease that was not authorised by the lessor and the sublessee does not benefit from a taking free rule, then the lessor's security interest under the unitary model will remain attached to the collateral in the hands of the sublessee, and will be temporarily perfected under s 34. That temporary perfection will protect the lessor in a priority dispute with a security interest granted by the sublessee (and the lessor's security interest will generally take priority, under ss 66 to 68), and will protect the lessor's security interest from vesting under s 267 if the sublessee becomes insolvent. The main exposure for the lessor is that a buyer or lessee from the sublessee might take the collateral free of the lessor's security interest because of s 52.

I indicated in Section 5.1.2 that my view is that the unitary model provides a better foundation for the operation of the Act than the possession model. One implication of the unitary model is that a lease of collateral that gives rise to a security interest under the Act will be regarded for the purposes of the Act as taking effect as if the lessor had transferred the collateral to the lessee, and then taken a security interest back from the lessee to secure amounts owing under the lease. That gives effect to the objective of applying a consistent set of rules to all transactions that operate in substance as security, regardless of the nature of the transaction or the location of title to the collateral. As I also see it, the main exposure for a lessor under this model is the risk under the taking free rule in s 52. I return to that risk in Section 7.6.11 below.

This does not mean that the lessee actually becomes the owner of the collateral in place of the lessor. It only means that the Act applies its internal rules as if the lessee were the owner of the collateral, and as if the lessor only held security over it. While that will be different to the position under laws outside the Act, it is not clear to me that the difference in approach would produce any insurmountable challenges in practice.

I accept however that the review has not had time to allow all sides of this debate to be fully aired. The issue is also clearly an extension of the discussion in Section 5.1.2 above about the meaning of the expression "rights in the collateral", and the basis on which a person in possession of personal property is able to grant a security interest over it. I propose for this reason to recommend that Government allow interested stakeholders an opportunity to provide further input on this question as well, with a view to including an agreed description of the relevant principles in the Explanatory Memorandum for any legislation that might be passed to give effect to other recommendations in this report.

7.3.1.3 *Recommendation*

Recommendation 170: *That Government expand the further consultation process described in Recommendation 51 to include consideration of the extent to which the competing models described in that Recommendation will affect the position of a lessor of collateral that is subsequently subleased by the lessee to a sublessee.*

7.3.2 Leases, and s 267

7.3.2.1 ***The issue***

A number of submissions questioned what should happen to a secured party if its grantor leases the collateral to a lessee who takes free of the secured party's security interest, the lessor fails to perfect against the lessee and the lessee then becomes insolvent.[3] Should the secured party's security interest be derivative of the lessor's security interest under the lease (in which case the security interest would effectively be extinguished, if the lessor's security interest vests in the lessee under s 267)? Or should the secured party's security interest be able to survive, despite a vesting of the lessor's security interest?

Consultation Paper 2 invited stakeholders to comment on this question.

7.3.2.2 ***Discussion of stakeholder feedback***

The views of respondents on this question were split along the same lines as discussed in Section 7.3.1. Some respondents argued that the secured party's security interest should not be exposed to loss because of an insolvency of the lessee, whereas others argued that the secured party's security interest could be no greater than the interest of the lessor – and if the lessor's security interest under the lease was unperfected and so vested in the lessee on the lessee's insolvency, then the security interest held by the lessor's secured party does too. Or put another way, the secured party only has security over the lessor's interest in the goods, and if that interest vests in the lessee on insolvency, then there is nothing left for the secured party's security interest to be attached to.

I agree with that latter view. Consistent with my recommendation in Section 7.3.1, though, I propose to recommend that Government allow interested stakeholders an opportunity to provide further input on this question as well, with a view to including an agreed description of the relevant principles in the Explanatory Memorandum for any legislation that might be passed to give effect to other recommendations in this report.

7.3.2.3 ***Recommendation***

Recommendation 171: *That Government expand the further consultation process described in Recommendation 51 to include consideration of the extent to which the competing models described in that Recommendation will affect a security interest over collateral that is leased by the grantor to a lessee, where the lessee subsequently becomes insolvent in a way that causes the grantor's interest in the leased goods to vest in the lessee under s 267.*

3 For example: AFC, S2 att A page 4; AICM, S1 page 10.

7.3.3 Lease/sublease chains

7.3.3.1 ***The issue***

One submission focused in particular on the effects of a sublease on the position of an owner of goods higher up a lease chain.[4]

The submission made the point quite forcefully that the equipment leasing industry is particularly affected by the way in which the Act enables a sublease of goods to adversely impact the interest of an owner or other lessor further up the lease chain. It noted that equipment lessors have little ability to control what happens to leased equipment in the hands of their lessee customers. A customer might sublease equipment to a third party under a transaction that is itself a security interest, even if the head lease prohibits this. That sublease might be a formal, documented agreement, or it could be an arrangement of a more informal nature. A customer that is part of a corporate group might also make the equipment available to other members of the group, again on either a formal or an informal basis.

That submission suggested a number of ways in which these risks for a head lessor (and to some extent for its customer as well) could be ameliorated.

As a threshold matter, I should note that I am not in favour of amending the Act to provide *ad hoc* solutions to individual problems, unless there is a truly pressing need to do so. Also, any solutions should not be limited in their application to security interests that happen to be in the form of a lease, as that would re-introduce some of the artificial form-based distinctions that the Act largely eradicates. The issues described above are ones that can affect any secured party to a lessor, not just one who happens to be the owner of the leased goods, so I will approach them as ones that should be considered for secured parties generally, not just for lessors.

Vesting on insolvency – s 267

A number of submissions suggested that s 267 should not apply to a security interest over equipment if, at the time of insolvency, there is any registration on the Register that identifies the specific equipment.[5] That identification could be by way of serial number, and the submissions suggested that the categories of collateral that can be identified by way of serial number could be widened, to extend the reach of this protective measure. The submissions suggested that it might also be possible to introduce a new collateral class, called "Other goods identified", and that the protective measure could extend to collateral in that class as well.

Section 267, the collateral classes and the concept of serial-numbered property are all considered separately in this report.[6]

Goods leased to a corporate group

One submission noted that it is common for an equipment lessor to lease goods to one company in a corporate group, and for that company to then make the equipment available to other members of the group from time to time under arrangements that could be PPS leases.[7] The submission suggested that it should be sufficient, in order to perfect a security interest that is granted by a member of a

4 AFC, S1 att B page 2.

5 For example: AFC, S1 att B page 2; ABA, S2 page 2.

6 See Sections 6.3 and 6.6 above, and Section 8.7 below.

7 AFC, S1 att B page 2.

corporate group under such an "internal" PPS lease, that a financing statement just be registered against the asset-holding member of the group. The submission went on to acknowledge that this solution might need to be limited to serial-numbered property (or goods that are "Other goods identified", as noted above).

It is not clear whether this proposal was put just in the context of s 267, or more generally. To the extent it relates to s 267, I return to it in Section 8.7 below. To the extent it is intended to apply more generally, though, I am not in favour of it. Currently, a person who searches the Register for security interests granted by a corporate grantor need only search against the grantor's details. This proposal would change that, as it would allow a security interest to be perfected by a registration that identified only the serial number (or other identifier) of the goods. While that could alleviate the burden for some secured parties, it would be a radical change to the overall architecture of the Act. The benefits that it would bring to those secured parties would be outweighed, I expect, by the detriments that it would produce for others.

Many if not most of those informal intra-group leasing arrangements will only be PPS leases because they have an indefinite term. I have recommended in Section 4.3.5.4 that the definition of PPS lease in s 13 be amended so that it does not capture a lease of an indefinite term unless it runs for more than one year. That may go some way to alleviating this concern.

Consultation Paper 2 invited stakeholders to comment on this.

7.3.3.2 ***Discussion of stakeholder feedback***

Most respondents were not in favour of the proposal that a registration against one member of a corporate group be able to perfect security interests that might arise as a result of intra-group dealings with the collateral, even if the proposal is limited to serial-numbered property. I am also not in favour, for the reasons outlined above.

7.3.3.3 ***Recommendation***

Recommendation 172: *That the Act not be amended to provide that a registration against one member of a corporate group is sufficient to perfect a security interest that is granted by another member of that group.*

7.4 Proceeds

7.4.1 Section 31(3) – grantor must have an interest in the proceeds

7.4.1.1 Proceeds of what?

7.4.1.1.1 ***The issue***

Section 31(3)(a)(i) provides that personal property will only be proceeds if (among other options):

> (i) the grantor has an interest in the proceeds; …

There is a similar provision in most of the Canadian PPSAs[8] and the NZ PPSA.[9]

8 For example Sask PPSA, s 2(1)(hh)(i)(B).

9 NZ PPSA, s 16 (definition of "Proceeds", para (a)(ii)).

The following example may help to demonstrate the effect of this requirement.

> A secured party has a security interest in a grantor's motor vehicle. The grantor sells the motor vehicle to a buyer without the secured party's consent. The buyer cannot rely on the taking free rules, so the security interest remains attached to the motor vehicle. The buyer later exchanges the motor vehicle for a caravan.

The effect of s 31(3)(a)(i) can be understood in two ways. First, it can be understood to mean that the security interest does not attach to the caravan, even though the caravan derives from a dealing in the motor vehicle, because the grantor does not have an interest in the caravan. Read in this way, the section is said to be designed to prevent a "geometric multiplication" of proceeds claims, and to limit the extent to which third parties could be prejudiced by the fact that it may not be apparent from the Register that a secured party holds a security interest in the property.[10]

The provision can however be viewed in a different way. It is clear from other provisions in the Act that a transfer of collateral that is subject to a security interest can have the result that the transferee becomes the grantor of that security interest for the purposes of the Act. See Section 7.2. This means that the buyer in the example becomes the grantor of the security interest in the motor vehicle in place of the original grantor. Seen that way, the security interest would attach to the caravan, as proceeds of the motor vehicle, because the grantor (ie the buyer) has an interest in it.

This way of approaching the issue also deals with the risk of undiscoverable security interests – that is, the risk that the buyer might sell the caravan to another person, who would be unable to discover the existence of the security interest, and so unwittingly not acquire clear title – albeit in a different way to the first approach. It achieves this through the fact that the security interest in the caravan will be unperfected. Even if the security interest was perfected against the original grantor by registration, that registration will have ceased to perfect the security interest when the motor vehicle was transferred to the buyer, because at that point the buyer became the grantor in place of the original grantor.[11] The security interest in the motor vehicle will be temporarily perfected under s 34, but when the buyer exchanges the motor vehicle for the caravan the security interest in the motor vehicle will not have been perfected by registration. This means that the security interest in the caravan (as proceeds of the motor vehicle) will at best be temporarily perfected (and then only for a short period) under s 33(2), and after that will be unperfected.

Admittedly, this way of approaching the application of s 31(3)(a)(i) does raise the potential for a "geometric multiplication" of claims. It could be asked, however, how often that would arise in practice. And this approach arguably has the advantage of fitting more neatly with other aspects of the Act's conceptual framework.

Consultation Paper 2 acknowledged that both ways of approaching s 31(3)(a)(ii) can produce clear and rational outcomes, and invited stakeholders to indicate which approach they preferred.

10 See Duggan & Brown, para 11.13.

11 This assumes that the secured party did not happen to have an appropriate registration against the buyer as well.

7.4.1.1.2 ***Discussion of stakeholder feedback***

The great majority of respondents were of the view that the better approach to s 31(3)(a)(i) is to apply it as if the reference in the section to the "grantor" were a reference to the original grantor of the security interest, and not to a transferee who might become the grantor of the security interest as a result of the transfer. I am comfortable with recommending that the Act be amended to confirm that that is the correct approach to the operation of the section.

7.4.1.1.3 ***Recommendation***

> **Recommendation 173:** *That s 31(3)(a)(i) be amended to make it clear that the grantor referred to in the section is the original grantor of the security interest, not a person who subsequently becomes the grantor as a result of the collateral being transferred to it.*

7.4.1.2 **Meaning of an "interest" in the proceeds**

7.4.1.2.1 ***The issue***

Section 31(3)(a)(i) refers to the grantor having "an interest in" the proceeds. This is different to the language that the Act uses in relation to the grant of security interests generally (under s 19(2)(a)), as that section requires that the grantor have "rights in" the collateral. In the context of the grant of a security interest, the Act uses the expression "interest in" collateral to refer to the interest of the secured party under the security interest, not the interest in the collateral that the grantor needs to have in order to be able to grant the security interest in the first place.

It is not clear why s 31(3)(a)(i) uses the expression "interest in", rather than "rights in". Consultation Paper 2 suggested, if there is no good reason for the different language, that it would be preferable to amend the section to make it consistent with the terminology used in s 19.

7.4.1.2.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree with this approach. The great majority, however, were in favour of amending the section to make it consistent with s 19.

7.4.1.2.3 ***Recommendation***

> **Recommendation 174:** *That the words "an interest" in s 31(3)(a)(i) be replaced with "rights".*

7.4.2 Section 31(3) – grantor can instead have the power to transfer rights in the proceeds to the secured party

7.4.2.1 ***The issue***

Section 31(3)(a)(ii) provides, as an alternative to the grantor having an interest in the proceeds under s 31(3)(a)(i), that personal property can be proceeds if (among other requirements):

> (ii) the grantor has the power to transfer rights in the proceeds to the secured party (or to a person nominated by the secured party); …

The Act contains similar language in relation to the grant of a security interest over original collateral, in s 19(2)(a). The corresponding language in s 19(2)(a) was discussed in Section 5.1.3 above.

Consultation Paper 2 suggested that s 31(3)(a)(ii) should be deleted, for the same reasons as discussed in Section 5.1.3 in relation to s 19(2)(a).

7.4.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were not of the view that s 31(3)(a)(ii) should be deleted. The great majority of respondents agreed, however, that the provision was not needed, and could be removed.

7.4.2.3 ***Recommendation***

Recommendation 175: *That s 31(3)(a)(ii) be deleted.*

7.4.3 Section 32 – drafting improvements

7.4.3.1 ***The issues***

Section 32 contains rules for what happens when collateral gives rise to proceeds. The core provision is s 32(1). It states:

> (1) Subject to this Act, if collateral gives rise to proceeds (by being dealt with or otherwise), the security interest:
>
> (a) continues in the collateral, unless:
>
> (i) the secured party expressly or impliedly authorised a disposal giving rise to the proceeds; or
>
> (ii) the secured party expressly or impliedly agreed that a dealing giving rise to the proceeds would extinguish the security interest; and
>
> (b) attaches to the proceeds, unless the security agreement provides otherwise.

A similar provision can be found in the Canadian PPSAs[12] and the NZ PPSA.[13]

The language of s 32(1) has raised a number of very practical problems.

<u>The meaning of "continues in the collateral"</u>

Section 32(1)(a) says that the security interest "continues in" the collateral. A similar expression is used in Part 3.4, in relation to security interests over goods that become an accession, or are processed or commingled.

It is not clear how the term "continues in" is to be lined up against the continuum used elsewhere in the Act, of a security interest being "attached to collateral", "enforceable against a third party" and "perfected". My view is that "continues in" has the same meaning as "remains attached to", although I acknowledge that this is not entirely clear.

If I am correct that "continues in" has the same meaning as "remains attached to", then the Act would be easier to understand if it just said so. I am mindful of the fact that the Canadian PPSAs and the NZ PPSA use the expression "continues in", but do not think that this should be grounds to not make what could otherwise be a helpful clarification.

12 For example Sask PPSA, s 28(1).

13 NZ PPSA, s 45(1).

Consultation Paper 2 invited stakeholders to comment on this.

What happens if there are no proceeds?

Section 32 is only engaged if a dealing produces proceeds. It does not say what happens if there are none – for example, if a grantor makes a gift of collateral, or if a grantor disposes of collateral in satisfaction of a pre-existing debt.

A security interest should be able to remain attached to the collateral even if it is dealt with in a way that does not give rise to proceeds, despite the fact that s 32 is silent on the point. Consultation Paper 2 suggested that it would be helpful to confirm this.

What happens if the secured party consents to a disposal of collateral, but only on the basis that its security interest remains attached?

As some submissions observed, s 32(1)(a)(i) appears to suggest that a security interest will not continue in collateral that is disposed of, if the secured party expressly or impliedly authorised the disposal.[14] If correct, this would mean that it is not open to a secured party to consent to a disposal on the basis that its security interest remains attached to the collateral after the disposal.

It has been suggested in relation to the Canadian PPSAs that the equivalent provision in that legislation should be read with an implied qualification to the effect that the security interest is only extinguished by a disposal if the secured party agreed that the disposal would extinguish its security interest.[15] It is possible to find some support for this in the language of the Act, but equally possible to point to factors in the Act that argue for the opposite view. It is also instructive to note that the corresponding provision in Article 9 was amended some years ago to make this explicit.[16] Either way, this uncertainty is undesirable.

Consultation Paper 2 recommended that this be clarified.

7.4.3.2 ***Discussion of stakeholder feedback***

A small number of respondents did not think that there was a great need to clarify that "continues in" is intended to mean "remains attached to". Most respondents agreed, however, that it would be helpful to make this change.

The overwhelming majority of respondents were in favour of amending s 32 to clarify that a security interest can remain attached to collateral if it is dealt with, even if the dealing produces no proceeds. They were also in favour of amending the section to clarify that a security interest can remain attached to collateral that is dealt with with the secured party's consent, if the consent was given on the basis that the security interest would remain attached to the collateral despite the dealing.

Consultation Paper 2 had suggested some alternative drafting for s 32 that was designed to address these concerns. Some respondents suggested some modifications to the drafting, principally in order to avoid the use of the word "extinguish". I have taken that into account in the framing of my recommendation below. The great majority of respondents were otherwise in favour of those amendments.

14 For example: AFC, S1 att B page 4; AICM, S1 page 9; LCA, S2 page 11.

15 Cuming Walsh & Wood, pages 383 to 385.

16 Article 9, §9-315(a)(1).

7.4.3.3 ***Recommendation***

Recommendation 176: *That s 32(1) be amended to read along these lines:*

"(1) Subject to this Act:

(a) if collateral is dealt with, the security interest remains attached to the collateral, unless the secured party expressly or impliedly agreed that a party to the dealing could take the collateral free of the security interest; and

(b) if collateral gives rise to proceeds (by being dealt with or otherwise), the security interest attaches to the proceeds unless the security agreement provides otherwise."

7.4.4 Section 32(2) – enforcing against both the collateral and the proceeds

7.4.4.1 ***The issue***

Section 32(1) provides a secured party with a potential windfall. The security interest will remain attached to the original collateral (in the hands of the dealee), and will also attach also to the proceeds from the dealing that were received by its grantor. While the secured party can of course only recover its secured amount once, if it had been under-secured (ie if the secured amount had been more than the value of the collateral), then the secured party could benefit from the dealing, because it can now pursue both the collateral and the proceeds.

Section 32(2) counters this potential windfall, by providing as follows:

> (2) If the secured party enforces a security interest against both collateral (other than an investment instrument or an intermediated security) and proceeds, the amount secured by the security interest in the collateral and proceeds is limited to the market value of the collateral immediately before the collateral gave rise to the proceeds.

Section 32(3) then qualifies this, by providing that s 32(2) does not apply if the transferee of the collateral had actual or constructive knowledge that the transfer was in breach of the security agreement.

The Canadian PPSAs[17] and the NZ PPSA[18] contain a provision that corresponds to s 32(2). Despite this, s 32(2) raises a number of questions.

While s 32(2) is intended to prevent a secured party from getting a windfall benefit by pursuing both the collateral and the proceeds, the section could in fact harm the secured party, because it caps the amount that the secured party can recover at the market value of the collateral immediately before the collateral gave rise to the proceeds. This could penalise the secured party, if the market value of the collateral could increase after that time. Section 32(2) does not apply to two such types of collateral (investment instruments and intermediated securities), but there are other types of collateral (such as commodities, or works of art) that could increase in value over time as well.

17 For example Sask PPSA, s 28(1).

18 NZ PPSA, s 45(2).

The other issue with the provision is that it potentially makes an incorrect assumption about the nature of proceeds. The provision makes sense (subject to the previous paragraph) if the proceeds in question are a replacement of the original collateral – for example, if the grantor sold the collateral for cash, or exchanged it for another asset. Under the definition of "proceeds" in s 31, however, proceeds can include any personal property that derives from a dealing with the collateral. This could include revenue that flows from a dealing with the collateral, and not just be property that is received as a replacement of the property's capital value.

The provision accommodates this to some extent, by excluding investment instruments and intermediated securities. However, the issue could still arise – for example, if the grantor hires out goods for rent (under s 31(1)(a)), or grants a licence of intellectual property in return for royalties (under s 31(1)(d)). In these circumstances, it is arguable that the limitation in s 32(2) is not appropriate.

It could even be argued that s 32(2) should be deleted in its entirety. For example, the capacity of the section to produce a windfall benefit for the secured party may be more perceived than real, as it is only an issue if the secured party was under-secured. One might also query why it is appropriate to shelter the grantor from the consequences of its breach of its security agreement, and why it is appropriate to protect the dealee just because the secured party chooses to pursue the proceeds in the hands of the grantor as well – if the secured party chose to enforce only against the collateral in the hands of the dealee, then the limitation in s 32(2) would not be engaged.

And finally on s 32(2), the language of s 32(3) suggests that a dealing covered by s 32(2) needs to be a "transfer". This may not always be the case, however, unless "transfer" is given a very broad meaning, or s 32(2) is read down so that it is only engaged where the proceeds in question are produced by a transfer, not some lesser dealing. If ss 32(2) and (3) are retained, then this should be clarified.

One submission proposed that s 32(3) should be deleted even if s 32(2) is retained, on the basis that it is inconsistent with the policy reason for the rule in s 32(2).[19]

7.4.4.2 ***Discussion of stakeholder feedback***

A number of respondents were in favour of deleting ss 32(2) and (3) entirely. Others, however, were in favour of retaining them, at least in part.

One response observed that courts in Canada have interpreted the concept of "proceeds" so that property is only proceeds of collateral if it is taken in exchange for the collateral.[20] The drafting of the definition of "proceeds" in s 31 of the Act does not lend itself to a similarly limiting interpretation. However, the fact that s 32(3) refers only to a "transfer" of collateral does seem to suggest that the drafters may have had in mind that s 32(2) should only be engaged if the proceeds arise as a result of a transfer of the collateral, and not as a result of some lesser dealing. One response suggested that the operation of s 32(2) should indeed be limited in this way, although one other response took the opposite view.

The majority of respondents were in favour of deleting s 32(3), even if s 32(2) is retained.

19 LCA, S2 page 11.

20 LW, CP2 page 11. See Cuming Walsh & Wood, pages 565 to 566.

In my view, the best way to balance the competing views of s 32(2) is to provide that it only applies if proceeds arise as a result of a transfer of the collateral. If that change is made, then the language in brackets in the section ("(other than an investment instrument or an intermediated security)") could be deleted as well. I agree that s 32(3) could then also be deleted.

7.4.4.3 ***Recommendations***

Recommendation 177: *That s 32(2) be retained, and that the start of s 32(2) be amended to read along these lines:*

> *"(2) If the secured party enforces a security interest against both collateral and proceeds that arise from a transfer of the collateral, the amount secured by the security interest in the collateral and proceeds is limited….".*

Recommendation 178: *That s 32(3) be deleted.*

7.4.5 Section 32(5) – priority in relation to proceeds

7.4.5.1 ***The issue***

Section 32(5) says this:

> (5) For the purposes of section 55 (default priority rules), the time of registration or possession in relation to original collateral, or the time of perfection of a security interest in original collateral, is also the time of registration, possession or perfection in relation to the proceeds of the original collateral.

There are three aspects of this section that are worth considering. First, it is not clear why the provision refers in two places to "possession". It may be that these references could be deleted. Secondly, the provision may be able to be simplified by using the concept of a security interest's "priority time" (as defined in s 55(5)), in that it could simply provide that the priority time for the proceeds is the same as the priority time for the original collateral. Thirdly, it should be asked why the application of this rule is limited to the default priority rules in s 55.

These issues were raised for discussion in Consultation Paper 2.

7.4.5.2 ***Discussion of stakeholder feedback***

A number of respondents were in favour of deleting the references to "possession" from s 32(5), but otherwise of leaving the section as is. Other respondents, however, were in favour of amending the section to refer instead to a security interest's "priority time", and of applying the rule generally, not just for the purposes of s 55.

One respondent made the interesting observation that s 32(5) appears to apply whether or not the security interest over the proceeds has been continuously perfected.[21] It is possible, under s 33 as it currently stands, that a security interest over proceeds may initially be temporarily perfected, but then become unperfected if it is not re-perfected within 5 business days. If the security interest is later re-perfected, then its priority time should run from the time of re-perfection, not from the priority time in relation to the original collateral. I agree that the drafting of s 32(5) should be adjusted to reflect this.

21 LW, CP2 page 12.

This will cease to be an issue for security interests that are perfected over the original collateral by registration, if my recommendation in Section 7.4.6.1 is accepted so that those security interests are then automatically perfected over the proceeds as well. However, it could still be an issue for security interests that were perfected by other means.

7.4.5.3 ***Recommendation***

> **Recommendation 179:** *That s 32(5) be amended to read along these lines:*
>
> *"(5) The time of registration in relation to original collateral, or the time of perfection of a security interest in original collateral, is also the time of registration or perfection in relation to the proceeds of the original collateral, if the security interest has been continuously perfected ."*

7.4.6 Section 33(1) – perfection of a security interest over proceeds

7.4.6.1 Should perfection be automatic?

7.4.6.1.1 ***The issue***

Section 33(1) provides that a security interest over proceeds is taken to be perfected if the security interest in the original collateral is perfected by a registration that:

(a) describes the proceeds, if the description complies with any regulations made for the purposes of paragraph (d) of item 4 of the table in section 153 (financing statements with respect to security interests); or

(b) covers the original collateral, if the proceeds are of a kind that are within the description of the original collateral; or

(c) covers the original collateral, if the proceeds consist of currency, cheques or an ADI account, or a right to an insurance payment or any other payment as indemnity or compensation for loss or damage to the collateral or proceeds.

A similar provision can be found in the Canadian PPSAs[22] and the NZ PPSA.[23]

Section 33(1) only perfects a security interest in proceeds if the security interest in the original collateral was perfected by registration, not if it was only perfected by possession or control. This is presumably on the basis that a secured party that has possession or control of the original collateral can ensure as necessary that it is perfected over any proceeds from the collateral as well.

The Regulations that were made for the purposes of item 4(d) of the table in s 153 allow proceeds to be described in a way that identifies the particular proceeds, that identifies a class to which the proceeds belong, or that simply describes the proceeds as "all present and after-acquired property".[24] The Register accommodates all of these options, but makes "all present and after-acquired property" the default choice. A well-advised secured party would be highly unlikely to override the default choice with a different formulation.

22 For example Sask PPSA, s 28(2).

23 NZ PPSA, s 46.

24 Item 2.4 of Schedule 1 to the Regulations.

It is not difficult to see why a secured party would like to use the "all present and after-acquired property" default option. At the time a secured party registers its financing statement, it is unlikely to know what the nature of any proceeds might be that the grantor might receive in the future from a dealing with the collateral. The default option removes that uncertainty for the secured party, and ensures that the security interest can be perfected over proceeds, whatever form they take. The downside to this approach, however, is that it diminishes the value of the information on the Register that is available for a searcher. This can be illustrated with an example.

> A secured party has a security interest over a grantor's motor vehicle. The security interest is perfected by registration against the class "motor vehicle", and the registration describes the proceeds by using the "all present and after-acquired property" option. The grantor then exchanges the motor vehicle for a race horse.

The secured party's security interest will be automatically perfected over the race horse, even though this will not be apparent from the Register. If the grantor then tries to sell the horse, a prospective buyer will not be able to tell from a search of the Register that the horse is subject to the security interest.

It is difficult to conceive of an alternative approach that does not disadvantage either the secured party or the unwitting potential buyer, and it may be inevitable that one of them needs to be preferred over the other. Consultation Paper 2 invited stakeholders to comment on whether they considered that the current risk allocation was appropriate.

One commentary on the Act makes the point, if the preferred approach is to continue to favour the secured party over the potential buyer, that it might be simpler to just provide that a security interest over proceeds is automatically perfected, if the security interest over the original collateral was perfected by registration.[25] That is the *de facto* position under the current combination of s 33(1)(a), the Regulations and the default configuration of the Register. It is also the approach taken (more explicitly) under the Ontario PPSA.[26] It would make the Act, the Regulations and the Register itself simpler if s 33 were amended to say this. It would then be possible to delete ss 33(1)(b) and (c) as well.

One of the submissions also argued in favour of making perfection over proceeds automatic, if the security interest over the original collateral was perfected by registration.[27]

Consultation Paper 2 invited stakeholders to comment on this.

7.4.6.1.2 *Discussion of stakeholder feedback*

A number of respondents were not convinced of the need to change the current provisions. An equivalent number agreed, however, that the Act should be amended so that it simply states that a security interest is automatically perfected over proceeds, if it was perfected by registration over the original collateral.

One respondent suggested as an alternative that the Register could be amended so that "all present and after-acquired property" was not the default option for completing the description of proceeds.[28] Even if the Register no longer

25 Duggan & Brown, para 11.38.

26 Ontario PPSA, s 25(2).

27 DIFA, S1 page 3.

28 AD, CP2 page 27.

automatically populated the box in that way, however, I expect that it would quickly become market practice to complete it in that fashion anyway, so I am not convinced that this would make much difference in practice (except that it would force registrants to think a bit more when they complete their registrations).

In my view, the *de facto* position under the Act and the current configuration of the Register is that almost all security interests over collateral that are perfected by registration will be automatically perfected over any proceeds as well. It would simplify the Act without changing its substantive effect if the Act was amended to just say that.

7.4.6.1.3 ***Recommendation***

> **Recommendation 180:** *That the Act be amended to provide that a security interest over collateral that is perfected by registration is automatically perfected over any proceeds of that collateral.*

7.4.6.2 **Section 33(1)(b) – description of the proceeds as original collateral**

7.4.6.2.1 ***The issue***

Section 33(1)(b) provides that a security interest in proceeds will be perfected if the proceeds are within the description of the original collateral in the financing statement.

It is not clear that s 33(1)(b) is needed, even if it is retained in its current form. If the proceeds are within the collateral description in the financing statement, then arguably the security interest over those proceeds is perfected on general principles without the need for the deeming provision. If the provision is needed, though, it is too narrow, as it should allow the security interest in the proceeds to be perfected by **any** registration that the secured party has against the grantor, not just the same registration as for the particular original collateral. Using the example given in Section 7.4.6.1 above, if the secured party already had a separate registration against the grantor for the collateral class "Livestock", then its security interest should be perfected against the horse, even though that is a different registration to the one that perfected its security interest over the motor vehicle.

Consultation Paper 2 invited stakeholders to comment on this.

7.4.6.2.2 ***Discussion of stakeholder feedback***

A number of respondents agreed that s 33(1)(b) was unnecessary, and could be deleted. The majority preferred, however, that it be retained.

The majority of respondents were also of the view that the section did not need to be amended along the lines described above. In my view, however, it would be useful to amend s 33(1)(b) (if it is retained) to clarify that the security interest over the proceeds could be perfected by any registration held by the secured party against the grantor, not just by the registration that perfected the security interest over the original collateral. It might be argued that this change is strictly not necessary, but the same could be said for the section as a whole. If s 33(1)(b) is to be retained, then I think it will help to avoid confusion if this point is clarified.

7.4.6.2.3 ***Recommendation***

> **Recommendation 181:** *If Recommendation 180 is not adopted, that s 33(1)(b) be amended to make it clear that the security interest is perfected over the proceeds if the proceeds are within the collateral description of any current financing statement made by the secured party against the grantor, not just the same financing statement.*

7.4.6.3 **Section 33(1)(c) – liquid proceeds**

7.4.6.3.1 ***The issue***

Section 33(1)(c) provides that a security interest in proceeds is deemed perfected if the proceeds consist of currency, a cheque, an ADI account or a right to payment as compensation for loss or damage to the collateral or the proceeds.

The rationale for this rule is said to be that a person who acquires an interest in these types of personal property should realise that they could have arisen from a dealing in other property of the grantor, and that the other property could have been subject to a security interest that is perfected by a financing statement that could be found by searching the Register.[29]

Consultation Paper 2 invited stakeholders to indicate whether they thought that this was an appropriate justification for this rule.

7.4.6.3.2 ***Discussion of stakeholder feedback***

The great majority of respondents were of the view that s 33(1)(c) should be retained.

Section 33(1)(c) will become unnecessary if the Act is amended as I have recommended in Section 7.4.6 (so that a security interest in proceeds is automatically perfected, if the security interest over the original collateral was perfected by registration). If that change is not made, however, then I am comfortable recommending that s 33(1)(c) be retained as well.

7.4.6.3.3 ***Recommendation***

> **Recommendation 182:** *If Recommendation 180 is not adopted, that s 33(1)(c) be retained.*

7.5 Temporary perfection

7.5.1 Should a transferee be obliged to notify secured parties of the transfer?

7.5.1.1 ***The issue***

Section 34 provides, if collateral that is subject to a perfected security interest is transferred and the transferee does not take free of the security interest, that the security interest is temporarily perfected for up to two years. This affords

29 Cuming Walsh & Wood, page 581.

the secured party with a period of time within which it can become aware of the transfer, and to then re-perfect against the transferee.

One submission suggested that it is not appropriate to burden the secured party with the risk that its security interest could become unperfected because of a transfer it did not authorise.[30] Some respondents made similar observations, suggesting that the Act should provide that a secured party that has perfected its security interest should not be exposed to the risk of losing its security interest because of some unauthorised action of the grantor.

That observation is entirely appropriate as a starting proposition. Even under prior law, though, a secured party faced the risk that it could lose its interest in collateral because of some unauthorised action by the grantor. If a secured party held a fixed charge, for example, it faced the risk that a buyer could acquire clear title to the collateral under the *bona fide* purchaser rule.[31] The Act also clearly accepts that a secured party will be exposed to the risk in some situations that it could lose its security interest because of an unauthorised action of the grantor, for example under the taking free rules.

The submission that raised this issue suggested that a person proposing to take an interest in collateral should be required first to search the Register, and to notify any prior-registered secured parties of its intended transfer. That would provide the secured party with the opportunity to take whatever steps it wants in response. The submission suggested that the proposal should not need to apply, however, for consumer property, or where a taking free rule applies.

7.5.1.2 *Discussion of stakeholder feedback*

I can see that this proposal might assist prior-registered secured parties. I expect, however, that it would impose too severe an impediment on the free flow of commerce, and for that reason would be quite unpalatable to both grantors and intending transferees. As I see it, there is no clear case for making this change.

7.5.1.3 *Recommendation*

> **Recommendation 183:** *That the Act not be amended to require an intending transferee of collateral to search the Register and advise any relevant secured party of the proposed transfer.*

7.5.2 Section 34 – application to proceeds?

7.5.2.1 *The issue*

If collateral that is subject to a perfected security interest is transferred, then the security interest is deemed by s 34(1) to be temporarily perfected over the transferred collateral for a period of up to 2 years after the transfer.

One submission suggested that it was not clear that s 34 applies only to the security interest over the original collateral, and expressed the view that it could be read as applying to the security interest over the proceeds as well.[32] The submission proposed that this be clarified.

30 DLA, S2 page 10.

31 See, for example, *Pilcher v Rawlins* (1872) 7 Ch App 259.

32 DLA, S2 page 10.

In my view, it is clear that s 34 is only dealing with the security interest in relation to the original collateral, not in relation to the proceeds. Section 34 addresses the fact that a security interest that had been perfected by a registration, for example, would cease to be perfected by that registration if the collateral is transferred, as the transfer would cause the transferee to become the "grantor" of the security interest (whereas the registration will have been made against the transferor).[33] The temporary perfection period in s 34 protects the secured party, by providing it with an opportunity to re-register before it becomes unperfected.

This protection is not needed for the proceeds, as the transfer does not cause a security interest over the proceeds to become unperfected – indeed, the transfer causes the security interest to attach to the proceeds in the first place. And the perfection of the security interest over the proceeds is dealt with separately, in s 33.

Consultation Paper 2 suggested however that this could be put beyond doubt by inserting "in the collateral" after "interest" in line 3 of s 34(1).

7.5.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that this was an appropriate change to make.

7.5.2.3 ***Recommendation***

> **Recommendation 184:** *That "in the collateral" be inserted after "interest" in line 3 of s 34(1).*

7.6 The taking free rules

7.6.1 What "value" should be provided, for a taking free rule to apply?

7.6.1.1 ***The issue***

The term "value" is defined in s 10 in this way:

> ***value:***
>
> (a) means consideration that is sufficient to support a contract; and
>
> (b) includes an antecedent debt or liability; and
>
> (c) in relation to the definition of purchase money security interest—has a meaning affected by section 14.

The term "new value" is also defined in s 10:

> ***new value*** means value other than value provided to reduce or discharge an earlier debt or liability owed to the person providing the value.

Most of the taking free rules provide that a person will only take an interest in collateral free of a security interest if, among other things, the person has provided either "value" or "new value" for the interest. The position for each of the taking free rules is summarised in the table below. (It will be seen that the table includes a number of rules that are currently classified by the Act as priority rules, rather than taking free rules. As this report discusses further below, I am of the view that it makes more sense for them to be treated as taking free rules, and moved to Part 2.5 of the Act.)

33 This assumes that no taking free rule applies – see s 37(3).

Section	Circumstance	Value required
43	Unperfected security interest	Value
44	Serial-numbered property	None
45(1)	Motor vehicle – the "day and a half" rule	New value
45(3)	Motor vehicle – seller or lessor is a prescribed person	New value
46	Ordinary course of business	None
47	Low-value personal domestic or household property	New value
48	Currency	None
49	Purchaser of investment instrument or intermediated security on stock exchange or similar	None
50	Investment instrument with possession or control	Value
51	Intermediated security in consensual transaction	Value
52	Temporarily perfected security interest	New Value
69	Creditor receiving payment of a debt	None
70	Negotiable instrument with possession or control	Value
71	Chattel paper in consensual transaction	New value
72	Negotiable document of title	Value

The use of "value" or "new value" in the taking free rules is broadly consistent with the approach taken in the Canadian PPSAs and the NZ PPSA. Despite this, it is not easy to extract a consistent rationale for the way in which the terms are used in the various rules.

"Value", or "new value"?

The choice of "new value" for some of the taking free rules, over "value", may have been driven by a desire to ensure that the rule is only engaged if the relevant transaction produces some proceeds that the secured party's security interest can then attach to under s 32. It is not clear, however, why that approach was not used for the other taking free rules as well. And in any event, the new value provided by the person who acquires the interest needs only to be sufficient consideration to support a contract. It does not need to reflect the market value of the interest being acquired, and may only be a nominal amount.

No value at all?

The fungible nature of currency may make it appropriate for there to be no value requirement at all in s 48 (although I have another concern with that taking free rule, that I will return to in Section 7.6.2), and the nature of the processes by which investment instruments or intermediated securities are traded on a stock exchange makes it impracticable (and unnecessary) to impose a value requirement on the taking free rule in s 49. And it is probably not necessary to specify a value

requirement in s 69 as it is currently formulated, as the payment being received will discharge the relevant debt. It is less easy to understand, however, why there is no clear value requirement in s 44 or 46.

Consultation Paper 2 invited stakeholders to comment on three questions: whether a good explanation can be provided for the choices of "value", "new value" or "no value" in the rules listed in the table; whether it might be appropriate to use a consistent requirement across all the rules (except perhaps for the rules in ss 48, 49 and 69); and whether it is acceptable as a policy matter that any new value could potentially only be a nominal amount.

7.6.1.2 ***Discussion of stakeholder feedback***

One respondent did not agree that the "value" qualifiers needed to be changed. All other respondents, however, were in favour of some increased consistency, and the great majority agreed with the amendments proposed in the Consultation Paper.

On the question of whether it made sense for "value" or "new value" to be able to be a nominal amount rather than "real" value, one respondent was of the view that this was not appropriate. All other responses, however, were in favour of leaving this as is. I agree that there is no clear case for change.

7.6.1.3 ***Recommendations***

Recommendation 185: *That the requirement for value in ss 43 to 52 and ss 69 to 72 be as follows:*

- *ss 48, 49 and 69 – no value requirement; and*
- *the remaining sections – new value.*

Recommendation 186: *That the Act continue to allow "new value" to be a nominal amount.*

7.6.2 The "knowledge" qualifier

7.6.2.1 ***The issue***

Most of the taking free rules provide that they will not apply if the person acquiring the interest has a specified level of knowledge of the security interest, or was involved in its creation. The disentitling factors can be any of:

- being a party to the transaction that gave rise to the security interest;
- having actual or constructive knowledge of the security interest;
- having actual knowledge that the transaction breaches the security agreement that provides for the security interest; or
- having actual or constructive knowledge that the transaction breaches the security agreement that provides for the security interest.

Using the same table as in the Section 7.6.1, the requirements for the different taking free rules are as shown below.

Section	Circumstance	Value required	Knowledge qualifier
43	Unperfected security interest	Value	Party to transaction
44	Serial-numbered property	None	Party to transaction
45(1)	Motor vehicle – the "day and a half" rule	New value	Actual or constructive knowledge of security interest
45(3)	Motor vehicle – seller or lessor is a prescribed person	New value	Actual or constructive knowledge of breach
46	Ordinary course of business	None	Actual knowledge of breach
47	Low-value personal domestic or household property	New value	Actual or constructive knowledge of breach
48	Currency	None	Actual or constructive knowledge of security interest
49	Purchaser of investment instrument or intermediated security on stock exchange or similar	None	None
50	Investment instrument with possession or control	Value	Actual or constructive knowledge of breach
51	Intermediated security in consensual transaction	Value	Actual knowledge of breach
52	Temporarily perfected security interest	New Value	Actual knowledge of breach
69	Creditor receiving payment of a debt	None	Actual knowledge of breach
70	Negotiable instrument with possession or control	Value	Actual or constructive knowledge of breach
71	Chattel paper in consensual transaction	New value	Actual or constructive knowledge of security interest
72	Negotiable document of title	Value	Actual or constructive knowledge of breach, if in business of acquiring such documents; otherwise, actual or constructive knowledge of security interest

These qualifiers broadly mirror the position under the Canadian PPSAs and the NZ PPSA. Again, however, there is no obvious explanation for the distinctions, except in relation to the taking free rule in s 49 (where the realities of the trading of securities on a stock exchange make a knowledge qualifier impracticable).[34]

Section 48

In my view, the current knowledge qualifier in s 48 is too strict. It might be argued that the fungible nature of currency is such that any type of knowledge qualifier is inappropriate. At a minimum, though, I believe that the holder of the currency should not be deprived of the benefit of the taking free rule just because they had actual or constructive knowledge of the existence of the security interest. The qualifier should only disentitle the holder from relying on the rule if they had actual (or possibly constructive) knowledge that their taking of the currency was a breach of the security agreement that gave rise to the security interest. I am also of the view that s 48 needs to be considered in tandem with s 69. This is discussed further in Section 7.6.12 below.

Generally – greater consistency?

The qualifier in each of the taking free rules clearly needs to be appropriate for that rule. Despite this, it appears that some rationalisation of the use of the qualifiers in the taking free rules is both possible and appropriate.

Consultation Paper 2 invited stakeholders to comment on these issues.

7.6.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that the use of "knowledge" qualifiers across the taking free rules should be more consistent.

One respondent suggested that the Act follow the approach taken in the Ontario PPSA and just refer to "knowledge".[35] The Ontario PPSA states that a person has "knowledge" of something when information comes to their attention under circumstances in which a reasonable person would take cognisance of it.[36] This approach would allow the Act to drop the distinction between "actual" and "constructive" knowledge, and would allow the definition of "constructive knowledge" in s 297 to be deleted. This suggestion has considerable merit.

As to whether the knowledge should be of the existence of the security interest or that it was being breached, my view is that the tests should be as follows:

- ss 43, 44 and 45(1) – knowledge of the security interest;
- ss 45(3) and 46 – knowledge of breach;
- s 47 – knowledge of the security interest;
- s 48 – knowledge of breach;
- s 49 – no knowledge qualifier;
- ss 50 to 52 – knowledge of the security interest; and
- ss 69 to 72 – knowledge of breach.

34 Indeed, knowledge is irrelevant, as the buyer will not know who the seller is.

35 AD, CP2 page 17.

36 Ontario PPSA, s 69.

7.6.2.3 ***Recommendations***

Recommendation 187: *That the Act be amended to provide that a person has knowledge of something for the purposes of the Act when information comes to their attention under circumstances in which a reasonable person would take cognisance of it.*

Recommendation 188: *That the taking free rules in the sections set out in the following table be amended so that the "value" and "knowledge" qualifiers in those sections are as set out in the following table:*

Section	Circumstance	Value required	Knowledge qualifier
43	Unperfected security interest	New value	Knowledge of security interest
44	Serial-numbered property	New value	Knowledge of security interest
45(1)	Motor vehicle – the "day and a half" rule	New value	Knowledge of security interest
45(3)	Motor vehicle – seller or lessor is a prescribed person	New value	Knowledge of breach
46	Ordinary course of business	New value	Knowledge of breach
47	Low-value personal domestic or household property	New value	Knowledge of the security interest
48	Currency	None	Knowledge of breach
49	Purchaser of investment instrument or intermediated security on stock exchange or similar	None	None
50	Investment instrument with possession or control	Value New value	Knowledge of security interest
51	Intermediated security in consensual transaction	New value	Knowledge of security interest
52	Temporarily perfected security interest	New Value	Knowledge of security interest
69	Creditor receiving payment of a debt	None	Knowledge of breach
70	Negotiable instrument with possession or control	New value	Knowledge of breach
71	Chattel paper in consensual transaction	New value	Knowledge of breach
72	Negotiable document of title	New value	Knowledge of breach

7.6.3 Meaning of "buyer" and "lessee"

7.6.3.1 ***The issue***

Most of the taking free rules operate in favour of a buyer or lessee of collateral. The terms "buyer" and "lessee" are not defined.

The term "lessee" is well-understood, and requires no particular comment. In contrast, the use of the term "buyer" in some of the taking free rules has raised the question of the extent to which this imports requirements from sale of goods legislation (or the general law, in the case of collateral that does not consist of goods) – in other words, whether a taking free rule will only operate in favour of a person as a "buyer" if the transaction in question is one that is otherwise a contract of sale and purchase on general principles.

This question has been explored at some length in a recent academic paper.[37] The view of the paper's author, with which I agree, is that the meaning of the term "buyer" as used in the Act should not be extracted solely from the language of the Act itself, but should be determined by reference to the broader Australian legal framework.

I would add one overlay to this, though, which is that there is one respect in which the framework of the Act dictates an outcome that goes beyond the general principles applicable to buyers and sellers. Because the Act treats a grantor of a security interest as if it were the owner of the collateral even if it is not the owner on general legal principles, the implication for the taking free rules is that a grantor can be a seller of collateral even if it does not have title (for example, if the grantor is the purchaser of goods subject to retention of title, or a lessee of goods under a PPS lease). To this extent, the principles that underpin the Act need to prevail over the principles that would otherwise apply at general law. [38]

Consultation Paper 2 invited stakeholders to comment on this.

7.6.3.2 ***Discussion of stakeholder feedback***

One respondent thought that it would be helpful for the Act to include a definition of "buyer", and in doing so to sweep up the concept of "purchaser" that is used in a number of other provisions in the Act. All other respondents, however, were in favour of leaving the meaning of "buyer" to be determined by the general law.

7.6.3.3 ***Recommendation***

> **Recommendation 189:** *That the Act not be amended to define the term "buyer".*

37 S. McCracken, *When is a "Buyer" a "Buyer"? Solving Riddles When New Legislation Confronts Established Concepts*, published in *Exploring Tensions in Finance Law – Trans-Tasman Insights* (Thomson Reuters, 2014).

38 See the discussion of this in Section 5.1.2 above. I believe that the alternative "possession" model would reach the same outcome as well, but by arguing instead that a person in possession can deal with collateral in a manner that is good against all the world other than the true owner, and the true owner's interest is defeated because the taking free rule says so.

7.6.4 Section 44 – serial-numbered property

7.6.4.1 The provision

Section 44 provides a taking free rule for serial-numbered property, as follows:[39]

> (1) A buyer or lessee of personal property takes the personal property free of a security interest in the property if:
>
> (a) the regulations provide that personal property of that kind may, or must, be described by serial number in a registration; and
>
> (b) searching the register, immediately before the time of the sale or lease, by reference only to the serial number of the property, would not disclose a registration that perfected the security interest.
>
> *Exceptions*
>
> (2) Subsection (1) does not apply if:
>
> (a) the buyer or lessee holds the personal property:
>
> (i) as inventory; or
>
> (ii) on behalf of a person who would hold the collateral as inventory; or
>
> (b) the security interest was created or provided for by a transaction to which the buyer or lessee is a party, unless the personal property concerned is of a kind prescribed by regulations for the purposes of this paragraph.

The Regulations provide that the personal property that "may, or must, be described by serial number in a registration" is:[40]

- motor vehicles;
- aircraft;
- watercraft; and
- certain types of intellectual property (designs, patents, plant breeder's rights, trademarks or licences over any of them).

7.6.4.2 Should the taking free rule apply to inventory?

7.6.4.2.1 *The issue*

The taking free rule in s 44 is not available for a buyer or lessee that holds the acquired interest as inventory. This broadly reflects the approach of the corresponding provision in the NZ PPSA,[41] but not the corresponding provision in the Canadian PPSAs.[42]

It is not readily apparent why a buyer or lessee should not be able to rely on the rule just because they acquire the personal property as inventory, particularly given the broad meaning that is given to that term in s 10.

Consultation Paper 2 expressed the view that this restriction on the operation of s 44 should be removed.

39 Section 44(3) contains a transitional provision that is not relevant for current purposes.

40 Item 2.2 in Schedule 1 to the Regulations.

41 NZ PPSA, s 55.

42 For example Sask PPSA, ss 30(6) and (7).

7.6.4.2.2 ***Discussion of stakeholder feedback***

One respondent had mixed views internally on this question. All other respondents were of the view, however, that s 44(2)(a) should be deleted. That continues to be my view as well.

7.6.4.2.3 ***Recommendation***

Recommendation 190: *That s 44(2)(a) be deleted.*

7.6.4.3 **What types of serial-numbered property should s 44 apply to?**

7.6.4.3.1 ***The issue***

The taking free rule in s 44 applies to all types of property that may or must be described by serial number in a registration. In that respect the rule is consistent with the corresponding rule in the Canadian PPSAs and the NZ PPSA. However, the Canadian PPSAs and the NZ PPSA have a much narrower concept of property that may or must be described by serial number in a registration. None of them extends it to intellectual property, for example, and in New Zealand the concept is limited just to motor vehicles.[43]

Consultation Paper 2 suggested that there is merit in considering whether s 44 should also be limited to just motor vehicles, or potentially just to motor vehicles and watercraft. At the moment, secured parties with a security interest over any serial-numbered property risk losing their security under s 44 unless they make specific registrations against each serial number. This can lead to the need to make large numbers of registrations, adding to the clutter on the Register.

The discussion in Consultation Paper 2 proceeded on the assumption that the purpose behind s 44 was to remove the need in some situations for a searcher to conduct a full search against the seller or lessor of personal property. The Consultation Paper acknowledged that it might be appropriate to provide that a person who is looking to buy or lease a motor vehicle should be able to rely just on a search against the serial number of the motor vehicle. Section 44 will most commonly apply to private sales or leases, and it would not be appropriate to expect the purchaser or lessee under such a sale or lease to undertake a full search against the grantor in order to determine whether the motor vehicle was subject to a security interest. Such sales or leases can happen at very short notice, and the buyer or lessee is unlikely in any event to be able to interpret the results of a full search.

The same could also be true for watercraft, at least for smaller ones.

In contrast, the other types of serial-numbered property are all business assets. A buyer or lessee of these types of assets is likely to be acquiring the asset for a business themselves, and the probable value and timeframe of the transaction are such that it might not be inappropriate to expect the buyer or lessee to undertake a full search of the seller or lessor before completing the transaction.

Consultation Paper 2 invited stakeholders to comment on the types of property that should be subject to the taking free rule in s 44.

43 Consultation Paper 2 had suggested that the Canadian PPSAs do not extend the concept to aircraft or watercraft either. One respondent (LW, CP2 page 13) has pointed out, however, that that is not correct – see Sask Regs, reg 13(2).

7.6.4.3.2 ***Discussion of stakeholder feedback***

Respondents expressed a range of views on this question. One respondent thought that the taking free rule in s 44 should be limited to motor vehicles with a Vehicle Identification Number (a point which I discussed above, in Section 6.6.3).[44] Most respondents were of the view, however, that the net should be cast more broadly. Most were of the view that it should at least extend to watercraft, on the basis that individuals often purchase boats. A significant number thought that s 44 should apply to registered intellectual property as well.

I mentioned above that Consultation Paper 2 proceeded on the assumption that the purpose of s 44 was to assist searchers, by reducing the circumstances in which they needed to conduct a full search against their seller or lessor. It has since been put to me that the overseas equivalents of s 44 have a different purpose, and one that is not relevant to the Act as it stands at present. According to that explanation, the overseas equivalents of s 44 are there to provide some relief from the fact that a transfer of collateral subject to a security interest does not change the identity of the grantor of that security interest. Under the Canadian PPSAs and the NZ PPSA, a secured party who took security from a transferor of collateral and perfected it against the transferor by registration will continue to have a perfected security interest in the collateral after the transfer (assuming no taking free rule applies), even though the registration is against the transferor rather than the transferee, and so is undiscoverable by a person who might then want to buy or lease the collateral from the transferee. The overseas equivalents of s 44 provide the buyer or lessee of serial-numbered property with protection against this risk, by allowing them to locate a security interest granted by a predecessor in title if it was registered against the serial number, or to take free of the security interest if it was not.

As I discussed above in Section 7.2, however, the Act approaches this issue differently. Unlike the Canadian PPSAs and the NZ PPSA, the Act treats the transferee of the collateral as the (new) grantor of the security interest (again, assuming that the security interest has remained attached to the collateral), so that the transferor-granted security interest is no longer perfected by the secured party's registration against the transferor. Instead, the security interest will be temporarily perfected for up to 2 years under s 34. This means that a prospective buyer or lessee of the collateral from the transferee does not need to rely on s 44, because they will be able to take the collateral free of the transferor-granted security interest under s 52 (because the security interest is only temporarily perfected).

I discuss the scope of s 52 in Section 7.6.11 below. As far as s 44 is concerned, though, this explanation for the presence of an equivalent to s 44 in the overseas PPSAs does again call into question whether s 44 is needed, or needs to apply to all types of serial-numbered property. I accept, though, that most respondents were not in favour of reducing the reach of s 44, and that there is no clear case for change.

One submission noted that s 44 contains some unnecessary language, in that it refers to personal property of a kind that may ", or must," be described by serial number in a registration.[45] The words "or must" are technically not necessary in the section, as a registration that "must" include the serial number will be ineffective if it does not, with the result that any related security interest will be unperfected. This means that a buyer or lessee would be able to take free of the security interest under s 43 instead.

44 HRIA, CP2 page 13.

45 LCA, S2 page 11.

I can see the strength of that argument. The Act refers however in a number of places to personal property that is of a kind that "may, or must, be described by serial number in a registration", and it might in fact cause confusion if the Act were to use a slightly different word string in s 44. In any event, it is not clear to me that the words do any harm, and I do not see that there is a clear need to delete them.

7.6.4.3.3 ***Recommendation***

> **Recommendation 191:** *That s 44 continue to apply to all types of property that may, or must, be described by serial number in a registration.*

7.6.5 Section 45(1) – the "day and a half" rule

7.6.5.1 ***The issue***

Section 45(1) re-enacts a version of the "day and a half" rule that applied in relation to motor vehicles in some States and Territories before the Act commenced operation.[46] It provides that a buyer or lessee of a prescribed type of motor vehicle may take the motor vehicle free of a security interest if, among other things:

(a) the regulations provide that motor vehicles of that kind may, or must, be described by serial number; and

(b) there is a time during the period between the start of the previous day and the time of the sale or lease by reference to which a search of the register (by reference otherwise only to the serial number of the motor vehicle) would not disclose a registration that perfected the security interest; and

There is no corresponding provision in the Canadian PPSAs or the NZ PPSA.

The section is designed to assist the purchase of motor vehicles outside normal business hours, by allowing a purchaser to undertake a search against the serial number up to one and a half days before completing the purchase (as the purchase could then happen at night or on a weekend, when a register might otherwise be closed).

One of the great advantages of the Register, of course, is that it does not close at nights or on weekends, and a prospective purchaser of a motor vehicle can now do a search at any time. This means that s 45(1) might no longer be necessary. Consultation Paper 2 suggested for this reason that s 45(1) could perhaps be deleted, or as an alternative, that it could be amended so that it only operates in favour of individuals.

Section 45(1) is also subject to a range of qualifications, in ss 45(1)(c) and 45(2). The purpose (and in some respects the meaning) of some of those qualifications is unclear. If s 45(1) is retained, then it would be desirable to simplify it, by rationalising or clarifying the purpose and meaning of some of those qualifications. This should include the removal of the carve-out for persons who buy or lease the motor vehicle as inventory, for the reasons discussed in Section 7.6.4.2.

Consultation Paper 2 also invited stakeholders to comment on these issues.

46 See, for example, the *Chattel Securities Act 1987* (Vic), s 7(1A).

7.6.5.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that s 45(1) was not needed under a registration system that provided searchers with real-time access to the register, and should be deleted. The majority of respondents, however, were in favour of retaining it, and then amending it as described above. I am comfortable with that approach.

7.6.5.3 ***Recommendations***

Recommendation 192: *That s 45(1) be retained, but that it only operate in favour of a buyer or lessee who is an individual.*

Recommendation 193: *That s 45(2)(c) be deleted.*

Recommendation 194: *That the content of ss 45(1)(c) and 45(2) be simplified.*

7.6.6 Section 45(3) – prescribed dealers

7.6.6.1 ***The issue***

Section 45(3) enables a buyer or lessee of a prescribed kind of motor vehicle to buy or lease the motor vehicle free of a security interest in the motor vehicle, if the seller or lessor is a member of prescribed class of persons. Regulation 2.2 prescribes the relevant class to be licensed motor vehicle dealers.

Similar to ss 44(2)(a) and 45(2)(c), s 45(4)(c) provides that this taking free rule is not available if the buyer or lessee holds the motor vehicle as inventory.

Consultation Paper 2 suggested that this qualification on the operation of the rule be removed.

7.6.6.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 45(4)(c) should be deleted.

7.6.6.3 ***Recommendation***

Recommendation 195: *That s 45(4)(c) be deleted.*

7.6.7 Section 46 – transactions in the ordinary course of business

7.6.7.1 Should the taking free rule apply to inventory?

7.6.7.1.1 ***The issue***

Section 46(1) provides that a buyer or lessee of personal property takes the personal property free of a security interest given by the seller or lessor, or that arises under s 32, if the personal property "was sold or leased in the ordinary course of the seller's or lessor's business of selling or leasing personal property of that kind". The Canadian PPSAs[47] and NZ PPSA[48] contain a similar provision.

47 For example Sask PPSA, s 30(2).

48 NZ PPSA, s 53.

This is probably the most important of all the taking free rules. Similar to the taking free rules in ss 44 and 45, however, s 46(2)(a) provides that the taking free rule cannot be relied on if the personal property is serialnumbered property, and the buyer or lessee holds the personal property as inventory. This qualification is not found in any of the Canadian PPSAs or the NZ PPSA.

Consultation Paper 2 expressed the view that the qualification is not appropriate, and should be deleted. This would be consistent with the approach taken to the corresponding language in ss 44 and 45.

7.6.7.1.2 ***Discussion of stakeholder feedback***

One respondent did not agree that the "inventory" qualifier in s 46 should be deleted. All other respondents agreed, however, that s 46(2)(a) should be removed.

7.6.7.1.3 ***Recommendation***

Recommendation 196: *That s 46(2)(a) be deleted.*

7.6.7.2 **Should the taking free rule apply to upstream security interests?**

7.6.7.2.1 ***The issue***

The taking free rule in s 46(1) only applies in relation to security interests that are given by the seller or lessor, or that attach to personal property as proceeds under s 32. This limitation is consistent with the corresponding provision in the Canadian PPSAs and the NZ PPSA. It does however erode the value of the taking free rule for a buyer or lessee. It means that the rule would not apply, for example, if the personal property was subject to a security interest that had been granted by a person other than the seller or lessor, and who then transferred the personal property to the seller or lessor in a manner that allowed that security interest to remain attached to the personal property. Section 46(1) will not allow the buyer or lessee to take the property free of that security interest, because it was not given by the seller or lessor.

There is a need here to choose between protecting the holder of the original security interest, and the person who buys or leases the personal property from the downstream seller or lessor. The decision in both Canada and New Zealand appears to have been to favour the interest of the secured party over that of the buyer or lessee.

Consultation Paper 2 invited stakeholders to comment on whether that is the most appropriate choice.

7.6.7.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that the taking free rule in s 46 should allow a buyer or lessee to take free of all security interests, not just security interests granted by the seller or lessor. The great majority, however, did not agree.

I accept that the consensus view is against making this amendment, and that there is no clear case for it to be made. I also note that a buyer or lessee will be able to take free of most security interests granted by earlier owners of the collateral, even without this change, because of s 52 (as that section currently stands).

7.6.7.2.3 ***Recommendation***

> **Recommendation 197:** *That s 46(1) continue to apply only to security interests that are given by the seller or lessor, or that arise under s 32.*

7.6.7.3 **Does it matter that the taking free rules overlap?**

7.6.7.3.1 ***The issue***

Finally, one submission suggested that the taking free rules should not overlap, and in particular that s 46 should be limited to goods, rather than apply to personal property generally.[49] This would be consistent with the corresponding provision in the Canadian PPSAs and the NZ PPSA.

Consultation Paper 2 expressed the view that it should not matter if there is overlap between some rules, and noted that limiting s 46 to goods would not eliminate all potential overlaps in any event.

7.6.7.3.2 ***Discussion of stakeholder feedback***

All respondents agreed that it did not matter that the taking free rules can have overlapping operation.

7.6.7.3.3 ***Recommendation***

> **Recommendation 198:** *That the Act not to be amended to limit s 46 to goods.*

7.6.8 Section 47 – the "low-value personal-use property" taking free rule

7.6.8.1 ***The issue***

Section 47(1) recognises that it may not be practicable or appropriate to expect a person to search the Register before acquiring personal property, if that person is (broadly put) a consumer, and the personal property has only a modest value. The section says this:

> (1) A buyer or lessee of personal property, for new value, that the buyer or lessee intends (at the time of purchase or lease) to use predominantly for personal, domestic or household purposes takes the personal property free of a security interest in the property if the market value (worked out at the time each part of the total new value is given) of the total new value given for the personal property is not more than:
>
> (a) $5,000; or
>
> (b) if a greater amount has been prescribed by regulations for the purposes of this subsection—that amount.
>
> (c) at the time the contract or agreement providing for the sale or lease is entered into, the buyer or lessee believes, and it is actually the case, that the market value of the personal property is more than:

49 DT, S2 page 6.

(i) $5,000; or

(ii) if a greater amount has been prescribed by regulations for the purposes of this paragraph—that amount.

A similar provision can be found in the Canadian PPSAs[50] (other than the Ontario PPSA), and the NZ PPSA.[51]

This taking free rule seems to be more complex than necessary – for example, the section could still achieve its policy purpose if the value assessment under s 47(1) were made just once (when the agreement to buy or lease is entered into), rather than each time part of the consideration is paid, and if the words ", and is actually the case," were deleted from s 47(2)(c).

One submission also pointed out that it is perhaps unfair to punish a buyer or lessee who spots a bargain, unless the discrepancy between the sale price and the real value is so great that the buyer or lessee should be alerted to the fact that something may be wrong (and so should make further enquiries).[52] At the moment though, the section disengages as soon as the market value of the personal property exceeds $5,000, even if only by a small amount. It might be appropriate for this reason to put a higher dollar amount in s 47(2)(c)(i) than in s 47(1)(a).

Consultation Paper 2 invited stakeholders to comment on these questions.

7.6.8.2 *Discussion of stakeholder feedback*

One respondent did not agree that s 47 should be amended. All other respondents agreed, however, that the section should be amended as described above.

7.6.8.3 *Recommendations*

Recommendation 199: *That s 47(1) be amended so that the market value only needs to be determined when the agreement to buy or lease is entered into.*

Recommendation 200: *That s 47(2)(c) be amended to provide that s 47(1) does not apply if, at the time the agreement for sale or lease is entered into, the buyer or lessee believes that the market value of the personal property is more than $10,000 (or any greater amount prescribed by regulation).*

7.6.9 Section 50 – investment instruments

7.6.9.1 *The issue*

Section 50 provides that a purchaser (broadly defined) of an investment instrument will take the investment instrument free of a security interest if the purchaser gives value, and takes possession or control. There is an equivalent provision in the Canadian PPSAs,[53] but not in the NZ PPSA.

50 For example Sask PPSA ss 30(3) and (4).

51 NZ PPSA s 54.

52 LCA, S2 page 12.

53 For example Sask PPSA s 31.1.

It is not immediately apparent why this taking free rule is necessary. It is not necessary for CHESS securities (both because CHESS securities are intermediated securities rather than investment instruments, and because they are covered in any event by s 49), so it is really only relevant to off-market transactions.[54] And it is not clear why an off-market purchaser of an investment instrument should enjoy a protection that is not available to a purchaser of other types of personal property, such as goods.

Consultation Paper 2 suggested that the Act adopt the New Zealand approach, and that s 50 be deleted. It also suggested that if the section is retained, it should be clarified whether the rule is intended to operate in favour of another secured party. As one submission pointed out, the language of s 50(1) suggests not, but ss 50(3) and 42(b) imply otherwise.[55] This uncertainty is undesirable.

7.6.9.2 ***Discussion of stakeholder feedback***

A small number of respondents agreed that s 50 could perhaps be deleted. The majority of respondents were of the view, however, that s 50 should be retained. There was also consensus, among those respondents who commented on the point, that the section should be amended to clarify whether it operates in favour of another secured party.

It remains less than clear to me why a purchaser of an off-market investment instrument should benefit from a taking free rule that is not available to a purchaser of other types of personal property. As the consensus among stakeholders is in favour of retaining the section, however, I propose to recommend that Government undertake further consultation on this question, as part of the further consultations that I have already recommended in relation to other issues affecting intermediated securities and investment instruments, before deciding whether s 50 should be retained or deleted.

7.6.9.3 ***Recommendations***

Recommendation 201: *That Government consider further, in consultation with industry, whether there are good policy reasons for retaining s 50 and, if there are not, that s 50 be deleted.*

Recommendation 202: *That s 50 be amended, if it is retained, to clarify that it does not operate in favour of another secured party.*

7.6.10 Section 51 – intermediated securities

7.6.10.1 ***The issue***

Section 51(1) provides that a person who takes an interest in an intermediated security will take the interest free of a security interest if:

(a) the transferee gives value for the interest (unless the interest acquired is itself a security interest); and

(b) the credit of the interest in the financial product in relation to which the intermediated security arises is made in accordance with a consensual transaction.

54 It also does not work well for CHESS securities – see LCA, S2 page 9.

55 LCA, S2 page 12.

It is quite difficult to align this provision with the mechanisms by which intermediated securities are in fact held and dealt with. When the holder of an intermediated security "transfers" its intermediated security, it is in fact not transferring anything, in the strict sense. Rather, it instructs its intermediary to debit its securities account by the agreed number of nominated financial products, in return for the intermediary agreeing to credit a corresponding number of those financial products to the securities account of the transferee.[56] The transferee does not take an interest in the intermediated security at all.

It is also difficult to apply the section to a transfer of securities through the CHESS system, but that is not so important because those transfers will be able to rely on the taking free rule in s 49.[57]

Similar to the point I have just discussed in relation to s 50, it is not readily apparent in any event why a transferee of an intermediated security in an off-market transaction should enjoy a protection that is not available to buyers or lessees of other types of personal property.

Consultation Paper 2 invited stakeholders to comment on this.

Consultation Paper 2 also suggested, if s 51 is retained, that it would be desirable to clarify the effect of s 51(1)(b) and, as one of the submissions pointed out, to clarify whether s 51(1) can be relied upon by another secured party – s 51(1)(a) suggests not, but s 42(b) suggests otherwise.[58]

7.6.10.2 *Discussion of stakeholder feedback*

The great majority of respondents were not in favour of deleting s 51, at least without further industry consultation. This is consistent with comments made by those respondents on other matters affecting intermediated securities and investment instruments, as discussed elsewhere in this report.

Similar to the point discussed in Section 7.6.9 regarding the corresponding rule in s 50, it is not clear to me why a purchaser of an off-market intermediated security should benefit from a taking free rule that is not available to a purchaser of other types of personal property. As the consensus among stakeholders is not in favour of deleting the section, however, I propose to recommend that Government undertake further consultation on this question, as part of the further consultations that I have already recommended in relation to other issues affecting intermediated securities and investment instruments, before deciding whether s 51 should be deleted or retained.

If s 51 is retained, then it should be amended to make it clear that it does not operate in favour of another secured party, and to clarify the effect of s 51(1)(b).

7.6.10.3 *Recommendation*

Recommendation 203: *That Government consider further, in consultation with industry, whether there are good policy reasons for retaining s 51 and, if there are not, that s 51 be deleted.*

56 Either directly (if the transferee is also a customer of that intermediary), or via another intermediary.

57 I have recommended in any event that CHESS securities be investment instruments, not intermediated securities. See Section 5.3.4.5.

58 LCA, S2 page 12.

Recommendation 204: *That s 51 be amended, if it is retained, to clarify that it does not operate in favour of another secured party, and to clarify the purpose and meaning of s 51(1)(b).*

7.6.11 Section 52 – temporarily perfected security interests

7.6.11.1 Reach of the section

7.6.11.1.1 *The issue*

Section 52 provides as follows:

> *Main rule*
>
> (1) A buyer or lessee, for new value, of the proceeds of personal property, or of goods or a negotiable document of title, takes the proceeds, goods or document free of a security interest that is temporarily perfected by force of this Act (other than a transitional security interest perfected by force of section 322) immediately before the time of the sale or lease, if the security interest is not otherwise perfected at that time.
>
> *Note:* Section 322 provides for the perfection of transitional security interests.
>
> *Exception*
>
> (2) Subsection (1) does not apply if the buyer or lessee has actual knowledge that the sale or lease constitutes a breach of the security agreement that provides for the security interest at:
>
> (a) the time new value is first given for the sale or lease, if the personal property is bought or leased with the intention of using it predominantly for personal, domestic or household purposes; or
>
> (b) in any other case—the time of sale or of entry into agreement for the lease.

As noted above in Section 5.3.12, there are some circumstances in which the Act deems a security interest to be perfected for a temporary period of time. This deemed temporary perfection assists the secured party, but does not publicise the existence of the security interest in the same way as registration, perfection or control. Section 52 responds to this by providing that a buyer or lessee for new value of some types of collateral can take free of a security interest that is only temporarily perfected.

It is not clear why s 52 is limited to collateral that is proceeds, goods or a negotiable document of title. It is possible that this list was intended to reflect the types of collateral that can be subject to one of the temporary perfection rules, but if that is the case then the drafting of s 52 did not keep up with the drafting of the temporary perfection sections.

Consultation Paper 2 suggested that it should be sufficient (and that s 52 would be simpler and easier to understand) if s 52(1) simply referred to "personal property".

7.6.11.1.2 *Discussion of stakeholder feedback*

A small number of respondents were not in favour of this amendment to s 52. All other respondents agreed, however, that s 52 should be amended so that it simply applied to "personal property".

7.6.11.1.3 ***Recommendation***

> **Recommendation 205:** *That s 52(1) be amended by replacing the references to proceeds, goods or negotiable documents of title with references to "personal property".*

7.6.11.2 **Should s 52 apply to transferred collateral?**

7.6.11.2.1 ***The issue***

Section 7.2 discussed the fact that the Act takes a different approach from the Canadian PPSAs and the NZ PPSA to the implications of a transfer of collateral, in that it treats a transfer of collateral subject to a security interest as causing the transferee of the collateral to become the grantor of the security interest, in place of the transferor. Section 7.2 pointed out that this presents a secured party under the Act with an exposure that is not faced by a corresponding counterpart in Canada or New Zealand, which is that the security interest could be defeated under s 52 if the transferee in turn sells or leases the collateral to someone else. It is worth considering whether this is an appropriate outcome.

One option would be to amend the Act to follow the Canadian and New Zealand model, so that a transfer of collateral did not change the identity of the grantor. That would mean, if the secured party had perfected its security interest by registration, that the registration would continue to perfect the security interest (assuming it remained attached to the collateral in the hands of the transferee), and s 52 would not be a risk. As I discussed in Section 7.2, however, I would not want to recommend that approach until it was clear that all the implications of the change had been considered and accepted.

One other option would be to amend s 52, so that it did not apply to a security interest that was temporarily perfected as a result of the operation of s 34.

7.6.11.2.2 ***Discussion***

Amending s 52 in the way just described would remove the risk for a secured party that it could lose its security interest in collateral under s 52 as a result of a transfer that was made without its consent. It would however disadvantage third parties dealing with a seller or lessor of collateral, as they would not be able to detect the existence of the secured party's security interest through a search on the Register, because that security interest will have been perfected by a registration against a previous (and potentially unknown) owner.

I am not in a position to make a recommendation on the question of which group is to be preferred – the prior secured parties, or the prospective buyers and lessees – although it is instructive to note that the Canadian and New Zealand models prefer the secured parties, at least to some extent. For that reason, I propose to recommend that Government consider this further, as part of a broader consideration of whether the Act should be amended to adopt the model that applies in Canada and New Zealand.

7.6.11.2.3 ***Recommendation***

> **Recommendation 206:** *If Government decides (pursuant to Recommendation 169) to allow the Act to continue to provide that a transfer of collateral subject to a security interest makes the transferee the grantor of the security interest, that Government consider whether s 52 should be amended to provide that it does not apply to a security interest that is temporarily perfected under s 34.*

7.6.11.3 **Section 52(2)**

7.6.11.3.1 ***The issue***

It must also be asked whether the complexity of s 52(2) is necessary. The intent behind s 52(2)(a) appears to be that a buyer or lessee that intends to use the property predominantly for personal, domestic or household purposes will be protected by s 52 if it did not have the requisite knowledge at the time it made the first payment (which could be a deposit) for the property.

Consultation Paper 2 suggested that all buyers or lessees would be served sufficiently well if s 52(2) simply provided that the rule is available if the buyer or lessee did not have the requisite knowledge at the time they committed to the purchase or lease – that is, when they entered into the agreement to buy or lease the property.

7.6.11.3.2 ***Discussion of stakeholder feedback***

All respondents agreed that the language of s 52(2) should be simplified. The great majority of respondents also agreed with the language proposed above.

7.6.11.3.3 ***Recommendation***

> **Recommendation 207***: That s 52(2) be amended so that any buyer or lessee can rely on s 52(1) unless they had the requisite knowledge at the time that they entered into the agreement to buy or lease the property.*

7.6.12 Section 69 – creditor who receives payment of a debt

7.6.12.1 Should s 69 be a priority rule, or a taking free rule?

7.6.12.1.1 ***The issue***

Section 69 provides as follows:

> (1) The interest of a creditor who receives payment of a debt owing by a debtor through a payment covered by subsection (3) has priority over a security interest (whether perfected or unperfected) in:
>
> (a) the funds paid; and
>
> (b) the intangible that was the source of the payment; and
>
> (c) a negotiable instrument used to effect the payment.
>
> Example: A bank account from which the funds were paid is an example of an intangible that was the source of the payment.

(2) Subsection (1) does not apply if, at the time of the payment, the creditor had actual knowledge that the payment was made in breach of the security agreement that provides for the security interest.

(3) Payments made by a debtor are covered by this subsection if they are made through the use of:

(a) an electronic funds transfer; or

(b) a debit, transfer order, authorisation, or similar written payment mechanism executed by the debtor when the payment was made; or

(c) a negotiable instrument.

A similar provision can be found in the Canadian PPSAs[59] and the NZ PPSA.[60]

Section 69 is currently framed as a priority rule. It is not clear why that is the case. Consultation Paper 2 suggested that it would make more sense for s 69 to be a taking free rule rather than a priority rule, and to relocate it to Part 2.5.

7.6.12.1.2 *Discussion of stakeholder feedback*

All respondents agreed that it made more sense for s 69 to be a taking free rule, rather than a priority rule.

7.6.12.1.3 *Recommendation*

Recommendation 208: *That s 69 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*

7.6.12.2 Align with s 48?

7.6.12.2.1 *The issues*

More substantively, the language of s 69 closely follows the corresponding provision in the Canadian PPSAs and the NZ PPSA, and as a result uses some terminology that may not be particularly relevant in Australia. This should be clarified. As one of the submissions suggested, it would also be worth exploring whether the language of the section could be aligned more closely with s 48, so that the same taking free principles could apply whether money was transferred in physical or electronic form.[61]

One submission suggested that the rule should be able to be relied upon by all payees, not just creditors.[62]

Consultation Paper 2 invited stakeholders to comment.

7.6.12.2.2 *Discussion of stakeholder feedback*

The great majority of respondents were in favour of aligning s 69 with s 48, and of adjusting its language so that the same taking free principles applied whether money was transferred in physical or electronic form.

59 For example Sask PPSA, ss 31(2) and (3).

60 NZ PPSA, s 95.

61 LCA, S2 page 12. See also DT, S2 page 10.

62 JLF, S2 page 15.

7.6.12.2.3 ***Recommendation***

> **Recommendation 209:** *That the language of s 69 be tailored more closely to Australian market conditions, and that the rules in ss 48 and 69 be more closely aligned.*

7.6.13 Section 70 – negotiable instruments

7.6.13.1 Meaning of "negotiable instrument"

7.6.13.1.1 *The issue*

The term "negotiable instrument" is defined in s 10 in this way:

> **negotiable instrument** means:
>
> (a) a bill of exchange (within the meaning of the Bills of Exchange Act 1909); or
>
> (b) a cheque (within the meaning of the Cheques Act 1986); or
>
> (c) a promissory note (within the meaning of section 89 of the Bills of Exchange Act 1909); or
>
> (d) any other writing that evidences a right to payment of currency, if:
>
> (i) the writing is of a kind that, in the ordinary course of business, is transferred by delivery with any necessary endorsement or assignment; or
>
> (ii) the writing satisfies the requirements for negotiability under the law governing negotiable instruments (including, but not limited to, instruments that are negotiable instruments within the meaning of this definition); or
>
> (e) a letter of credit that states that it must be presented on claiming payment;
>
> but does not include any of the following:
>
> (f) the creation or transfer (including a successive transfer) of a right to payment in connection with interests in land, if the writing evidencing the creation or transfer does not specifically identify that land;
>
> (g) a document of title;
>
> (h) an intermediated security.

Paragraphs (a) to (c) of the definition, together with paragraph (d)(ii), are reflective of the general law understanding of the term "negotiable instrument". The remaining paragraphs, however, take the defined meaning well beyond the meaning given to the term on general principles. In doing so, the definition follows the Canadian PPSAs[63] and the NZ PPSA.[64] It does however make the Act harder to follow.

It is not clear whether this approach was taken as a drafting convenience, or whether some deeper policy issue was at play.

Consultation Paper 2 suggested, if there is no good policy reason for defining the term in this rather counter-intuitive way, that the definition be brought back into line with the general law understanding of the term.

63 For example Sask PPSA, s 2(1)(v).

64 NZ PPSA, s 16.

7.6.13.1.2 ***Discussion of stakeholder feedback***

The great majority of respondents were in favour of bringing the concept of negotiable instrument back into line with the general law meaning of the term. That is my view as well.

7.6.13.1.3 ***Recommendation***

> **Recommendation 210:** *That the definition of "negotiable instrument" in s 10 be deleted, to allow the term to have the same meaning as at general law.*

7.6.13.2 **Is s 70 needed?**

7.6.13.2.1 ***The issue***

Section 70 provides that a person who acquires an interest in a negotiable instrument may have priority over a perfected security interest in the negotiable instrument if, among other requirements, the person gave value for the interest and took possession or control.

It must be asked whether s 70 is needed. To the extent that the defined term "negotiable instrument" reflects the general law meaning, then s 70 essentially replicates the "holder in due course" rules from the *Bills of Exchange Act 1909* and the *Cheques Act 1986*. Those rules are already preserved by s 256 of the Act. To the extent that the defined term goes beyond the general law meaning,[65] it must be asked why the rule in s 70 is appropriate.

Consultation Paper 2 invited stakeholders to comment on this.

7.6.13.2.2 ***Discussion of stakeholder feedback***

The great majority of respondents were in favour of retaining s 70, despite its overlap with the corresponding rules in the *Bills of Exchange Act 1909 and the Cheques Act 1986*). While it is not clear to me that both sets of rules are necessary, I accept that there is no consensus in favour of deleting s 70, and no clear case for change.

7.6.13.2.3 ***Recommendation***

> **Recommendation 211:** *That s 70 be retained.*

7.6.13.3 **Should s 70 be a priority rule, or a taking free rule?**

7.6.13.3.1 ***The issue***

Like s 69 (discussed in Section 7.6.12 above), s 70 is framed as a priority rule, rather than a taking free rule. It is not clear why that is the case.

7.6.13.3.2 ***Discussion***

I am not aware of any good reason why s 70 should be a priority rule, rather than a taking free rule. In my view, it would make the Act internally more consistent, and easier to work with, if this was changed.

65 I have separately recommended that it not do so. See Section 7.6.13.1.

7.6.13.3.3 ***Recommendation***

> **Recommendation 212:** *That s 70 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*

7.6.14 Section 71 – chattel paper

I have recommended separately that the concept of chattel paper should be deleted from the Act. See Section 4.3.3. That would result in the deletion of s 71 as well.

7.6.15 Section 72 – negotiable documents of title

7.6.15.1 Is s 72 needed?

7.6.15.1.1 ***The issue***

Section 72 provides:

> The interest of a holder of a negotiable document of title has priority over a perfected security interest in the document of title if:
>
> (a) the holder gave value for the document of title; and
>
> (b) the holder:
>
> (i) in the case of a holder who acquired the document of title in the ordinary course of the holder's business of acquiring documents of title of that kind—acquired the interest without actual or constructive knowledge that the acquisition constitutes a breach of the security agreement that provides for the security interest; or
>
> (ii) otherwise—acquired the document of title without actual or constructive knowledge of the security interest.

There is a similar provision in the Canadian PPSAs[66] and the NZ PPSA.[67] The section effectively repeats, in relation to negotiable documents of title, the rule for negotiable instruments in s 70 that is discussed above in Section 7.6.13.

Consultation Paper 2 invited stakeholders to comment on the appropriateness of this rule.

7.6.15.1.2 ***Discussion of stakeholder feedback***

The great majority of respondents were in favour of retaining s 72, despite its overlap with s 70 (and in turn with the corresponding rules in the *Bills of Exchange Act 1909* and the *Cheques Act 1986*). While it is not clear to me that this amount of overlap is necessary, I accept that there is no consensus in favour of deleting s 72, and no clear case for change.

7.6.15.1.3 ***Recommendation***

> **Recommendation 213:** *That s 72 be retained.*

66 For example Sask PPSA, s 31(5).

67 NZ PPSA, s 99.

7.6.15.2 Should s 72 be a priority rule, or a taking free rule?

7.6.15.2.1 *The issue*

In the same way as for ss 69 and 70 (see Sections 7.6.12 and 7.6.13), I am not aware of any good reason why s 72 should be a priority rule, rather than a taking free rule. In my view, it would make the Act internally more consistent, and easier to work with, if this was changed.

7.6.15.2.2 *Recommendation*

> **Recommendation 214:** *That s 72 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*

7.6.16 Section 53 – subrogation

7.6.16.1 *The issue*

Section 53 applies where a person (the *transferee*) acquires personal property from another person (the *transferor*), and the transferee takes the personal property free of a security interest because of the operation of Part 2.5. Section 53(2) provides:

> (2) The rights of the secured party are subrogated, in relation to the property, to the rights (if any) of the transferor and any predecessor of the transferor (including the right to receive any part of the purchase price for the property which has not been paid).

There is no corresponding provision in the Canadian PPSAs or the NZ PPSA. Rather, the provision appears to have been drawn from the *Chattel Securities Act 1987* (Vic).[68]

The drafting of s 53(2) is somewhat curious. In my view, it should be the "secured party", not the "rights of the secured party" that is subrogated. Also, it is not clear what would happen if there were more than one security interest over the personal property, and the transferee had taken free of both (or all) of them. Are they all subrogated to the transferor's rights to receive payment of the purchase price? If so, on what basis?

More importantly though, it is not clear what the section adds to s 32. The right to receive payment of the purchase price for the transferred personal property will be proceeds of the personal property under s 31, and the secured party will acquire an interest in the right to receive the purchase price because its security interest will attach to the right as proceeds, under s 32(1)(b).

Consultation Paper 2 suggested that s 53 does not add any value to the Act, and that it should be deleted.

7.6.16.2 *Discussion of stakeholder feedback*

All respondents were of the view that s 53 should be deleted.

7.6.16.3 *Recommendation*

> **Recommendation 215:** *That s 53 be deleted.*

68 *Chattel Securities Act 1987* (Vic), s 7(7), prior to repeal of the section as of 30 January 2012.

7.6.17 Sections 37 and 38 – returned collateral

7.6.17.1 When should s 37 apply?

7.6.17.1.1 *The issue*

If a person buys an item of collateral and takes it free of a security interest, then the effect of the taking free rule will be to extinguish the security interest. If the person acquires the collateral by way of lease rather than buying it, however, the security interest may not be extinguished. Rather, the security interest may simply become subject to the lease, and the secured party will only be able to enforce its security interest in a manner that does not disturb the lessee's right under the lease.

Section 37(1) provides as follows:

> (1) If a grantor or debtor sells or leases goods that are subject to a security interest, and the buyer or lessee takes the goods free of the security interest because of the operation of this Act, the security interest reattaches to the goods at a particular time (the repossession time) if, at that time, the goods come into the possession of the grantor or debtor, or of a transferee of chattel paper created by the sale or lease, in any of the following circumstances:
>
> (a) in the case of a sale—the contract of sale is rescinded;
>
> (b) in the case of a lease—the lease expires or is rescinded;
>
> (c) the transferee seizes the goods in the exercise of a right in enforcing a security agreement;
>
> (d) the grantor or debtor repossesses the goods in the exercise of a right in enforcing the contract of sale or the lease;
>
> (e) any other circumstances prescribed by the regulations.

A similar provision can be found in the Canadian PPSAs,[69] but not in the NZ PPSA.[70]

Section 37(1) appears to assume that the effect of a sale or lease of goods that allows the buyer or lessee to take free of a security interest is that the security interest "detaches" from the goods. While that will be the case for a sale, it will not necessarily be the case for a lease. If goods are leased in a way that does not cause the lease to be characterised as a security interest (if a car is rented out over the weekend, for example), then a security interest over the goods should clearly remain attached to the goods even during the term of the lease.

If the lease gives rise to a security interest, different considerations may apply. This will depend on whether a lease that is a security interest is treated by the Act as a transfer of the leased goods from the lessor to the lessee. This question was discussed in Section 7.3 above. If it is treated by the Act as a transfer, then it would be appropriate to accept that the taking free rule causes the security interest to detach (in the same way as it would for a sale), so that it could then re-attach under s 37 in the circumstances contemplated by the section. If such a lease is not a transfer, however, then s 37 should not imply that the taking free rules cause a security interest in the leased goods to detach in the first place.

Consultation Paper 2 suggested that s 37 be amended to make it clear that it only applies to a sale or lease that caused the security interest to detach.

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69 For example Sask PPSA, s 29(1).

70 For an explanation, see Gedye Cuming & Wood, page 217.

7.6.17.1.2 ***Discussion of stakeholder feedback***

A number of respondents expressed the view that the drafting of any change to s 37 would need to be considered carefully. The great majority of respondents agreed, however, that the language of s 37 should be adjusted to clarify the point discussed above.

7.6.17.1.3 ***Recommendation***

> **Recommendation 216:** *That s 37 be amended to make it clear that it only applies if the effect of the buyer or lessee taking the goods free of a security interest was that the security interest ceased to be attached to the goods.*

7.6.17.2 **Interaction between ss 37 and 32**

7.6.17.2.1 ***The issue***

One submission suggested that s 37 should apply to a security interest that ceased to be attached to collateral as a result of the operation of s 32.[71] Consultation Paper 2 invited stakeholders to comment on this.

7.6.17.2.2 ***Discussion of stakeholder feedback***

One respondent made the good point that s 37 says that it applies where a buyer or lessee takes goods free of a security interest "because of the operation of this Act".[72] That language should be broad enough to pick up a situation where a buyer or lessee acquires its interest free of a security interest through the operation of s 32, as well as the rules in Part 2.5, particularly if s 32 is amended as I have recommended above in Section 7.4.3.

7.6.17.2.3 ***Recommendation***

> **Recommendation 217:** *That s 37 not be amended to make it clearer that it applies where a person has taken collateral free of a security interest because of the operation of s 32.*

7.6.17.3 **Sections 37 and 38 – drafting issues**

7.6.17.3.1 ***The issue***

Consultation Paper 2 noted that the drafting of ss 37 and 38 focuses too heavily on the treatment of chattel paper, to the detriment of other secured financing techniques.

7.6.17.3.2 ***Discussion of stakeholder feedback***

The great majority of respondents agreed that the drafting of ss 37 and 38 should be adjusted so that it applies appropriately for all types of security interests.

71 AFC, S2 att A page 4.

72 AD, CP2 page 23.

7.6.17.3.3 ***Recommendation***

> **Recommendation 218:** *That ss 37 and 38 be amended to ensure that they apply appropriately for all types of security interests.*

7.6.18 Can there be taking free rules outside the Act as well?

7.6.18.1 ***The issue***

While Commonwealth legislation was amended to accommodate the implications of the Act, the same did not happen to the same extent at the State and Territory level. As one example, legislation in all States and Territories continues to provide that a buyer in possession of goods, or a mercantile agent, can dispose of goods even though they do not have title.[73] It is not clear whether these provisions continue to operate despite the commencement of the Act, or whether those rules are not capable of "operating concurrently" with the Act, in which case they will no longer apply, to that extent.[74]

Consultation Paper 2 suggested that the taking free rules in the Act do not need to be an exhaustive code, and that additional taking free rules outside the Act should be able to continue to apply.

7.6.18.2 ***Discussion of stakeholder feedback***

Respondents had mixed views on this question. A number were of the view that the taking free rules in the Act should be an exhaustive code, while others were of the view that they should not, and that other laws should be able to provide for additional taking free rules as well.

There is no doubt that it would be convenient as a matter of secured transactions law to have all the taking free rules that could affect security interests in the one place, ie in the Act. Against that, however, there may be policy considerations outside the sphere of secured transactions law that make it desirable to have additional taking free rules in other laws that could apply to security interests as well. The rules for negotiable instruments in the *Bills of Exchange Act 1909* and the *Cheques Act 1986* are an example of this. The Act deals with them expressly, but this demonstrates that there can be rules from other contexts that may need to apply to security interests as well. The issue is also complicated by the fact that any additional taking free rules might derive from State or Territory law, rather than Commonwealth law.

This question involves considerations that go beyond matters of secured transactions law. Government, in consultation with the States and Territories, will need to decide whether or not it is appropriate to allow for taking free rules outside the Act, taking all relevant considerations into account. The outcome of that decision-making process should then be spelt out clearly in the Act. If it is decided as a matter of policy that taking free rules from other laws should be able to apply to security interests as well, then it would also be desirable to identify those laws in the Act, so that secured parties can at least use the Act as a tool to find them.

73 For example, ss 31 and 67 of the *Goods Act 1958* (Vic).

74 Under s 254(1) of the Act.

7.6.18.3 ***Recommendation***

> **Recommendation 219:** *That Government consider, in consultation with the States and Territories, whether or not taking free rules may be contained in laws other than the Act, and that the Act be amended to set out the agreed position.*

7.7 The priority rules – competitions between security interests

7.7.1 When is priority determined?

7.7.1.1 ***The issue***

A grantor may grant more than one security interest in the same item of collateral. If a grantor has granted more than one security interest over an item of collateral, Part 2.6 of the Act provides rules to determine which of those security interests ranks ahead of the other – that is, which has the higher priority.

As one submission noted, though, the Act does not say when this priority determination is to be made.[75] Most of the time this will not matter, as the priority ranking as between security interests will not normally change. It is not difficult, however, to conceive of circumstances where this would be possible. The ranking as between two security interests could change, for example, if the first-ranking security interest's registration expires in the middle of the enforcement process.

As another example, a PMSI financier could finance an asset but not register immediately. If an earlier secured party with a perfected all-assets security enforces against the collateral before the PMSI financier has registered, the earlier secured party will have the superior priority position. If the PMSI financier then registers within the 15 business day period and so attains PMSI status, however, is it then able to take over conduct of the enforcement process because it now has the better priority?

The Canadian PPSAs and the NZ PPSA are also silent on this question. Case law in Canada and New Zealand has taken the view that priority is to be assessed by reference to the point in time at which the security interests "come into conflict" – which will usually be the time when one of the secured parties commences enforcement action, for example by seizing the collateral. That, however, is not the only option. It would also be possible to assess priorities when the collateral is realised, and a leading Canadian commentary argues that priority should be assessed even later, when the collateral has been realised and proceeds are available for distribution.[76]

It would be helpful to clarify what point in time should be used to determine which of two or more competing security interests has priority. Consultation Paper 2 suggested that it should be the time at which proceeds from the realisation of the collateral are available for distribution, and invited stakeholders to comment.

75 HW, S2 page 10.

76 Cuming Walsh & Wood, pages 471 and 472.

7.7.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that the Act should not clarify this question, or that priority should be able to be re-assessed on an ongoing basis, rather than set definitively at one point in time. The great majority of respondents were of the view, however, that priority as between security interests should be determined when the security interests come into conflict. I am comfortable with that approach.

7.7.1.3 ***Recommendation***

> **Recommendation 220:** *That the Act be amended to confirm that the priority position as between competing security interests is determined at the time when they come into conflict.*

7.7.2 Section 55(2) – priority as between two unperfected security interests

7.7.2.1 ***The issue***

Section 55(2) states that the default priority rule as between two unperfected security interests over an item of collateral is that priority is determined by the order in which the security interests attached to the collateral. In most cases, this will be the order in which the secured parties entered into their security agreement with the grantor.

The Canadian PPSAs[77] and the NZ PPSA[78] contain a similar provision.

The rule in s 55(2) does not explain how priority is to be determined if both security interests attach at the same time. This could happen, for example, if the security interests are over an item of collateral that the grantor does not acquire until after it has entered into both security agreements.

The Replacement Explanatory Memorandum suggested that the security interests should rank equally.[79] Consultation Paper 2 suggested, in contrast, that priority in this situation should be determined by the order in which the secured parties entered into their respective security agreements with the grantor. Consultation Paper 2 went on to propose that the Act be amended to confirm this.

7.7.2.2 ***Discussion of stakeholder feedback***

One respondent was of the view that the security interests in this situation should rank equally. All other respondents agreed, however, that priority as between two unperfected security interests should be determined by the order in which the security agreements were entered into.

7.7.2.3 ***Recommendation***

> **Recommendation 221:** *That the Act be amended to make it clear that priority as between two unperfected security interests that attach to collateral at the same time is to be determined by the order in which the security agreements were entered into.*

77 For example Sask PPSA, s 35(1)(c).

78 NZ PPSA, s 66(c).

79 Replacement Explanatory Memorandum, para 2.110.

7.7.3 Section 55(5) – the "priority time" for a security interest

7.7.3.1 ***The issue***

Section 55(4) states that the default priority rule as between two perfected security interests is that priority is determined by reference their respective "priority times". Section 55(5) explains how a security interest's priority time is determined, in this way:

> (5) For the purposes of subsection (4), the ***priority time*** for a security interest in collateral is, subject to subsection (6), the earliest of the following times to occur in relation to the security interest:
>
> (a) the registration time for the collateral;
>
> (b) the time the secured party, or another person on behalf of the secured party, first perfects the security interest by taking possession or control of the collateral;
>
> (c) the time the security interest is temporarily perfected, or otherwise perfected, by force of this Act.

Provisions reflecting this principle can also be found in the Canadian PPSAs[80] and the NZ PPSA.[81]

The drafting of s 55(5) is rather convoluted. Consultation Paper 2 suggested that it could be simplified, without compromising its effect, by condensing paragraphs (a), (b) and (c) into two paragraphs, so that the section reads like this:

> (5) For the purposes of subsection (4), the ***priority time*** for a security interest in collateral is, subject to subsection (6), the earliest of the following times to occur in relation to the security interest:
>
> (a) the registration time for the collateral; and
>
> (b) the time at which the security interest becomes perfected.

Consultation Paper 2 noted that this suggested drafting also has the advantage of avoiding the need to refer to the time at which a security interest was "first" perfected. That is helpful, because s 55(6) goes on to say that a time is only a priority time for a security interest if the security interest has been continuously perfected since that time. If a security interest was initially perfected, then became unperfected but was reperfected sometime later (for example, if the secured party was perfected by possession, gave the goods up for a period of time and then took possession back), then its priority time should be the time at which it retook possession. However, that may not be the case under s 55(5)(b) because that was not the time at which its security interest was "first" perfected. The alternative drafting suggested above circumvents this problem.

7.7.3.2 ***Discussion of stakeholder feedback***

Respondents expressed a range of views on this question. A small number were of the view that the section did not need to be amended. The great majority agreed, however, that the section should be simplified.

80 For example Sask PPSA, s 35(1)(a).

81 NZ PPSA, s 66(b).

A number of respondents were concerned about the way that the proposed drafting referred in paragraph (b) to the time at which the security interest "becomes perfected". The concern expressed by those respondents was that this would be read as referring to the security interest being in fact perfected, when the reference (according to those responses) should instead be to the secured party having taken the relevant perfecting step (ie of registration, or of taking possession or control).

In fact, the proposed drafting **was** intended to have the effect that a security interest's priority time under paragraph (b) is the time at which the security interest becomes perfected. Paragraph (a) of the drafting deals with security interests that are perfected by registration, and allows their priority to run from the time of registration (whether or not the security interest was in fact perfected at that time). In the case of a security interest that is perfected by possession or control, however, I took the view that its priority should only run from the time at which it was fully perfected, not from the time at which the secured party took possession or control. I believe that this is the effect of the current drafting of s 55(5)(b). So if a secured party had possession of another person's personal property for a period of time, for example, and then later took security over it, the secured party's priority should be determined from when it took the security interest, and not from the earlier time when it happened to have possession. The current drafting was intended to simplify the language of s 55(5), not change its meaning.

7.7.3.3 ***Recommendation***

Recommendation 222: *That the language of s 55(5) be simplified, potentially by amending it to read:*

> *"(5) For the purposes of subsection (4), the **priority time** for a security interest in collateral is, subject to subsection (6), the earlier of the following times to occur in relation to the security interest:*
>
> *(a) the registration time for the collateral; and*
>
> *(b) the time at which the security interest becomes perfected."*

7.7.4 Section 57 – perfection by control

7.7.4.1 Should perfection by control enjoy a superior priority?

7.7.4.1.1 *The issue*

I have already raised for discussion the question of whether the Act should allow certain types of security interests to be perfected by control – see Section 7.3 above. The following discussion assumes that the concept of perfection by control is retained.

Section 57(1) provides that:

> (1) A security interest in collateral that is currently perfected by control has priority over a security interest in the same collateral that is currently perfected by another means.

A similar provision can be found in the Canadian PPSAs,[82] but not in the NZ PPSA.

82 For example Sask PPSA, s 35.1(2).

The rule in s 57(1) applies for all types of collateral for which perfection by control is permitted.

Even if it is accepted that security interests over certain types of collateral should be able to be perfected by control, it does not necessarily follow that a security interest, if perfected in this way, should rank ahead of security interests that are perfected by other means.

Intermediated securities

The genesis for the super priority that the Act affords to security interests that are perfected by control appears to be one or more of the UNIDROIT Securities Convention,[83] Article 9 and the Canadian PPSAs. As discussed in Section 5.3.4.1, though, it must be asked whether it is premature for the Act to be providing for perfection by control over intermediated securities, or for affording a superior priority position for security interests that are perfected in that way, without the balance of the legislative package in Article 8 of the UCC or the Canadian Securities Transfer Acts.

ADI accounts

It could be argued that allowing an ADI to obtain super-priority through perfecting by control over its own ADI accounts is consistent with the fact that ADIs are also able to rely on set-off rights, and on their general law right to combine accounts. The superior priority position that an ADI is able to achieve through perfection by control could simply be seen to be a confirmation of the position that the ADI is expected to enjoy in any event.

Other types of collateral

It is more difficult to understand why a superior priority position should be afforded to security interests that are perfected by control over the other types of collateral listed in s 21(2)(c). I have suggested in Section 5.3 above that Government should consider removing some of those types of collateral from the list in s 21(2)(c) – that is, that a security interest should not be able to be perfected by control over some of those types of collateral. Even if perfection by control continues to be available for security interests over those other types of collateral, however, it is not easy to understand why those security interests should have superior priority. As discussed in Section 5.3.3, perfection by control is the functional equivalent for intangibles of perfection by possession, and it must be asked why perfection by control should enjoy a superior priority, when perfection by possession does not.

Consultation Paper 2 invited stakeholders to comment on these matters.

7.7.4.1.2 ***Discussion of stakeholder feedback***

Respondents expressed a range of views on these questions. A number of respondents thought that super-priority should not be available for all the types of security interests that are currently able to be perfected by control. Other respondents were of the view, however, that the provisions did not need to be changed.

In my view, it is appropriate to continue to allow an ADI's security interest over an ADI account with it to enjoy super-priority, for the reasons given in Section 5.3.7.3. It is less clear that super-priority is appropriate for all the other types of collateral

83 UNIDROIT Securities Convention, Article 19.

over which a security interest can be perfected by control, however, and my inclination is to recommend that the availability of the super-priority be limited to intermediated securities, investment instruments and ADI accounts. I have already recommended in Section 5.3 that Government undertake further consultation with industry regarding the scope of the rules relating to perfection of security interests by control, so I propose to recommend that Government also give further consideration, as part of those further consultations, to the extent to which those security interests should have super-priority.

7.7.4.1.3 ***Recommendation***

> **Recommendation 223:** *That Government consider, as part of the further consultations referred to in Recommendations 64 to 76, whether it is appropriate for a security interest that is perfected by control to be entitled to a super–priority, for each of the types of collateral listed in s 21(2)(c).*

7.7.4.2 **Section 57(2) – priority as between security interests that are both perfected by control**

7.7.4.2.1 ***The issue***

The nature of the rules for perfection by control are such that it is possible for more than one security interest to be perfected by control over an item of collateral at the same time.

Section 57(2) provides the following rule to resolve priority competitions between two security interests that are perfected by control:

> (2) Priority between 2 or more security interests in collateral that are currently perfected by control is to be determined by the order in which the interests were perfected by control (where the perfection by control has been continuous).

Section 57(2) appears to leave unanswered the question of what happens if two security interests are perfected by control at the same time. This could happen, for example, if two security interests are perfected by control over collateral that the grantor acquires after both secured parties have put their control mechanisms in place. Section 7.7.2 above considered a similar question in relation to s 55(2).

Consultation Paper 2 suggested that priority in this situation should go to the secured party that took control first.

7.7.4.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that priority as between two security interests that are perfected by control should be resolved in favour of the secured party that took control first.

7.7.4.2.3 ***Recommendation***

> **Recommendation 224:** *That s 57(2) be amended to provide, if more than one security interest is perfected by control over an item of collateral at the same time, that priority is afforded to the security interest that is held by the secured party that took control first.*

7.7.4.3 Section 57(2A) – proceeds of collateral under a security interest that is perfected by control

7.7.4.3.1 *The issue*

Section 57(2A) provides as follows:

> (2A) A perfected security interest (the ***priority interest***) in the proceeds of original collateral has priority over any other security interest in the proceeds, except a security interest in the proceeds as original collateral that is perfected by control, if:
>
> (a) the security interest in the first-mentioned original collateral was perfected by control when the collateral gave rise to proceeds; and
>
> (b) the priority interest is not perfected by control.

This provision is unique to the Act.

The drafting of s 57(2A) is not easy to follow. It appears to be saying, broadly, that if a security interest is perfected over collateral by control and that collateral gives rise to proceeds over which the security interest is also perfected (but not by control), then the security interest in the proceeds has priority over any other security interest, unless the other security interest is itself perfected by control.[84]

This seems to be a very generous concession, and the policy behind it is not clear. In the case of an ADI that has a security interest over an ADI account with it, for example, the effect of the section seems to be that the ADI would have a super-superior priority claim to any property that was acquired using funds from the ADI account. It is hard to understand why this should be so.

Consultation Paper 2 invited stakeholders to comment on whether it is desirable to afford this level of additional protection to a security interest that is perfected by control, and suggested, if there is no appropriate justification for retaining s 57(2A), that it should be deleted.

7.7.4.3.2 *Discussion of stakeholder feedback*

A small number of respondents argued that s 57(2A) is appropriate, and should be retained. The great majority of respondents were of the view, however, that the section should be deleted. That is my view as well.

7.7.4.3.3 *Recommendation*

> **Recommendation 225:** *That s 57(2A) be deleted.*

7.7.5 Section 58 – priority of advances

7.7.5.1 *The issue*

Section 58 contains this rule:

> A security interest provided for by a security agreement has the same priority in respect of all advances (including future advances), and the performance of all obligations, secured by the agreement.

84 As a demonstration of the fact that the drafting is not easy to follow, one commentary reads it as having the opposite effect: Duggan & Brown, para 11.48. See also LCA, S2 page 13.

Similar provisions can be found in the Canadian PPSAs[85] and the NZ PPSA.[86]

The intent behind s 58 appears to be that a security interest has the same priority for all amounts and obligations secured by it, whether they arise before or after the security interest itself arises. It is not clear, however, why the section does not just say this. The current wording also casts doubt (by negative implication) over whether the security interest can cover future obligations. This is undesirable.

Consultation Paper 2 suggested that it would simplify and clarify the Act if s 58 were amended to respond to these points.

The expression "future advance" is used in only one other place in the Act, in s 18(4). I have already recommended (in Section 5.2.1) that s 18(4) be amended in a way that means that it no longer uses the term "future advance". If that recommendation is adopted and s 58 is amended as recommended below, then the definition of "future advance" is no longer needed, and can be deleted.[87]

7.7.5.2 ***Discussion of stakeholder feedback***

Respondents were divided on this issue. A number of respondents were of the view that the section did not need to change. The majority of respondents agreed, however, that s 58 should be amended along the lines set out above.

7.7.5.3 ***Recommendations***

Recommendation 226: *That s 58 be amended to read along these lines:*

> *"A security interest has the same priority for all amounts and obligations secured by it, whether they are incurred or arise before or after the security interest arises."*

Recommendation 227: *If Recommendations 56 and 226 are adopted, that the definition of "future advance" in s 10 be deleted.*

7.7.6 Section 59 – circular priority systems

7.7.6.1 ***The issue***

Section 59 says this:

> A security interest (the ***first security interest***) has priority over another security interest (the ***last security interest***) if, by the operation of this Act (including this section):
>
> (a) the first security interest has priority over security interests of a particular kind (the ***intermediate security interests***); and
>
> (b) the intermediate security interests have priority over the last security interest.

Section 59 is unique to the Act. None of the Canadian PPSAs or the NZ PPSA contains a corresponding provision.

85 For example Sask PPSA, s 35(5).

86 NZ PPSA, s 72.

87 This would also deal with an inherent circularity in the definition of the term. See AFC, S2 page 7.

Section 59 appears to be designed to deal with circular priority systems. A circular priority system can arise where more than two secured parties have a security interest over an item of collateral, but the effect of the individual priority rules as between each pair of security interests is that none of the secured parties has priority over all the others.

There are a number of ways in which this could arise under the Act. Take, for example, the following fact pattern:[88]

> *SP1 has a perfected security interest over G's truck. G purchases a container crane and attaches it to the truck. SP2 then agrees to make G a loan, secured against the crane. SP1 consents to SP2's security interest. SP2 fails to perfect its security interest.*
>
> *G then grants security over the truck (including the crane) to SP3. SP3 perfects.*

This produces a circular priority system:

- SP1 ranks ahead of SP3 (under s 55(4)), and
- SP3 ranks ahead of SP2 (under s 91(b)), but
- SP2 ranks ahead of SP1 (under s 91(a)(i)).

Circular priority systems can arise under section 64, if an accounts financier gives its s 64 notice to some but not all of the prior secured parties. A circular priority system can also arise in a competition that involves the priority rule in s 73. Again, this can be illustrated with an example:

> *SP1 and SP2 both have perfected security interests over G's truck. SP1's security interest has the earlier priority time.*
>
> *G takes the truck to T for repairs. T repairs the truck, but refuses to return it to G until G has paid T for the repairs. T happens to know of SP2's security interest, and that is a breach of SP2's security agreement for T to have an interest in the truck. T is not aware of the existence of SP1's security interest.*

This produces a circular outcome because:

- SP1 ranks ahead of SP2 (under s 55(4)), and
- SP2 ranks ahead of T (because T cannot satisfy s 73(1)(e)), but
- T ranks ahead of SP1 (under s 73(1)).

Although s 59 appears to be targeted at resolving circular priority systems, it is unable to do so. That is because it does not provide a mechanism for deciding which of the security interests should be the "first security interest" for the purposes of the section.

There is no easy solution for circular priority conundrums. In my view, the best approach is to simply rely on the default priority rules in s 55 where they can apply. In the case of an interest under s 73, of course, s 55 cannot assist because that interest is not a security interest. In that case, the s 73 interest should probably prevail. Either way, s 59 is not the answer. For these reasons, Consultation Paper 2 suggested that s 59 should be deleted.

88 The fact patterns in this Section are taken from B Whittaker, *Circular priority conundrums – cutting the Gordian Knot* (2014) 42 ABLR 62.

7.7.6.2 ***Discussion of stakeholder feedback***

One respondent was of the view that s 59 should be retained. All other respondents agreed, however, that it had no useful role to play, and should be deleted.

7.7.6.3 ***Recommendation***

Recommendation 228: *That s 59 be deleted.*

7.7.7 Section 61 – priority agreements

7.7.7.1 ***The issue***

Section 61 says this:

> (1) A secured party may (in a security agreement or otherwise) subordinate the secured party's security interest in collateral to any other interest in the collateral.
>
> (2) The subordination:
>
> (a) is effective according to its terms between the parties; and
>
> (b) may be enforced by a third party if the third party is the person, or one of a class of persons, for whose benefit the subordination is intended.

Section 61 is based on a corresponding provision in the Canadian PPSAs[89] and the NZ PPSA.[90] This has had the result, however, that it has adopted language that is not consistent with Australian terminology. When s 61 refers to a "subordination", it appears to be referring to what we would more usually call a "priority agreement". In Australian parlance, a priority agreement is an arrangement under which one secured party agrees that its prior-ranking security interest is to rank behind another security interest over the same property. A subordination agreement, in contrast, is an agreement under which two creditors agree that the debts owed to one of them should only be repaid if debts owing to the other creditor have been paid first. Those debts could be secured or unsecured.

While it is possible to work out that s 61 is referring to priority agreements, the Act would be simpler to follow if it used familiar language in familiar ways. For this reason, Consultation Paper 2 suggested that the Act refer in s 61 and other relevant provisions to "priority" rather than "subordination" agreements.

7.7.7.2 ***Discussion of stakeholder feedback***

All respondents agreed that the references in the Act to a "subordination" agreement should be replaced, where appropriate, with a reference to a "priority" agreement instead.

7.7.7.3 ***Recommendation***

Recommendation 229: *That the language of s 61 and other relevant sections in the Act be amended to refer to "priority" rather than "subordination" agreements between secured parties.*

89 For example Sask PPSA, s 40(1).

90 NZ PPSA, s 70.

7.7.8 Sections 62 and 63 – purchase money security interests

7.7.8.1 Leases that are in-substance security interests

7.7.8.1.1 *The issue*

The term "purchase money security interest" is defined in s 14(1):

> (1) A ***purchase money security interest*** means any of the following:
>
> (a) a security interest taken in collateral, to the extent that it secures all or part of its purchase price;
>
> (b) a security interest taken in collateral by a person who gives value for the purpose of enabling the grantor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;
>
> (b) the interest of a lessor or bailor of goods under a PPS lease;
>
> (d) the interest of a consignor who delivers goods to a consignee under a commercial consignment.

The Canadian PPSAs[91] and the NZ PPSA[92] contain a similar definition.

It can be seen that the definition captures leases that are security interests if they are PPS leases. However, it is not so clear how the definition captures a lease that is an in-substance security interest under s 12(1), but not a PPS lease as well (for example, because the lease is for a term of less than one year, or because the lessor is not regularly engaged in the business of leasing goods). This may not have been a concern under Article 9 (from which the definition originates), on the basis that security leases were recharacterised by US law as secured loans, and so covered by paragraph (a) of the definition. That is not the case, however, under Australian general law. There is no obvious reason why the concept of a PMSI should cover a lease that is a PPS lease, but not cover a lease that is an in-substance security interest without being a PPS lease as well.

Consultation Paper 2 said that the intention may have been that leases that are in-substance security interests are covered by paragraph (a) or (b), but that this was not clear. Consultation Paper 2 suggested that the position should be clarified.

7.7.8.1.2 *Discussion of stakeholder feedback*

One respondent made the point that the internal logic of the Act treats a security lease (whether or not it is a PPS lease) in the same way as if the lessor had transferred title to the leased goods to the lessee, and taken security back for the unpaid purchase price.[93] This is discussed above, in Section 7.3. If that is accepted as correct, then a security lease should be a PMSI under paragraph (a) of the definition of that term in s 14.

All other respondents agreed, however, that it would be helpful to clarify the point. One respondent added that it would also be helpful to confirm this for consignments that give rise to an in-substance security interest under s 12(1), but are not a commercial consignment.[94]

91 For example Sask PPSA, s 2(1)(jj).

92 NZ PPSA, s 16(1).

93 AD, CP2 page 32.

94 SP, CP2 page 23.

The status of security leases and security consignments as PMSIs may be resolved sufficiently by the way in which Government responds to the conceptual issues discussed in Section 7.3. If not, then I agree it would be helpful to clarify that a security lease and a security consignment can be a PMSI, whether or not it is also a PPS lease or a commercial consignment.

7.7.8.1.3 *Recommendation*

> **Recommendation 230:** *That the Act be amended, if necessary, to make it clear that s 14(1) captures all leases or consignments that give rise to a security interest, whether or not they are a PPS lease or a commercial consignment.*

7.7.8.2 Sale and lease-backs

7.7.8.2.1 *The issue*

Section 14(2)(a) states that an interest will not be a PMSI, even if it is otherwise within s 14(1), if the interest is:

> (a) an interest acquired under a transaction of sale and leaseback to the seller; …

There is a similar qualification in the Canadian PPSAs[95] and the NZ PPSA.[96]

One of the reasons given for allowing a PMSI to take priority over prior-perfected security interests is that a PMSI swells the grantor's asset pool, by adding a new asset to it. As the PMSI does not reduce the asset base over which a prior-perfected security interest has priority, the prior secured party should be indifferent to the fact that the PMSI holder has priority over the new asset.[97]

This explains why sale and lease-backs are excluded. Under a sale and lease-back, no new asset is being added to the grantor's asset pool. Rather, an existing asset is being taken out of the pool and then returned to it.

One submission suggested that not all sale and lease-backs should be excluded, and that a sale and lease-back should be able to qualify for PMSI treatment if the asset is "almost new", in that it was acquired by the grantor in anticipation of the sale and lease-back and only held by the grantor for a short period of time to enable the sale and lease-back to be completed.[98] The submission argued that sale and lease-back arrangements are a useful source of finance for small business, but that the Act's treatment of sale and lease-backs has restricted the extent to which small businesses can now use them.

There could be good commercial reasons why a grantor needs to complete the initial acquisition of an asset itself, rather than arrange for title to pass direct to a PMSI financier. The grantor may have standing purchase arrangements in place with a long-term supplier that do not allow it to require that title to a particular asset go direct to the PMSI financier. It is also possible, if the goods come from overseas, that the PMSI financier will want the grantor to complete the import

95 For example Sask PPSA, s 2(1)(jj).

96 NZ PPSA, s 16(1) (definition of "Purchase money security interest", para (b)).

97 I acknowledge that does over-simplify the issue. If the assets are the grantor's inventory, for example, they are more likely to be replenishing an existing pool, than adding to it.

98 AFC, S1 page 4 and att B, page 7.

process itself, before title then passes to the PMSI financier. The potential downside to allowing a window of time within which a grantor can own an asset before passing it on to a PMSI financier, though, is that the grantor may need to fund the purchase price from other sources in the meantime, and might do this by way of a further loan from a prior-registered secured party. That loan may not then be repaid from the proceeds of the later PMSI funding.

For this reason, allowing sale and lease-backs to be a PMSI could inappropriately disadvantage prior secured parties. Consultation Paper 2 suggested that a suitable compromise might be to allow a sale and lease-back to be a PMSI if the grantor has title for only a short period of time, and the PMSI financier pays its purchase price for the goods direct to the person who sold the goods to the grantor. That may not always be practicable, but would allow some flexibility.

The same submission also suggested that a sale and lease-back transaction involving a used motor vehicle should be able to qualify as a PMSI if the grantor is a motor vehicle dealer that holds the vehicle as inventory, and wants to finance the vehicle using a bailment or floor plan financing arrangement. This was said to be relevant when the vehicle was a trade-in, presumably because the dealer has no option but to acquire the vehicle directly in such a situation.

I can understand the practical difficulties that this presents for motor vehicle dealers. This proposal faces the same difficulty as just discussed, though, which is that the used vehicle does not add new value to the dealer's asset base. It is acquired in part-exchange for another asset (the new vehicle purchased by the customer), and while that vehicle may itself have been financed by a PMSI, that will not necessarily be the case.

Consultation Paper 2 suggested that the benefits of this proposal are likely to be outweighed by the difficulties involved in drafting it in a way that did not adversely affect other secured parties, and by the complexity that this would add to the Act. The proposal would also run counter to the principle that issues should not be addressed through *ad hoc* carve-outs unless there is a truly pressing need to do so.

7.7.8.2.2 ***Discussion of stakeholder feedback***

A number of respondents said that they were not convinced that the "swell the asset pool" is a sufficient explanation for the PMSI priority rule. Those respondents argued that the "sale and lease-back" exclusion should be removed, so that any sale and lease-back could be a PMSI. Other respondents argued that a sale and lease-back should be able to be a PMSI if the on-sale to the lessor took place within a short period of time after the grantor itself acquired the asset.

The majority of respondents were of the view, however, that the current rule should be maintained – that is, that a sale and lease-back transaction should not be able to give rise to a PMSI.

One respondent made the point that courts in Canada have applied the definition of PMSI flexibly.[99] In one case,[100] for example, a grantor arranged a bank loan to fund the purchase of a herd of cattle, and agreed to give the bank a security interest over the cattle. There was however a delay in the bank providing the funding, so the grantor obtained interim finance to pay the seller, and then used the bank loan to repay the interim finance when the bank funding came through.

99 AD, CP2 page 32.

100 *Agricultural Credit Corp of Saskatchewan v Pettyjohn* (1991) 79 DLR (4th) 22.

The court in that case agreed that the bank's security could be a PMSI, even if the bank's loan technically had not been used to pay the purchase price for the cattle, because the interim finance and the bank loan were in substance two stages of the one transaction. As the respondent put it, it would have been elevating form over substance to deny the bank PMSI status in that case. If Australian courts were to take a similar approach, then they might hold that a transaction was not in substance a sale and lease-back if the grantor only acquired the asset as an interim step in what was intended to be a single lease financing transaction.

Whether or not Australian courts are prepared to approach the interpretation of s 14 in this way, in my view the Act should not disqualify a sale and lease-back transaction from being a PMSI if the purchase price for the collateral never passes through the hands of the grantor. Apart from this, though, I accept that the majority view at this time is that it would not be appropriate to make any further change.

7.7.8.2.3 ***Recommendation***

> **Recommendation 231:** *That the Act be amended to provide that a sale and lease-back can give rise to a PMSI if (and to the extent that) the PMSI secured party paid the purchase price for the collateral directly to the supplier.*

7.7.8.3 **Reimbursed deposits**

7.7.8.3.1 ***The issue***

One submission suggested that the Act could perhaps be amended to allow a PMSI financier to also claim PMSI status for an amount that the financier might pay to the grantor (rather than direct to the seller), to reimburse the grantor for a deposit that the grantor might itself have paid to the seller.[101]

7.7.8.3.2 ***Discussion***

I can see that this would be a useful enhancement of the PMSI rules for the PMSI financier. However, this proposal faces the same difficulty as sale and lease-backs more generally, which is that it is not clear that the grantor's net asset pool will be increased by the full value of the asset. For example, the grantor may have used a bank facility to fund the deposit, and it may not use the reimbursement to pay the amount back to the bank. It would also complicate the drafting of the PMSI provisions, and be at variance with the overseas models. I am not satisfied that there is a clear case for making this change.

7.7.8.3.3 ***Recommendation***

> **Recommendation 232:** *That the Act not be amended to provide a security interest with PMSI status to the extent it secures funds provided by a secured party to a grantor or debtor to reimburse it for a deposit previously paid for the collateral.*

101 ABA, S2 page 7.

7.7.8.4 Personal, domestic or household goods

7.7.8.4.1 *The issue*

Sections 14(2)(c) and 14(2A) have the effect that a security interest in an asset cannot be a PMSI if the grantor intends to use asset predominantly for personal, domestic or household purposes, unless the asset is serial-numbered property.

These provisions are unique to the Act.

It is difficult to see what the policy rationale might be for this. The "new value" rationale for the PMSI priority should not be any less applicable just because the collateral is to be used for personal, domestic or household purposes, and much of the effect of the carve-out is eroded in any event by the qualification for serial-numbered property (which would exclude motor vehicles from the carve-out).

A number of submissions proposed that these provisions be deleted.[102]

Consultation Paper 2 asked whether stakeholders were able to provide an explanation for the carve-out and agreed, if there were no good explanations, that ss 14(2)(c) and (2A) should be deleted.

7.7.8.4.2 *Discussion of stakeholder feedback*

All respondents agreed that ss 14(2)(c) and (2A) should be deleted.

A number of respondents observed that the carve-out may have been included out of a concern that allowing a person to undertake PMSI finance with their personal, domestic or household goods might erode the value of director's guarantees, and so hurt a small business's ability to raise secured finance. That explanation reflects my recollection of events as well. I also agree with those respondents, however, that this is not a particularly satisfactory reason for the carve-out, and agree with the view of all respondents that there is no good reason to retain it.

One respondent also queried whether part or all of s 14(2)(b) should be deleted. That section provides that a PMSI does not include:

> (b) an interest in collateral (as original collateral) that is chattel paper, an investment instrument, an intermediated security, a monetary obligation or a negotiable instrument; …

I would be reluctant to recommend any change to s 14(2)(b) without first affording stakeholders an opportunity to comment. In any event, the types of property listed in the section are, for the most part, types of property over which a secured party can perfect by control. To the extent that is the case, there is less of a need to make it possible for the security interest to be a PMSI as well.

7.7.8.4.3 *Recommendation*

Recommendation 233: *That ss 14(2)(c) and (2A) be deleted.*

102 For example: AICM, S1 page 8; LCA, S1 page 5; QLS, S1 page 2; CW, S1 page 2.

7.7.8.5 Should PMSIs be able to be cross-collateralised?

7.7.8.5.1 *The issue*

The definition of "PMSI" in s 14 provides that a security interest in collateral will only be a PMSI to the extent that it secures (broadly) the unpaid purchase price of the collateral.[103] For example, if a supplier's retention of title clause states that the supplier retains title to goods until it has been paid both the purchase price for those goods and all other amounts owed (eg on account of other supplied goods), then the security interest over those goods will only be a PMSI to the extent of the unpaid amount of those goods, and a non-PMSI security interest for the balance.

If a supplier has made a number of deliveries to a customer, and a competing secured creditor enforces its security over the customer at the time when the supplier has been paid for some but not all of them, the supplier may only be able to successfully assert its PMSI priority if it is able to demonstrate which deliveries have been paid for, and which not. If two or more deliveries are of identical products, the supplier may need to show which of the goods relate to which delivery. This may be impossible to do.

Article 9 responds to this dilemma by allowing the PMSIs in this situation to cross-collateralise, if the collateral is inventory.[104] This means that the supplier can claim PMSI status for its security interest over all the goods it has supplied that are still held by the buyer, without needing to demonstrate which of the particular deliveries remains unpaid.

Two submissions recommended that this approach be adopted in the Act.[105] Consultation Paper 2 agreed that there is merit in that suggestion, and asked whether stakeholders agree.

7.7.8.5.2 *Discussion of stakeholder feedback*

A small number of respondents were not in favour of this proposal. All other respondents agreed, however, that cross-collateralisation should be allowed.

One response expressed the view that cross-collateralisation should not be available if the collateral in question is serial-numbered property.[106] I agree as a more general proposition that the rule should only apply where the inventory is in effect fungible, so that it is not possible to identify what inventory might have been supplied to the grantor at what time. Cross-collateralisation should not be available if the items of inventory are separately identifiable.

7.7.8.5.3 *Recommendation*

> **Recommendation 234:** *That the Act be amended to enable PMSIs in inventory to be cross-collateralised, to the extent that the items of inventory are not separately identifiable.*

103 See ss 14(7) and (8).

104 Article 9, §9-103(b)(2).

105 LCA, S2 page 8; DT, S2 page 6. See also Electaserv, S1 page 2.

106 AFC, SP2 page 23.

7.7.8.6 Use of the term "PMSI" in the Act

7.7.8.6.1 *The issue*

One submission noted that the Act refers in many places to a PMSI, without it necessarily being clear whether it is intended to refer to any security interest that is within the definition of the term in s 14, or whether is only intended to refer to a PMSI that has qualified for the PMSI priority in s 62.[107] The submission suggested that it might be helpful to clarify which meaning is intended in each section.

The current approach is consistent with the approach taken in the Canadian PPSAs and the NZ PPSA. Consultation Paper 2 asked stakeholders to comment, however, on whether it would be helpful to clarify the references in this way.

7.7.8.6.2 *Discussion of stakeholder feedback*

A number of respondents were of the view that it would be helpful for the Act to clarify the meaning of each reference to a PMSI. Most respondents agreed, however, that the references are generally to a security interest that falls within the definition of a PMSI in s 14, whether or not it enjoys the super-priority afforded to some PMSIs by s 62. As some of those respondents pointed out, it should only be necessary to clarify the meaning of the reference in those provisions where it should have a different meaning. I agree with that approach.

As one response noted, one section where the reference should have the narrower meaning is s 103.[108]

7.7.8.6.3 *Recommendation*

> **Recommendation 235:** *That references in the Act to a PMSI not be amended to indicate whether they refer to a PMSI as defined in s 14 or to a PMSI that has priority under s 62 (on the basis that the references are simply to a PMSI as defined in s 14), and that clarifying language only be included where the intention is to refer only to a PMSI that has priority under s 62 (such as in s 103).*

7.7.8.7 Refinancing a PMSI

7.7.8.7.1 *The issue*

Section 14(5) says this:

> (5) A purchase money security interest does not lose its status as such only because the purchase money obligation is renewed, refinanced, consolidated or restructured (whether or not by the same secured party).

There does not appear to be a corresponding provision in the Canadian PPSAs or the NZ PPSA. Canadian courts have however gone some way towards implying the same result into their legislation.[109]

107 DLA, S2 page 4.

108 JLF, CP2 page 34.

109 See Cuming Walsh & Wood, pages 456 to 460.

The section has the effect, for example, that a security interest that was taken to secure a loan that funded the purchase of an asset will not cease to be a PMSI just because the loan is refinanced or restructured, as long as it remains secured by that security interest.

The section does not say what happens, however, if the security interest itself changes – for example, if a manufacturer sells some goods on retention of title terms, and later agrees to transfer title to the grantor in return for taking a security interest (in the more traditional way) for its unpaid purchase price.

This question arises frequently in the equipment finance sector, particularly if a grantor wants to refinance a PMSI financing with a different financier. If the initial PMSI finance was by way of a secured loan, it would be possible in theory for the outgoing financier to transfer the secured loan (with the security interest) to the new financier. That, however, would be an administratively inefficient way to approach the refinance, and would not be consistent with market practice. And even that approach will not work if the new financier uses a different type of PMSI – for example, if the outgoing financier had provided a secured loan, but the incoming financier wants to provide its PMSI finance by way of a lease.

One submission suggested that the "rollover" protection in s 14(5) should also allow the security interest itself to be replaced.[110]

This suggestion, if implemented, should not adversely affect other secured parties, as it is simply another way of replacing a PMSI financing with another PMSI financing. Also, it could enhance the grantor's ability to access cost-effective finance, by expanding its capacity to utilise available financing sources.

Consultation Paper 2 suggested for these reasons that this could be a valuable enhancement to the Act.

7.7.8.7.2 ***Discussion of stakeholder feedback***

All responses agreed that a PMSI that refinances an existing PMSI should also be able to benefit from the PMSI priority under s 62. As a number of those responses pointed out, though, the Act would also need to make it clear that the timeframe for registration of the replacement PMSI will need to be measured by reference to the date on which the grantor first had possession of the collateral as grantor under the replacement PMSI, rather than the date on which the grantor obtained possession under the original financing.

7.7.8.7.3 ***Recommendation***

> **Recommendation 236:** *That s 14(5) be expanded to make it clear that a security interest that replaces a PMSI can also be a PMSI.*

7.7.8.8 **The timeframe for registration – when should it start?**

7.7.8.8.1 ***The issue***

Section 62 provides that a PMSI that is perfected by registration within the timeframe required in the section will have a preferred priority position, in that it can defeat a security interest that is not a PMSI even if the non-PMSI security interest has an earlier priority time. If the collateral is goods and is inventory,

110 AFC, S1 att B, page 9. See also LCA, S2 page 8.

the security interest needs to be perfected by registration before the grantor "obtains possession". If the collateral is goods but not inventory, the secured party needs to perfect by registration within 15 business days of the grantor obtaining possession.[111]

Section 63 sets out a rule that regulates the priority as between competing PMSIs where one of the PMSIs is held by a seller, lessor or consignor of the collateral. That rule also turns in part on when the grantor obtains possession.

The Canadian PPSAs[112] and the NZ PPSA[113] contain similar provisions.

Submissions representing the leasing industry suggested that the time period within which the secured party needs to perfect by registration in relation to goods should be calculated from the time at which the secured party agreed to fund the PMSI, rather than from when the grantor obtained possession.[114] The submissions said that the current approach is of particular concern for the motor vehicle finance industry, because it does not reflect Australian market practice.

The current structure of ss 62 and 63 is a reflection of the way in which the motor vehicle finance industry apparently operates in North America. In North America, the finance typically is initially provided by the motor vehicle dealer, and the dealer makes any necessary registrations. The dealer then bundles up its finance contracts at appropriate intervals and transfers them to a financier (as chattel paper – see Section 4.3.3 above). The dealer will be able to ensure that the PMSI registrations are made on time, because the dealer will know when the grantor is given possession of the vehicle.

In Australia, motor vehicle finance arrangements are organised quite differently. Here, the dealer does not provide the finance itself. The dealer may assist the purchaser/grantor to fill in the finance company's paperwork, but it will simply send the paperwork off to the finance company, potentially at irregular intervals. If the finance company approves the finance, it will then reimburse the dealer for the agreed amount, and itself make the necessary registrations at that time.

The finance company will not necessarily know, however, exactly when the dealer gave possession of the vehicle to the grantor. And there is a risk that more than 15 business days could pass before the finance company receives the paperwork from the dealer and completes the registration. As a way to address this, the submissions argued that the time period should be calculated by reference to the point in time at which the finance company approves the finance. It was also suggested that the time period could then be shortened, as a trade-off.

This would clearly assist the motor vehicle finance industry. However, the proposal does raise concerns. Even if the time period is shortened, the proposal has the potential to significantly lengthen the aggregate period of time within which the PMSI may be perfected by registration. It also makes it extremely difficult for another secured creditor to determine whether the registration was in fact made within the necessary timeframe, because that other secured party will have no way of being able to ascertain when that time period commenced.

Consultation Paper 2 invited stakeholders to comment on these issues.

111 The same time periods apply for collateral other than goods as well. In that case, though, they are determined by reference to the point in time at which the security interest attaches to the collateral.

112 For example Sask PPSA, ss 34(2), (3) and (5).

113 NZ PPSA, ss 73, 74 and 76.

114 AFC, S1 page 5; AFC, S2 page 5.

7.7.8.8.2 ***Discussion of stakeholder feedback***

A small number of respondents argued that the timeframe should be determined by reference to when the secured party provided its funding. The great majority of respondents were of the view, however, that the timeframe should continue to be assessed by reference to when the grantor obtained possession.

Representatives of the leasing industry have been both consistent and diligent in arguing their case. As I see it, however, their case faces at least two substantial hurdles. First, they were not successful in arguing their preferred position through the consultation process that preceded the passage of the Act, and to my knowledge no new arguments have been advanced that might make it appropriate for Government to reconsider the view on the issue that it reached at that time. Secondly, it is clear from responses that the weight of stakeholder views is against any change. As I see it, no clear case has been made for changing the current policy setting.

7.7.8.8.3 ***Recommendation***

Recommendation 237: *That ss 62 and 63 continue to assess whether a registration is made in time to achieve PMSI super-priority by reference to the time when the grantor obtains possession, not when the secured party provides its funding.*

7.7.8.9 **Capacity in which the grantor has possession**

7.7.8.9.1 ***The issue***

As several submissions pointed out, ss 62 and 63 do not clearly explain how the registration timeframes are to be determined if the grantor has possession of the collateral in some other capacity before the goods become subject to a PMSI.[115] This could happen, for example, if a farmer takes possession of some machinery for testing purposes before then agreeing to buy it (and finance it under a secured loan or lease). The question could also arise if a lessee has leased goods for an indefinite term, and the lease runs for more than one year so that it becomes a PPS lease at the end of that year (if my recommendation in Section 4.3.5.4 is adopted).[116]

In my view, the answer is that the timeframe is determined by reference to the time at which the grantor first possesses the goods **in its capacity as grantor** – while it will have had possession before then, this will have been in a different capacity and should not count. The submissions that identified this issue went on to suggest that this be confirmed.

Consultation Paper 2 invited stakeholders to indicate whether they agree with this view, and whether they believe that the Act should be amended to clarify this.

7.7.8.9.2 ***Discussion of stakeholder feedback***

All respondents agreed with this view. It is also consistent with the approach I have recommended above in relation to the refinancing of a PMSI – see Section 7.7.8.7 above.

115 ABA, S1 page 3; AICM, S1 page 15; LCA, S1 page 6; QLS, S1 page 7; CW, S1 page 5.

116 This assumes that the lease is not an in-substance security interest.

7.7.8.9.3 *Recommendation*

> **Recommendation 238:** *That the Act be amended to clarify that references in ss 62 and 63, and elsewhere in the Act, to a grantor obtaining or having possession of personal property, are references to the grantor obtaining or having that possession in its capacity as grantor.*

7.7.8.10 How long should the registration grace period be?

7.7.8.10.1 *The issue*

Some submissions suggested that the timeframes for PMSI registrations should be aligned with other relevant timeframes, such as the 20 business day period under s 588FL of the Corporations Act.[117]

Consultation Paper 2 expressed the view, in contrast, that this was not necessary, and that there is no compelling need to align the PMSI timeframes with the timeframes in s 588FL of the Corporations Act.[118]

Another submission suggested that the registration period for PMSIs over inventory could be extended.[119] The Act currently requires that a PMSI over inventory be perfected by registration before the grantor obtains possession of the goods, if it is to benefit from the PMSI priority. This is in contrast to the position for non-inventory, for which the secured party has 15 business days to register.

This distinction in procedural requirements derives from the Canadian PPSAs.[120] Under those Acts, however, the PMSI financier also needs to send a notice to prior-registered secured parties, to alert them to the fact that it will be taking a PMSI over the grantor's inventory. The PMSI financier must send them the notice before the grantor obtains possession of the inventory, so that the prior secured party is warned in advance that it will not have priority over the new inventory and so has an opportunity to decide whether or not to advance further funds against it. The requirement that the PMSI financier also register before the grantor obtains possession is related to this.

Currently, s 62 does not require the PMSI financier to send notices to prior secured parties. That is discussed below. If the Act is not amended to require the PMSI financier to notify prior secured parties that it is taking a PMSI, then there may well be merit in simplifying s 62 to provide a 15 business day registration timeframe for all types of PMSI.

Consultation Paper 2 invited stakeholders to comment on this.

7.7.8.10.2 *Discussion of stakeholder feedback*

Respondents had mixed views on this question. One respondent argued that the timeframe should be dispensed with altogether. Others were of the view that the current distinction should be maintained. They argued that an inventory financier does not need the 15 business-day grace period because inventory financiers usually have an ongoing relationship with the grantor, and so have an opportunity to register before making the first supply.

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117 For example: ABA, S1 page 3.

118 I also recommend separately in this report that s 588FL of the Corporations Act be deleted. See Section 9.2.2.1 below.

119 NSWBC, S1 page 3.

120 For example Sask PPSA, s 34.

The majority of respondents agreed, however, that there was no good reason for distinguishing between inventory and non-inventory in this context, and that the "15 business day" timeline should apply for all.

That is my view as well. While it may be true that many inventory financiers have an ongoing relationship with the grantor, this will not always be the case. The risk for an inventory financier is also exacerbated by the fact that the term "inventory" includes any collateral that is leased out by the grantor, and a one-off financier of bespoke equipment would need to register before the grantor takes possession in order to get the PMSI priority, whether or not the equipment is inventory of the grantor in the vernacular sense, if the grantor happens to then lease it out.

On the information available to me, the reasons that are given for the difference in treatment as between inventory and non-inventory in Canada are not relevant here. It would simplify the operation of the Act if a consistent set of rules were to apply to both types of collateral.

7.7.8.10.3 ***Recommendation***

> **Recommendation 239:** *That ss 62 and 63 be amended to provide a uniform timeframe of 15 business days for a registration that perfects a PMSI for all types of collateral, including collateral that is inventory.*

7.7.8.11 **Should the registration need to indicate that the security interest is a PMSI? Should a PMSI financier be required take other steps to notify prior secured parties of its PMSI?**

7.7.8.11.1 ***The issue***

Section 62(2)(c) states that a PMSI will only be eligible for the preferred priority status under s 62 if the registration indicates that it is a PMSI, in accordance with item 7 of the table in s 153(1). This is often referred to colloquially as "ticking the PMSI box".

Should the "PMSI box" be deleted?

A number of submissions suggested that s 62(2)(c) should be deleted.[121] They argued that many registrants do not know how to decide whether to tick the PMSI box, and that the consequences of answering the question incorrectly are too draconian – the secured party could lose its PMSI priority (if it has a PMSI but fails to indicate that correctly in the registration), or its registration could be entirely ineffective under s 165(c) (if it claims PMSI status for a security interest that is in fact not a PMSI).

The Canadian PPSAs[122] and Article 9[123] do not require the financing statement to disclose that the security interest is a PMSI. Instead, if the collateral is inventory they require the secured party to notify prior-registered secured parties of its PMSI. This is clearly more helpful for secured parties with a prior registration than the Australian approach, as the Australian approach will only alert existing secured parties to the existence of the PMSI if they happen to do a check search.

121 For example: LCA, S1 page 8; DT, S2 page 12. Not all submissions agreed – see AICM, S2 page 22.

122 For example Sask PPSA, s 34(3).

123 Article 9, §9-324(b).

One submission advocated this approach for the Act.[124]

The position in New Zealand is different again. New Zealand does not require that notice be given to existing secured parties, or that the registration indicate that the security interest is a PMSI. It has been said that the reason for this was that:

> the PMSI super-priority rule merely reflects the rights that title-holders (such as suppliers retaining title under a "romalpa clause") would otherwise have had under the previous law, and that general financiers tended, in any case, to discount the value of inventory under their all assets security.[125]

Which approach is best? The North American approach is the most favourable to existing secured parties, as they receive notice of the PMSI and do not need to rely on check searches. The Australian approach, in contrast, only helps existing secured parties if they do in fact undertake check searches (for example, before advancing further funds). This would not be customary, and would be likely to impose a significant administrative burden on bank lending departments.

The New Zealand approach is the least helpful of all to existing secured parties, as it provides no mechanism that could alert them to the existence of later PMSIs, whether by way of a check search or otherwise.

It seems to me that the current approach in the Act relies on an assumption that is not necessarily valid, which is that secured parties routinely undertake check searches before advancing further funds. If that assumption is indeed incorrect, then it may be fair to argue that the Act should not require a secured party who takes a PMSI to indicate this in the registration (as nothing is gained from it), and that s 62(2)(c) should be deleted.

If s 62(2)(c) is retained, should the PMSI holder be required to provide more information?

One submission pointed out that a PMSI does not automatically benefit from the PMSI priority just because it is perfected by a registration that has ticked the PMSI box.[126] A PMSI over goods will only benefit from the PMSI priority if the registration was made within time – before the grantor obtained possession if the goods are inventory, or within 15 business days of that time if they are not.

A searcher of the Register will not be able to tell whether a PMSI registration was made within the required timeframe, and so will not be able to tell whether a PMSI does in fact have PMSI priority. The submission suggested for this reason, if s 62(2)(c) is retained, that the PMSI holder should also be required to set out in the registration the date on which the grantor obtained possession (if this is known), or alternatively to indicate in the registration that the grantor will obtain possession after the registration has been made.

I can see that this could potentially provide a searcher with information that would help it to determine whether a particular PMSI did have the benefit of the PMSI priority, at least in circumstances involving non-inventory where the registration is not made until after the grantor has taken possession of the goods. It is likely, however, that this proposal could produce significant operational difficulties for a

124 DT, S2 page 8.

125 C Wappett, L Mayne and A Duggan, *Review of the Law on Personal Property Securities: An International Comparison of Personal Property Securities Legislation*, Commonwealth of Australia, Attorney-General's Department, July 2006, para 3.2.3.

126 DLA, S2 page 5.

secured party, and I anticipate that the incremental benefit that this suggestion might produce would be outweighed by its detriments.

If s 62(2)(c) is deleted, should the PMSI holder be required to give notice instead?

If s 62(2)(c) is deleted, what if anything should be included in its place? Should the Act adopt the North American approach of requiring the PMSI holder to notify existing secured parties, or the New Zealand approach, and not require the PMSI holder to take any additional steps at all? A PMSI holder would no doubt argue that it should not be put to the effort of having to notify prior-registered secured parties that it is taking a PMSI. That does however appear to be the established practice in North America. It might also be possible for secured parties to automate the process, particularly if the functionalities of the Register could be enhanced so as to allow Register users to download email addresses direct from the Register.

Consultation Paper 2 invited stakeholders to comment on these questions.

7.7.8.11.2 ***Discussion of stakeholder feedback***

A number of responses were in favour of retaining the PMSI box on the Register. An equivalent number were of the view, however, that the PMSI box should be deleted.

I am not convinced that the PMSI box serves a sufficiently useful function for it to be retained. It provides little or no useful information for a future secured party or for a transferee of collateral, as their position will not be affected by whether or not a prior security interest is a PMSI. It would flag to a prior-registered secured party that it might rank behind a later-registered secured party (because the later registration identifies that the security interest that it perfects is or might be a PMSI), but that will only help the prior-registered secured party if does in fact undertake a check search. And a secured party will normally require its grantor to agree not to give **any** later security interest over its collateral, so the grant of any later security interest is likely to be a default under the earlier security agreement – again, whether or not it is a PMSI.

The PMSI box may help an insolvency appointee to sort through the registrations of an insolvent grantor, in order to decide how to proceed with the insolvency administration, but I am not convinced that this is sufficient reason by itself to require all secured parties to decide whether or not their security interest might be a PMSI and to reflect this in their registration. As I discuss in Section 6.1, the Register needs to be able to be used with confidence by users who are not steeped in the legal intricacies of the Act, and there would need to be a compelling reason in my view to make it appropriate to continue to impose on a registrant the need to understand the detail of what can be or not be a PMSI, as part of the registration process.

One respondent argued that the Act should instead require a PMSI financier who wants to benefit from the PMSI priority to notify prior-registered secured parties of its PMSI, along the lines of the North American approach.[127] Other respondents were of the view, however, that this was not appropriate, and that a PMSI financier should not be required to take any further steps to get the benefit of the PMSI priority.

127 AD, CP2 page 35.

7.7.8.11.3 ***Recommendation***

Recommendation 240: *That s 62 not be amended to require a secured party that wants to claim PMSI priority to give notice of this to existing secured parties, or to provide other information in its registration.*

Recommendation 241: *That s 62(2)(c), and item 7 of the table in s 153(1), be deleted.*

7.7.9 Section 64 – accounts financiers

7.7.9.1 The priority rule, and the policy behind it

7.7.9.1.1 ***The issue***

Section 64 provides that a non-PMSI that is taken for new value in an account as original collateral, and is perfected by registration, can have priority over a perfected PMSI that is granted by the same grantor in the account as proceeds of inventory. The non-PMSI in the account will rank ahead of the PMSI if it is perfected by registration before the registration time for the PMSI.[128] It will also rank ahead of earlier PMSIs,[129] if the secured party gives a prescribed notice to the holders of those PMSIs in accordance with the section.

A number of the Canadian PPSAs[130] also include a provision that allows a security interest in an account as original collateral, if given for new value and perfected by registration, to rank ahead of later PMSIs. The NZ PPSA does this too.[131] In other words, they disengage the priority that the later PMSI would otherwise have because of its PMSI status, and allow priority to be determined by the "first to perfect" principle. Australia is unique, however, in allowing the non-PMSI to defeat PMSIs with an earlier priority time as well.

Section 64 is designed to assist companies to finance their working capital through the sale or other financing of their accounts through an accounts financier. The explanation given overseas for this rule is that an accounts financier would not be prepared to purchase or lend against a company's accounts if they constantly faced the risk of losing priority to subsequent PMSI holders. By disengaging the PMSI priority for later PMSI holders, the accounts financier can rely on its registration, and the state of the register at the time that it registered, to determine its priority position. It is said that this does not overly compromise the position of subsequent PMSI holders, as they can search the register before taking their PMSI to see if an accounts financier has registered against the grantor, and so determine what the strength of their PMSI will be over any accounts that the grantor generates through the sale of their inventory.

That analysis assumes that it is apparent from the accounts financier's financing statement that it has or will have a security interest over the grantor's accounts. I will return to that point shortly. In the present context, though, the point to note

128 And before the PMSI is perfected in some other way.

129 Technically, this should be a PMSI that has already been perfected, or that has an earlier registration time. The terms "earlier", "later" and similar expressions are used here to simplify the explanation.

130 For example Sask PPSA, s 34(6).

131 NZ PPSA, s 75A.

is that this analysis does not explain why it is appropriate to enable the accounts financier to defeat prior PMSI holders as well.

I am advised that this additional concession was granted because of the importance of the receivables finance industry to Australian businesses. The comparison that can be drawn is that the Canadian PPSAs and Article 9 afford special protections to chattel paper, including a capacity to defeat prior security interests, because of the important role that chattel paper plays in North American financing practice. Enabling an invoice financier to defeat prior PMSIs could be said to be based on the same principle, applied in the Australian context.

Two submissions questioned the rationale for the s 64 priority regime.[132] The issue was not raised in other submissions, but it was not apparent whether this is because there is no concern with the overall policy intent of the section, or whether it is because the industries that supply inventory on retention of title terms do not have an organisation that speaks for them on questions such as this. Consultation Paper 2 invited stakeholders to comment on this.

7.7.9.1.2 ***Discussion of stakeholder feedback***

A number of respondents did query the rationale for allowing accounts financiers to defeat prior-registered PMSI holders. The majority of respondents were of the view, however, that the overall policy setting of s 64 is appropriate. As I see it, there is no clear case for changing it.

7.7.9.1.3 ***Recommendation***

Recommendation 242: *That s 64 be retained.*

7.7.9.2 **An alternative to s 64?**

7.7.9.2.1 ***The issue***

One submission suggested, possibly as an alternative to s 64, that the Act should simply provide that a retention of title financier is not able to trace its PMSI into proceeds, at least if the proceeds are acquired by an accounts financier.[133]

7.7.9.2.2 ***Discussion***

This suggestion would certainly provide a simpler outcome than s 64 does at present. It could also be argued that inventory suppliers may not place much store on the value of any accounts that are generated by the on-sale of their inventory – that is, that inventory suppliers may not be upset at not being able to trace their PMSI into the accounts, because they did not place much value on the accounts anyway.

I do not have any evidence before me that might support such an assertion. The submission that offered this suggestion acknowledged itself that this proposal could have adverse and inappropriate consequences for a supplier, particularly if the supplier did allow for the value of the accounts when setting the credit terms on which it is prepared to supply its inventory. I do not feel that I could recommend this proposal without much more information than is available to me at present.

132 LCA, S2 page 8; DT, S2 page 9.

133 ABA, S2 page 8.

7.7.9.2.3 ***Recommendation***

> **Recommendation 243:** *That the Act not be amended to provide that a retention of title supplier is not able to trace its security interest into receivables that are acquired by a receivables financier.*

7.7.9.3 **Should the accounts financier be able to take priority over some non-PMSI security interests?**

7.7.9.3.1 ***The issue***

Section 64 allows an accounts financier to take priority over earlier PMSIs, but not over other earlier security interests. If an earlier financier had a general security interest rather than a PMSI, then s 64 will not help the accounts financier, and they would need to negotiate a priority agreement with the earlier financier in order to take priority.

The value of s 64 is further eroded by the fact that the main type of PMSI financier, a supplier of inventory who sells goods on retention of title terms, will often use an "all-moneys" retention of title clause. Under s 14(3), that clause will give rise to a PMSI over the supplied goods in relation to the purchase price of those particular goods, and will be a security interest (but not a PMSI) in relation to all other secured amounts. Some suppliers also take an express security interest over sale proceeds as original collateral, and make a separate registration against the collateral class "accounts". Both these processes reduce the extent to which an accounts financier can benefit from s 64.

Consultation Paper 2 suggested that it might be appropriate to allow the accounts financier to take priority over all security interests held by the PMSI financier over the account, not just the PMSI over the account as proceeds of the inventory over which the financier held the PMSI as original collateral.

7.7.9.3.2 ***Discussion of stakeholder feedback***

The majority of respondents did not agree with the suggestion that s 64 should allow an accounts financier to defeat not just PMSIs, but also non-PMSIs held by the same secured party. I suspect from reading the responses, however, that some respondents may have understood the Consultation Paper as suggesting that an accounts financier could use s 64 to defeat all prior security interests, not just security interests held by a secured party who also had a PMSI over the collateral. That was not the intention.

In my view, there is no good logic to allowing an accounts financier to defeat a PMSI that is traced by an inventory supplier into the proceeds of the inventory, but not allow the accounts financier to defeat a non-PMSI that is also held by the inventory supplier over the proceeds, whether that is as proceeds of a separate non-PMSI over the inventory, or as a security interest over the proceeds as original collateral. If we accept the policy setting that an accounts financier should be able to defeat prior PMSIs, it would be contrary to the objectives of the Act to then leave a gap in the section that robs it of much of its value.

One response took this one step further, and argued that s 64 should allow an accounts financier to defeat **any** security interest that exists in an account as the proceeds of original collateral, whether or not the secured party also held a PMSI,

and whether or not the original collateral had been inventory.[134] While I can see that that would be an attractive proposition from the perspective of an accounts financier, the proposal would expand the reach of s 64 in a manner that I would not want to recommend without first providing stakeholders with an opportunity to comment.

7.7.9.3.3 ***Recommendation***

> **Recommendation 244:** *That s 64 be amended to provide that an accounts financier can use the section to take priority over both a PMSI held by an inventory financier in the proceeds of its inventory, and over a non-PMSI security interest held by the same inventory financier in those proceeds.*

7.7.9.4 **Should the accounts financier be able to take priority over PMSIs granted by a different grantor?**

7.7.9.4.1 ***The issue***

One submission queried whether it is appropriate that the operation of the section be limited to PMSIs that are granted "by the same grantor".[135] The submission suggested that this can be unduly limiting in transactions involving a chain of leases and subleases, where the accounts financier wants to purchase payment rights under the bottom sublease. Section 64 may be unhelpful in such a transaction because the PMSI that the accounts financier is competing with may have been granted by a grantor higher up the leasing chain.

It is not clear how often this would arise in practice. Consultation Paper 2 nonetheless invited stakeholders to express their views on whether s 64 should apply only to PMSIs that are granted by the same grantor, or whether it should be able to apply to PMSIs granted by other grantors as well.

7.7.9.4.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of expanding the operation of s 64 so that an accounts financier could use it to defeat PMSIs that were granted by a different person to the grantor of the accounts financier's security interest. The majority of respondents, however, were not in favour of this change.

7.7.9.4.3 ***Recommendation***

> **Recommendation 245:** *That s 64 continue to only apply to PMSIs that are granted by the same person as the person who granted the security interest in the account.*

134 ASF, CP2 page 21.

135 DIFA, S2 att A page 3.

7.7.9.5 **Should the accounts financier be able to take priority more easily over PMSIs that are perfected, but not by registration?**

7.7.9.5.1 ***The issue***

Section 64(1)(a) provides that an accounts financier will only defeat PMSIs by means of its registration (rather than by giving notices under s 64(1)(b)) if it registers before the earlier of the registration time for the competing PMSI, or the time at which the competing PMSI is perfected.

The effect of this second option (the time at which the competing PMSI is perfected) is a little unclear. It would be expected that all (or nearly all) PMSIs would be perfected by registration, and the only potential role for this additional language may be to pick up situations where a PMSI is perfected by possession, or by one of the temporary perfection rules. It is not clear how often that would happen.

The presence of the second option in s 64(1)(a) also presents practical difficulties for an accounts financier. If a PMSI is perfected by a means other than registration, the accounts financier is unlikely to be able to find out about it. This means as a practical matter that the accounts financier cannot rely on the alternative mechanism (the notice mechanism in s 64(1)(b)) to take priority, as they will not know where to send the notice (indeed, they will not even know that they need to send the notice).

This is not particularly practicable. It might be thought appropriate for these reasons to amend s 64(1)(a) so that it only refers to a PMSI's registration time.

Consultation Paper 2 invited stakeholders to comment on this.

7.7.9.5.2 ***Discussion of stakeholder feedback***

A number of respondents did not agree that s 64 should be amended in response to this. The majority of respondents were of the view, however, that it was appropriate to simplify the operation of s 64 in this way.

7.7.9.5.3 ***Recommendation***

Recommendation 246: *That s 64(1)(a)(i) be deleted.*

7.7.9.6 **The nature of the registration**

7.7.9.6.1 ***The issue***

As just discussed, the policy balance as between an accounts financier and subsequent PMSIs is currently tipped in favour of the accounts financier because the holder of a subsequent PMSI can search the Register before agreeing to finance the grantor's inventory. That assumes, however, that it will be apparent from the Register that the accounts financier is taking a security interest over the grantor's accounts.

Under the current rules for registering financing statements, an accounts financier is not required to register against the collateral class "accounts". Rather, it could register against the collateral class "all present and after-acquired property", or "all present and after-acquired property, except". It should be asked, however, whether an accounts financier should only be able to rely on s 64 if it registers a financing statement against the collateral class "accounts". This would at least help later PMSI holders to narrow down their field of enquiry when they do their search.

This would not prevent an accounts financier from making a wider registration as well, if that was needed. However, it would assist later PMSI holders, without greatly inconveniencing the accounts financier.

Consultation Paper 2 invited stakeholders to comment on this.

One submission suggested as an alternative that an accounts financier be able to note on the Register that s 64 applies to its security interest.[136]

7.7.9.6.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree with this suggestion. One respondent suggested as an alternative that an accounts financier be required to "tick a s 64 box" if it wanted to claim s 64 priority.[137] As I discuss in Section 6.3, however, I am not in favour of this proposal.

The majority of respondents were in favour of amending the Act to provide that an accounts financier should need to register against the collateral class "accounts", if it wanted to claim the s 64 priority.

7.7.9.6.3 ***Recommendation***

> **Recommendation 247:** *That s 64 be amended to require that the relevant registration be against the collateral class "accounts".*

7.7.9.7 **The notice process**

7.7.9.7.1 ***The issue***

Section 64 provides that an accounts financier can take priority over an earlier PMSI by giving the secured party notice at least 15 business days before the earlier of the day on which the accounts financier registers its financing statement, and the day on which the account financier's security interest attaches.

One submission pointed out that this makes it difficult for a financier to rely on s 64 if it already has security over the grantor's accounts, for example under a general security agreement that has been perfected by a registration against the 'allpap" collateral class.[138] A number of other submissions pointed out that it exposes the accounts financier to the risk that another PMSI holder might register a financing statement within that 15 business day period.[139] If that happened, the accounts financier would need to give notice to that new PMSI holder as well, and then wait a further 15 business days. This is not very efficient.

Some accounts financiers have overcome this "rolling 15 business day problem" by using a number of carefully-constructed financing statements, registered in a specific order. Submissions suggested, however, that the problem should be addressed more efficiently, by providing that the accounts financier can register before or when it gives the notice (rather than wait 15 business days), but on the basis that the s 64 priority will only apply to accounts to which its security interest attaches after the 15 business days have expired.[140]

136 DIFA, S2 att A page 9.

137 SP, CP2 page 27.

138 JLF, S1 page 33.

139 For example: ABA, S2 page 8; DIFA, S2 att A page 1.

140 JLF, S1 page 34; AICM, S1 page 16; LCA, S1 page 7; QLS, S1 page 7; CW, S1 page 5; ABA, S2 page 8; DIFA, S2 att A page 1; DLA, S2 page 11.

The intent behind the advance notice is to give an existing PMSI holder an opportunity to respond to the prospect of losing its priority, for example by shortening its credit terms or moving to a cash-on-delivery basis. That opportunity may be more theoretical than real. Whether or not that is the case, though, the proposed alternative does not appear to operate to the further detriment of an existing PMSI holder, and would significantly simplify the operation of s 64. I think that this is a worthwhile proposal.

As a separate matter, some submissions suggested that the 15 business day period should be shortened, to assist the accounts financier to complete its registrations within the 20 business day window under s 588FL of the Corporations Act.[141]

Consultation Paper 2 invited stakeholders to comment on these questions.

One submission also pointed out that there is a defect in the drafting of s 64(1)(b), because it states that the accounts financier must hold the security interest when the notice is given, but also requires that the security interest may not attach until the notice period has expired.[142] It is difficult to explain how an accounts financier can simultaneously satisfy both requirements.

7.7.9.7.2 ***Discussion of stakeholder feedback***

One respondent was of the view that the notice process should be scrapped altogether. All other respondents, however, were in favour of simplifying it in the manner described above.

7.7.9.7.3 ***Recommendation***

Recommendation 248: *That s 64(1)(b)(ii) be amended to provide that a "priority interest" in an account will take priority in relation to the account if the priority interest first attaches to the account at least 15 business days after the secured party with the priority interest has given notice to the PMSI secured party in accordance with s 64(2).*

Recommendation 249: *That s 64(1)(b)(i) be amended to reflect the fact that the secured party will not hold the priority interest until it has attached.*

7.7.9.8 **To whom should the notices be given?**

7.7.9.8.1 ***The issue***

One submission suggested that s 64(1)(b)(i) should only require that the notices be given to the secured parties that indicated in their registration that their security interest is a PMSI.[143]

This could work in either of two ways. It might mean that the accounts financier would only obtain priority over earlier PMSIs that were registered as such. That would produce a somewhat perverse result, however, as the accounts financier would rank ahead of earlier PMSIs that did enjoy PMSI priority, but behind earlier PMSIs that did not. The more likely effect of such an approach would be that the

141 DIFA, S2 att A page 2; DLA, S2 page 11.

142 DIFA, S2 att A page 2.

143 JFL, S1 page 33.

holder of a perfected PMSI that did not enjoy PMSI priority would rank behind the accounts financier, but not receive any warning of this because they did not get the notice.

I have separately recommended that the PMSI box be deleted.[144] Even if it is retained, my preference would not be to require that the notices only need to be given to secured parties who have claimed PMSI status in their registration. While sending out the s 64 notices does involve administrative effort, automation should be able to help to keep the workload to manageable levels, particularly if users of the Register are able to download email addresses directly from the Register. In fairness to the PMSI holders who are about to lose their priority, I think it is appropriate that they receive a notice to alert them to this.

Consultation Paper 2 invited stakeholders to comment on this proposal.

7.7.9.8.2 ***Discussion of stakeholder feedback***

A small number of respondents supported the proposition that the accounts financier should only need to give the notice to a secured party that had claimed PMSI status in its registration. All other respondents, however, were of the view that the accounts financier should be required to send the notice to all registered secured parties that had a PMSI, whether or not this was disclosed in their registration.

7.7.9.8.3 ***Recommendation***

> **Recommendation 250:** *If s 62(2)(c) is retained, that s 64 not be amended to provide that an accounts financier only needs to send notices under the section to secured parties that have indicated in their registration that their security interest is a PMSI.*

7.7.9.9 **What should the notices say?**

7.7.9.9.1 ***The issue***

Section 64(2)(b)(i) provides that a notice under s 64 must contain "a description of the inventory to which the notice relates". One submission suggested that it be made clear that the description can be generic, as it would be a formidable task to require the accounts financier to tailor the notice for each addressee, even if the accounts financier had the information that it would need to do this.[145]

The section may already allow the notice to be quite generic, as a "description" of personal property is defined in s 10 to include a description that simply identifies the class to which the personal property belongs. I agree, however, that an accounts financier should not need to wrestle with this question. In my view, it should be sufficient for the notice to state that:

- the accounts financier may be acquiring an interest in accounts that are proceeds of inventory in which the PMSI holder may also have a security interest; and

144 See Section 7.7.8.11.

145 JLF, S1 page 34.

- the effect of s 64 is that the accounts financier will have priority over the PMSI in relation to accounts to which its security interest attaches after 15 business days from the day the notice is given.[146]

Consultation Paper 2 invited stakeholders to comment on this proposal.

7.7.9.9.2 ***Discussion of stakeholder feedback***

All respondents agreed that a notice under s 64 only needed to set out the information described in the above two bullet points.

7.7.9.9.3 ***Recommendation***

Recommendation 251: *That s 64(2)(b) be amended to provide that a s 64 notice need only state that:*

- *the accounts financier may be acquiring an interest in accounts that are proceeds of inventory in which the PMSI holder may also have a security interest; and*
- *the effect of s 64 is that the accounts financier will have priority over the PMSI in relation to accounts to which its security interest attaches after 15 business days from the day the notice is given.*

7.7.10 Section 76 – returned collateral

7.7.10.1 ***The issue***

Section 37 deals with situations where collateral has been sold or leased in a manner that allows the buyer or lessee to take the collateral free of a security interest, but the collateral comes back into the possession of the seller, lessor or a transferee of chattel paper because the sale or lease has been rescinded or expires, or has been enforced. The section provides, broadly, that the security interest re-attaches to the collateral, and that the security interest is taken to have been continuously perfected over the intervening period, if it was perfected by registration and the registration is still current. Section 38 deals with a similar situation, but in circumstances where the sale or lease created an account or chattel paper and the seller or lessor has transferred the account or chattel paper to another person. If the collateral is returned because the sale or lease has been rescinded or expires or has been enforced, then s 38 deems the transferee of the account or chattel paper to have a security interest in the collateral (as compensation for the fact that the account or chattel paper will have been rendered largely worthless by the return of the collateral). In this case, the deemed security interest is temporarily perfected, allowing the transferee an opportunity to perfect by registration.

Sections 37 and 38 are discussed separately, in Section 7.6.17.

Section 76 addresses the situation where the buyer or lessee has also given security over the collateral, and provides a priority rule for the competition between the security interest over the collateral that has attached (or re-attached) under s 37 or 38, and the security interest that was granted by the buyer or lessee.

146 This assumes that the recommendation to this effect in Section 7.7.9.7 is adopted.

One submission noted that there are a number of drafting difficulties with s 76, and in particular with s 76(3), that prevent it from having full effect.[147] Section 76(3) says this:

> (3) A security interest (the priority interest) in goods that is granted by a person who acquires an interest in the property has priority over a security interest in the goods that reattaches under section 37, or is granted by the operation of section 38, if:
>
> (a) the priority interest attaches while the goods are in the possession of the person; and
>
> (b) immediately before the repossession time (referred to in paragraph 37(1)(d) or 38(1)(d)), the priority interest is perfected.

The drafting difficulties identified in the submission are these:

- First, s 76(3)(a) says that the priority interest will only have priority if it attaches while the goods are in possession of the grantor of that interest (ie in the hands of the buyer or lessee). That overlooks the fact that the priority interest may have been granted before the buyer or lessee took possession. I am not aware of any reason why the priority interest should not be entitled to priority just because it was granted before the buyer or lessee obtained possession. The more important point is that the priority interest be granted before the repossession time.
- Secondly, s 76(3)(b) implies, by referring specifically to ss 37(1)(d) and 38(1)(d), that the priority interest can take priority only if the reason for the return of the collateral is the one listed in those sections (which is that the collateral was repossessed because of default). I suspect that this is a drafting error. The expression is defined more broadly in the lead-in text to ss 37(1) and 38(1), and I believe that s 76(3)(b) should simply refer to the repossession time "(referred to in paragraph 37(1) or 38(1))".

Consultation Paper 2 invited stakeholders to comment on these points.

7.7.10.2 *Discussion of stakeholder feedback*

All respondents agreed that it would be appropriate to amend s 76 to address the issues set out above.

7.7.10.3 *Recommendations*

Recommendation 252: *That s 76(3)(a) be amended by replacing "while the goods are in the possession of the person" with "before the repossession time (referred to in paragraph 37(1) or 38(1))".*

Recommendation 253: *That s 76(3)(b) be amended by replacing "paragraph 37(1)(d) and 38(1)(d)" with "subsection 37(1) or 38(1)".*

147 LCA, S2 page 14.

7.7.11 Sections 85 and 86 – crops and livestock

7.7.11.1 ***The issue***

Section 85 provides a special priority rule for a security interest that is taken in relation to crop inputs:

> A perfected security interest (the ***priority interest***) that is granted by a grantor in crops or the proceeds of crops has priority over any other security interest that is granted by the same grantor in the same crops or proceeds if:
>
> (a) the priority interest is granted for value; and
>
> (b) the priority interest is granted to enable the crops to be produced; and
>
> (c) either:
>
> (i) the security agreement providing for the priority interest is made while the crops are growing; or
>
> (ii) the crops are planted during the period of 6 months after the day the security agreement providing for the priority interest is made.

Section 86 provides a similar rule in relation to livestock.

Similar rules can be found in most of the Canadian PPSAs,[148] but not in the NZ PPSA.

Sections 85 and 86 provide a priority position that is similar in some respects to a PMSI, except that the priority is over the crop or livestock that benefits from the input, rather than over the input itself (presumably because the input disappears, as it is used). However, they raise a number of issues:

- First (as a drafting issue), it is not the security interest itself that "enable[s] the crops to be produced". Rather, it is the input (the funding of which is secured by the security interest) that does this.
- Secondly, the sections present existing secured parties with the same problem as PMSIs under s 62, which is that they are likely to be and to remain unaware of the existence of the security interest, and that it will rank ahead of them even though it has a later priority time.
- Thirdly, it is not clear how the sections intersect with the priority that is given to security interests that are perfected by control.

One submission drew attention to one particular difference between the rules in ss 85 and 86.[149] The priority rule in s 86 (relating to livestock) does not adversely affect PMSIs – that is, the rule says that it does not give the input provider's security interest priority over another security interest, if the other security interest is a PMSI. The rule in s 85 (relating to crops) does not contain this qualification, and so would appear to give the input financier priority over a PMSI in the crops too. The Replacement Explanatory Memorandum notes the different approach as between the two sections, but does not explain it.[150]

The submission suggested that the rules be made consistent.

148 For example Sask PPSA ss 34(11) and (12).

149 DIFA, S2 att A page 5.

150 Replacement Explanatory Memorandum, para 3.7.

The explanation for the distinction may be quite prosaic, in that it could be based on the fact that it would be very difficult to have a PMSI over crops (unless, perhaps, they were purchased as young plants using PMSI finance, and then planted). It is much easier, in contrast, to have a PMSI over livestock. If this is the explanation, then I see no reason in principle why the "(other than a purchase money security interest)" qualification could not be included in s 85 as well.

More generally, ss 85 and 86 could actually make it more difficult for a farmer to raise finance from traditional sources, as the farmer's bank may be less prepared to provide the farmer with finance because of the risk that it could rank behind a future inputs financier. Alternatively, a farmer's bank may insist that the farmer not grant any security interests that could benefit from the priority in s 85 or 86, in which case the sections would have no role to play.

One submission also pointed out that the priority rule for accounts financiers in s 64 does not apply to security interests under ss 85 and 86, because they are not PMSIs.[151] The submission said that this is making it difficult for farmers to use their receivables as a source of finance.

Some submissions suggested that ss 85 and 86 should be deleted.[152] One submission suggested that suppliers of inputs tend not to take security of the types contemplated by ss 85 and 86.[153] That submission also suggested that the sections had made agricultural finance for banks "more complex and arguably of higher risk".[154]

Consultation Paper 2 noted that it would be desirable to hear further, for example from agribusiness financiers or farming organisations, as to whether ss 85 and 86 are thought to be desirable, or whether the sections are thought on balance to adversely affect funding availability for farmers because of the negative implications that they have on other funding sources. If the rules are of little or no net benefit, then it would be preferable to simplify the Act, and to remove them. This would be consistent with the position in New Zealand.

Consultation Paper 2 invited stakeholders to comment on these questions.

7.7.11.2 *Discussion of stakeholder feedback*

A small number of respondents argued in favour of retaining ss 85 and 86. The majority of respondents were of the view, however, that they should be deleted.

I am also minded to recommend that they be deleted. I am conscious, however, that the review received no additional input on this question from specialist agribusiness financiers or farming organisations, and I would like to ensure that their views are taken fully into account before any decision to delete them is implemented. For that reason, I propose to recommend that Government undertake further consultation on the benefits or otherwise of ss 85 and 86, before confirming whether they should be deleted.

151 DIFA, S2 att A page 4.

152 For example: ABA, S2 page 4; AFC, S2 att A page 3.

153 ABA, S2 page 5.

154 ABA, S2 page 4.

7.7.11.3 ***Recommendations***

> **Recommendation 254:** *That Government afford agribusiness financiers and farming organisations a further opportunity to comment on whether ss 85 and 86 should be retained or deleted.*
>
> **Recommendation 255:** *If s 85 is retained, that it be amended by inserting "(other than a purchase money security interest)" after "other security interest" in line 3.*

7.8 The priority rules – competitions with other interests in the collateral

7.8.1 Section 73 – trustee's liens

7.8.1.1 ***The issue***

One submission suggested that s 73 be amended to address the priority of a trustee's lien as against a secured party with a security interest in the trust assets.[155]

The juridical nature of a trustee's lien is not clear.[156] The issue identified by the submission stems from the fact, however, that the lien (however characterised by the law) can allow a trustee to satisfy (or reimburse itself for) properly incurred debts, out of trust assets. If a trustee of a trust with an ABN grants a security interest both in its own right and as trustee to secure a debt that it properly incurred as trustee, but the secured party only registers a financing statement against the trustee's ACN and not the trust's ABN, then this would suggest that the security interest was unperfected as against the trust assets, and would rank behind other perfected security interests over those assets. However, the security interest is perfected as against the trustee personally, so if the trustee's lien ranks ahead of security interests over the trust assets, could the secured party still defeat perfected security interests over the trust assets "through the back door", because it has security over the trustee's personal assets, including its rights under the lien?

The submission suggested that the appropriate response might be to subordinate the trustee's lien to security interests that are perfected over the trust assets. While that would respond to the immediate issue, though, it might have the potential to raise other, broader concerns.

Consultation Paper 2 invited stakeholders to comment on this proposal.

7.8.1.2 ***Discussion of stakeholder feedback***

A small number of respondents favoured the view that the trustee's lien should rank ahead of a perfected security interest over the trust assets. The majority of respondents were of the view, however, that the trustee's lien should rank behind.

155 LCA, S2 page 13.

156 See N D'Angelo and H Busljeta, *The Trustee's lien or charge over trust assets: A PPSA security interest or not?* (2011) 22 JBFLP 251.

This issue will go away, of course, if my recommendation in Section 6.7.4.1 is adopted, so that a registration to perfect a security interest over trust assets is made against the trustee's details, rather than the trust's ABN. Even if that recommendation is not adopted, however, I am not convinced that this issue is significant enough to warrant an amendment to the Act. If Government wishes to clarify the issue, then a preferable approach may be to deal with it by way of a legislative instrument under s 73(7).

7.8.1.3 ***Recommendation***

> **Recommendation 256:** *That the Act not be amended to address whether a trustee's lien ranks ahead of or behind a security interest over the assets of the trust.*

7.8.2 Section 74 – execution creditors

7.8.2.1 Does the section reflect Australian practice?

7.8.2.1.1 ***The issue***

Section 74 provides relevantly as follows:

> (1) The interest of an execution creditor in collateral has priority over any security interest in the same collateral that is not perfected at the time covered by subsection (4) (even if such a security interest is later perfected).
>
> …
>
> (4) This subsection covers the following times:
>
> (a) if the collateral is seized by the execution creditor or by another person on behalf of the execution creditor—the time of seizure;
>
> (b) in any other case—the time when:
>
> (i) an order is made by a court in respect of a judgment in relation to the execution creditor; or
>
> (ii) a garnishee order is made in relation to the execution creditor.

Section 74 reflects similar provisions in the Canadian PPSAs[157] and the NZ PPSA.[158] It is not clear, however, that s 74(4)(a) accurately reflects the manner in which an execution creditor in Australia is able to arrange for a person's property to be seized and sold, and for the sale proceeds to be applied to satisfy a judgment debt owed to it by the person.

As I understand it, the property under an Australian execution process is not seized by the execution creditor, but by a sheriff. Also, the sheriff does not seize the property "on behalf of the execution creditor", but as an officer of the court. If this is correct, then it may be that s 74(4)(a) has no role to play, and could be deleted. This would help to simplify the Act.

Consultation Paper 2 invited stakeholders to comment on the suggestion that s 74(4)(a) be deleted.

157 For example Sask PPSA, s 20(1).

158 NZ PPSA, s 103.

7.8.2.1.2 ***Discussion of stakeholder feedback***

A number of respondents agreed that s 74(4)(a) could be deleted. An equivalent number suggested instead that the language of the section should be amended, so that it does accommodate the way in which judgments are executed against property in Australia. One respondent suggested language for this purpose that seems to address the issue neatly but without being prescriptive,[159] and I am happy to adopt that language as my recommendation.

7.8.2.1.3 ***Recommendation***

Recommendation 257: *That s 74(4)(a) be amended to read:*

"(a) if the collateral is seized as part of the execution process – the time of seizure;".

7.8.2.2 **Application to after-acquired property**

7.8.2.2.1 ***The issue***

One submission pointed out that the current structure of s 74 is problematic in the way in which it can apply to future property.[160] A secured party may have taken all-assets security from a grantor, and have appropriately registered an "all present and after-acquired property" financing statement. Its security interest will not be perfected, however, over property that is not yet in existence (or in which the grantor does not yet have sufficient rights to support attachment for some other reason), as the security interest will not yet have attached to that property. If it is possible for a writ of execution to relate to property that a grantor might acquire after the writ is issued, then the effect of s 74 is that the execution creditor will necessarily rank ahead of the secured party, even though the secured party had already taken all steps that it could to perfect its security interest. This seems to be an anomaly.

Consultation Paper 2 invited stakeholders to comment on this.

7.8.2.2.2 ***Discussion of stakeholder feedback***

A small number of respondents did not clearly support this proposal. All other respondents, however, were in favour of amending s 74(1) to provide that an execution creditor only has priority over a security interest if the priority time for the security interest is after the date specified in the section.

7.8.2.2.3 ***Recommendation***

Recommendation 258: *That s 74(1) be amended to provide that an execution creditor only has priority over a security interest if the "priority time" for the security interest is after the date specified in the section.*

159 AD, CP2 page 38.

160 JLF, S2 page 16.

7.8.2.3 Application to interests that are not security interests

7.8.2.3.1 *The issue*

One submission also pointed out that the combined effect of s 8(2) and reg 1.4(5)(b) of the Regulations is that s 74 applies to some interests that are not otherwise subject to the Act.[161]

It is not clear whether the objective of these provisions is simply to ensure that s 74 can function as intended even though the execution creditor's interest is itself not a security interest, or whether these provisions are saying that the execution creditor's interest can defeat those other types of interests, even though they are not security interests. If the latter is correct, then the holder of such a non-security interest is put in an invidious position, as they will be defeated by the execution creditor if their interest is unperfected, yet will be unable to perfect their interest because it is not subject to the Act.

Consultation Paper 2 expressed the view that s 74 should only allow an execution creditor to defeat an interest that is subject to the Act, and that the Act should be amended to clarify this.

7.8.2.3.2 *Discussion of stakeholder feedback*

A number of respondents did not agree with this proposal, or did not think that it was necessary. The majority of respondents agreed, however, that it was desirable to clarify that s 74 only allows an execution creditor to defeat an interest that is a security interest under the Act.

7.8.2.3.3 *Recommendation*

> **Recommendation 259:** *That s 8(2) and reg 1.4(5)(b) be amended to make it clear that s 74 can only afford an execution creditor priority over another interest if that other interest is a security interest that is subject to the Act.*

7.9 Accessions

7.9.1 Potential overlap with Part 3.4

7.9.1.1 *The issue*

One submission pointed out that there is potential for overlap between Part 3.3 (dealing with accessions) and Part 3.4 (dealing with processed and commingled goods).[162] The submission gave the example of paint sprayed onto a car body as goods that could be regarded as being both an accession (as defined in s 10) and goods that have been so processed that they have lost their identity in the product (ie the car).

The tenor of Part 3.3, dealing with accessions, is that an accession is something that remains capable of being removed from the whole. On that basis, the paint sprayed onto a car body is not an accession. Instead, the paint has lost its separate identity, and so is processed goods and subject to Part 3.4.

161 JLF, S2 page 16.

162 JLF, S2 page 18.

Consultation Paper 2 agreed however that it could be helpful to clarify the interaction between the two sets of rules, and suggested that the potential for confusion would be eliminated if the definition of "accession" in s 10 were expanded to make it clear that goods are not an accession if they have lost their identity in a product and so are covered by Part 3.4.

7.9.1.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that this point was sufficiently self-evident that it was not necessary to clarify it further. An equal number of respondents were of the view, however, that it would be helpful to make the change. In my view, an amendment to clarify this would not add to the complexity of the Act, and would help to remove a potential uncertainty.

One response suggested that the use of the term "accession" was confusing, because the term has a specific meaning at general law that might not fully reflect the definition used in the Act.[163] The response suggested that the Act use a different term, such as "addition" or "accessory". I am not satisfied, however, that this would make much of a difference to understanding of the Act, and see no strong case for this change.

7.9.1.3 ***Recommendation***

Recommendation 260: *That the definition of "accession" in s 10 be amended to clarify that goods will not be an accession to other goods if their identity has been lost in the other goods in a way that engages the application of Part 3.4 of the Act.*

7.9.2 Terminology – "continues in"

7.9.2.1 ***The issue***

Part 3.3 of the Act contains a number of provisions dealing with security interests in accessions. A number of those provisions refer to the fact that a security interest in goods that become an accession can "continue in" the accession. As discussed in Section 7.4.3 above, it is my view that "continues in" is intended to mean the same as "remains attached to". Consultation Paper 2 suggested that it could make the Act easier to work with if the references in the Act to a security interest "continuing in" collateral were amended to confirm this.

7.9.2.2 ***Discussion of stakeholder feedback***

A number of respondents did not agree with this proposal, possibly because they felt it was not necessary. The majority of respondents were of the view, however, that this change should be made.

7.9.2.3 ***Recommendation***

Recommendation 261: *That references in Part 3.3 of the Act to a security interest "continuing in" an accession be amended to refer to the security interest "remaining attached to" the accession.*

163 JLF, CP2 page 27.

7.9.3 Section 90 – competitions with an interest in the whole

7.9.3.1 *The issue*

Section 90 sets out some circumstances in which a person's interest in the whole can take priority over a security interest that had attached to goods before they became an accession. They include the interest of:

(a) a person who acquires for value an interest in the whole after the goods become an accession, but before the security interest in the accession is perfected;

(b) an assignee for value of a person with an interest in the whole at the time when the goods become an accession, but before the security interest in the accession is perfected;

It is difficult to see what paragraph (b) adds to paragraph (a), as an assignee of a person with an interest in the whole (under paragraph (b)) will necessarily be acquiring an interest in the whole (under paragraph (a)).

Consultation Paper 2 suggested that s 90(b) could be deleted.

7.9.3.2 *Discussion of stakeholder feedback*

One respondent thought that s 90(b) should be retained, because it provided additional comfort for a purchaser.[164] All other respondents agreed, however, that s 90(b) should be deleted.

7.9.3.3 *Recommendation*

Recommendation 262: *That s 90(b) be deleted.*

7.9.4 Other comments in submissions

None of the submissions raised any other concerns regarding Part 3.3 of the Act, other than in relation to a secured party's ability to remove an accession from the host goods on enforcement. That issue is dealt with in Section 8.3.3.

7.10 Processed and commingled goods

7.10.1 Should processed goods and commingled goods be dealt with separately?

7.10.1.1 *The issue*

Part 3.4 of the Act contains rules that deal with a situation where goods that are subject to a security interest are commingled with other goods, or are so manufactured, processed or assembled that they lose their identity in an end product.

As a number of the submissions noted, it must be asked whether it is appropriate to apply the same rules to both processed and commingled goods.[165] It has been pointed out with some force that the rules in Part 3.4 appear to have been

164 LM, CP2 page 15.

165 JLF, S1 page 34; ABA, S2 page 5.

designed principally with processed (rather than commingled) goods in mind, and that they can produce unfair outcomes when applied to goods that are commingled.[166]

My view is that this concern should be addressed, and that Part 3.4 should be recast so that there are separate rules for each of processed and commingled goods. This would add modestly to the length of the Act, but would produce fairer outcomes for secured parties with a security interest in commingled goods than is the case at present.

Under such an approach, the current rules in Part 3.4 would continue to apply (subject to the comments below) to processed goods. In contrast, the rules for commingled goods could be based on the principle that a party with an interest in goods that are commingled into a larger bulk should share in that larger bulk in the proportion that its goods represents of all contributions to the bulk. To the extent that more than one party had an interest in goods that become part of a larger bulk, their rights as against each other would continue to be resolved as if the goods were still separate, but on the basis that the aggregate of their claims could not exceed the relevant proportion of the bulk, as described in the previous sentence. If a secured party wants to enforce its security interest in a share of the bulk, it would need to separate the relevant share from the bulk, and then enforce against that separate share.

Consultation Paper 2 invited stakeholders to comment on this proposal.

One submission suggested that the provisions dealing with commingled goods should also apply to the commingling of fungible intangibles.[167] Consultation Paper 2 invited comments on this as well.

7.10.1.2 ***Discussion of stakeholder feedback***

One respondent did not agree that commingled goods needed to be dealt with separately. A number of respondents were concerned to see the detail of the drafting before they could express a firm view. All other respondents were of the view, however, that it would be appropriate to have bespoke provisions for commingled goods, rather than deal with them using the same rules as for processed goods.

Responses did not comment on the suggestion that the commingling rules should also apply to fungible intangibles. It is interesting to note, though, that other PPSA jurisdictions do not appear to have felt the need to have rules for commingled intangibles. The timeframe for completion of the review has not allowed the reason for this to be investigated further, so I am not in a position to make a specific recommendation on this proposal. Instead, I propose to recommend that Government explore this question further, through industry consultation and further investigation of the position in Canada and under Article 9.

166 A Boxall and D Loxton, *Commodity transactions and Part 3.4 of the Personal Property Securities Act 2009: an anomalous outcome* (2013) Commercial Law Quarterly Vol 27 No. 2, page 3.

167 JLF, S2 page 17.

7.10.1.3 ***Recommendations***

Recommendation 263: *That Part 3.4 of the Act be split into two, and that commingled goods be dealt with separately, in accordance with these principles:*

1. *A party with an interest in goods that are commingled into a larger bulk shares in that larger bulk in the proportion that its goods represent of all contributions to the bulk.*
2. *To the extent that more than one party had an interest in goods that become part of a larger bulk, their rights as against each other continue to be resolved as if the goods were still separate, but on the basis that the aggregate of their claims may not exceed the relevant proportion of the bulk, as described in the previous paragraph.*
3. *If a secured party wants to enforce its security interest in a share of the bulk, it must separate the relevant share from the bulk, and then enforce against that separate share.*

Recommendation 264: *That Government consider further, in consultation with industry and through consideration of the position in Canada and under Article 9, whether the commingling rules should be extended to commingled intangibles.*

7.10.2 Section 100 – deemed perfection

The balance of this Section 7.10 relates to Part 3.4 of the Act as it applies to processed goods.

7.10.2.1 ***The issue***

Section 100 says this:

> For the purposes of section 55 (default priority rules), perfection of a security interest in goods that subsequently become part of a product or mass is to be treated as perfection of the security interest in the product or the mass.

Consultation Paper 2 asked whether stakeholders considered that s 100 should apply more broadly, and not just in relation to the default priority rules in s 55.

7.10.2.2 ***Discussion of stakeholder feedback***

Respondents had a range of views on this question. Almost all respondents agreed that some change was desirable. Some of those respondents thought that the rule should apply generally. Others thought that the rule should only apply in some additional contexts, such as for the purposes of the priority rules in ss 62 and 63, or for the purposes of s 267.

In my view, the rule in s 100 should apply for the purposes of the PMSI priority rules, so that a perfected PMSI over an input can be capable of retaining that status over the processed whole. The rule should also apply for the purposes of the "vesting on insolvency" rule in s 267, and for s 588FL of the Corporations Act if that section is retained.

In my view, though, the rule should not apply for the purposes of the taking free rules, in particular for the purposes of s 43. If a secured party with a security interest over an input wants to protect itself from the risk that a buyer of the finished product could take the finished product free of its security interest, then the secured party should ensure that its registration is broad enough to cover the finished product as well. Otherwise, a buyer of the finished product would need to search the Register not just for registrations that covered the finished product, but for registrations that could cover any of the inputs as well.

A secured party with a security interest over an input is likely to know that the input will be used in a production process, so it should not be a significant imposition to require them to register against the finished product as well as the input. In my view, the balance of convenience as between the secured party and a buyer lies in favour of placing this onus on the secured party.

7.10.2.3 ***Recommendation***

> **Recommendation 265:** *That s 100 be amended by replacing "section 55 (default priority rules)" with "this Act (other than Part 2.5)".*

7.10.3 Sections 101 to 103 – resolving competitions between security interests

7.10.3.1 Section 101 – competition with a security interest over the whole

7.10.3.1.1 ***The issues***

Section 101 says this:

> Any priority that a security interest continuing in the product or mass has over another security interest in the product or mass is limited to the value of the goods on the day on which they became part of the product or mass.

Section 32(2) deals with a similar issue, in relation to proceeds.[168] Unlike s 101, however, s 32(2) does not just limit the security interest's priority over other security interests. Rather, it limits the amount recoverable under the security interest.

The relevance of this can be explained with a slightly-modified version of an example from one of the submissions:[169]

> $40,000 worth of woodchips is mixed with $10,000 worth of resin to make $100,000 worth of chipboard. There is a perfected security interest over the woodchips securing $50,000, and an unperfected security interest over the finished chipboard securing $20,000.

Section 101 limits the priority held by the woodchips security interest to $40,000. Because the section does not limit the amount recoverable, however, the secured party can also rely on its security interest to recover the remaining $10,000 out of the sale proceeds from the chipboard after the $20,000 has been paid to the holder of the unperfected security interest. And the secured party would have been able to recover its $50,000 without interference if it had been the only secured party with a security interest over the chipboard (for example, if the grantor had gone into insolvency, and the unperfected security interest had vested in the grantor under s 267).

168 Section 32(2) is discussed further in Section 7.4.4 above.

169 JLF, S2 page 18.

This appears to give the secured party a windfall. Consultation Paper 2 invited stakeholders to comment on whether this is appropriate, or whether the section should instead operate as a cap on the amount recoverable.

The submission that supplied the above example also queried how s 101 would operate if the security interest was over both the woodchips and the chipboard. Would s 101 limit the secured party's reliance on its security interest over just the woodchips, or its security interest over the chipboard as well? The answer to that, I believe, is that s 101 only imposes a cap on a security interest that continues in a product or mass, ie under s 99(1). It does not appear to limit the operation of a security interest that is taken directly over the product or mass itself.

The same submission also queried whether it was appropriate to set the value of the goods by reference to the date on which they were processed. If the goods in question are gold, for example, might it be more appropriate to set the gold's value by reference to the price of gold as at the day the processed goods are sold in the enforcement proceedings?

Consultation Paper 2 invited stakeholders to comment on these questions.

7.10.3.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were not in favour of amending s 101 to set a cap on the amount recoverable under a security interest, rather than just a cap on its priority. All other respondents, however, were in favour of making this change.

A small number of respondents were in favour of amending the section so that the cap was set by reference to the value of the goods at the date the security interest was enforced. The great majority, however, were not in favour of amending this aspect of the section, and took the view that the section should continue to operate by reference to the value of the goods on the date on which they were processed.

7.10.3.1.3 ***Recommendations***

Recommendation 266: *That s 101 be amended so that it limits the amount recoverable under a security interest, not just its priority.*

Recommendation 267: *That s 101 not be amended to change the point in time at which the value of the input is assessed.*

7.10.3.2 **Competition with another continuing security interest**

7.10.3.2.1 ***The issue***

Section 102(2) provides, where more than one perfected security interest continues in a product that results from processed goods, that the perfected security interests share in the product in proportion to their amount secured. Section 102(3) contains a similar rule for multiple unperfected security interests.

It is not clear that these rules are appropriate. If the competing security interests had originally been over the same property that then became part of their product, then they should share in the same way as they would have shared if the goods had not been processed. The aggregate amount that they could recover would be limited however to the value of those goods on the day that they became part of the product. To this extent, the rules would be similar to the rules suggested in Section 7.10.1 above for commingled goods.

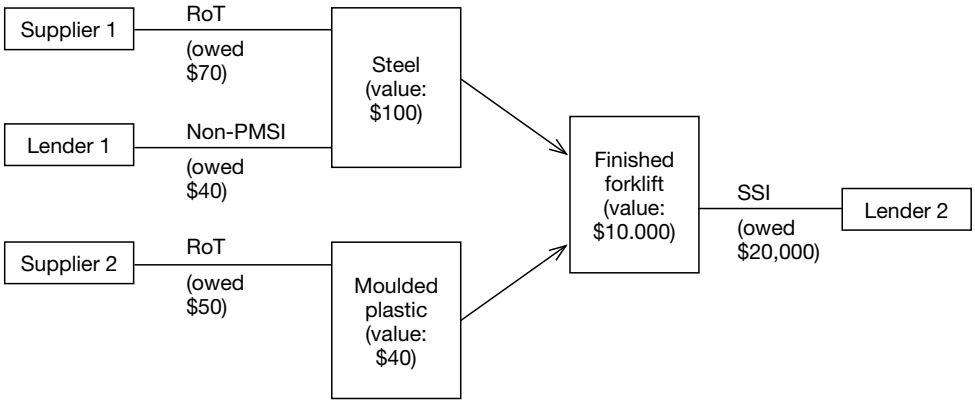
The Act does not clearly explain how to resolve a competition between a security interest over an input, and a security interest that has been separately taken over the finished product. Section 101 (discussed above) limits the extent to which the security interest over the input can have priority, but does not explain whether it has priority in the first place.

In my view, the correct approach should simply be to allow the general rules of the Act to apply. If a security interest over an input was perfected before a security interest taken over the whole product, then the security interest over the input should prevail (subject to the limitation that its priority (or, if the recommendation in Section 7.10.3.1 is adopted, its secured amount) is capped at the value of the input). If the security interest over the whole was perfected first, then it takes priority (with no cap). If one of the security interests was a purchase money security interest and had priority under s 62, though, it would take priority over the other security interest (again, subject to the cap, in the case of the security interest over the input).

This can be demonstrated with the following example.

Example

A company manufactures forklifts. It has given a number of security interests over some of the inputs, and separately has given a lender a security interest over the finished forklifts, as follows:



Supplier 1 has supplied $100 of steel to the company, and is still owed $70 of the purchase price. Lender 1 has taken security over the company's steel stockpile as a non-PMSI, and is owed $40. Supplier 2 has supplied moulded plastic to the company. The plastic was worth $50 when it was sold, and Supplier 2 is still owed that $50, but the plastic has lost value since it was delivered to the company, and is now worth only $40.

The company has also given Lender 2 a specific security interest over its inventory of finished forklifts. Lender 2 is owed $20,000.

Supplier 1 and Supplier 2 have perfected their security interests in accordance with s 62, and have the PMSI super priority. Supplier 1 registered its financing statement before Supplier 2. Lender 1 registered its financing statement before Lender 2.

The priority position as between the competing security interests would be this:

First priority Supplier 1 for $70 and Supplier 2 for $40, ranking equally.

Supplier 1 and Supplier 2 both have PMSI priority, and so defeat both Lender 1 and Lender 2 under s 62. The amount that Supplier 2 can recover from the enforcement proceeds is however capped at the value of its input, ie $40, even though it is owed $50.

Another possibility would be for Supplier 1 to rank ahead of Supplier 2 because it perfected first, in reliance on the priority rule in s 55(4). This could product an unfair result, however, as it might (in some situations) result in a windfall benefit for Supplier 1 at the expense of Supplier 2. If it was thought that it was undesirable to have security interests ranking equally, though, the answer might need to be to fall back on s 55(4), and give priority to whichever of the PMSIs has the earlier priority time.

Second priority Lender 1, for $30.

Lender 1 defeats Lender 2 under s 55(4). However the amount that Lender 1 can recover from the enforcement proceeds is capped at the residual value of its input after Supplier 1 has been paid out, ie at $30, even though it is owed $40.

Third priority Lender 2, for whatever enforcement proceeds remain, up to $20,000.

This approach would also address the points raised in some submissions about the potentially anomalous operation of ss 102 and 103.[170]

Consultation Paper 2 invited stakeholders to comment on these issues.

7.10.3.2.2 ***Discussion of stakeholder feedback***

It appears that the explanation of these principles in Consultation Paper 2 (which did not include the example given above) was not as clear as it could have been, as a number of respondents indicated that they could not fully understand it. I hope that the example I have included in the above discussion will help with this.

The principles set out above were supported, however, by the majority of the respondents that expressed a view on them.

7.10.3.2.3 ***Recommendation***

Recommendation 268: *That ss 102 and 103 be amended to reflect the following principles:*

1. *The aggregate amount recoverable under a security interest (or multiple security interests) over an input that becomes part of a product or mass is capped at the value of the input when it became part of the product or mass.*
2. *If there was more than one security interest over the input, they rank inter se in the order that would have applied if the input was still separate.*
3. *If the amount recovered on enforcement is not enough to pay out all secured parties (taking into account any cap under the previous two items on the amount they can recover), the priority between them is established using the other priority rules.*

170 For example: JLF, S2 page 19.

7.11 Sections 79 to 81

7.11.1 Section 79 – transfers of collateral despite a prohibition in the security agreement

7.11.1.1 ***The issue***

Section 79 provides in effect that a grantor of a security interest can transfer the collateral to a third party, even if the security agreement prohibits the transfer. This means, for example, that a lessee under a finance lease can transfer the leased goods (subject to the lease) to a third party, despite a prohibition on transfers in the lease agreement.

The lease agreement could still provide that the transfer was a default. However, the secured party lessor would need to exercise its enforcement rights in relation to the collateral against the transferee, not the original lessee.[171]

There are equivalent provisions in some of the Canadian PPSAs,[172] and the NZ PPSA.[173]

Section 79 differs from the position that applied, at least to some extent, under the general law before commencement of the Act (and that will continue to apply to dealings in property that are outside the section).

Consultation Paper 2 invited stakeholders to indicate whether the policy outcome produced by s 79 is appropriate. Consultation Paper 2 also noted that the section only deals with "transfers" of collateral, and does not clearly cover the grant of a security interest as well. The Consultation Paper asked stakeholders whether s 79 should apply to the grant of a security interest, in addition to transfers.

7.11.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that s 79 should be deleted. The great majority of respondents were of the view, however, that the section should be retained, and that it should apply to the grant of a security interest over collateral as well as a transfer of it.

One respondent also made the good point that s 79 can help to ensure the integrity of the priority and taking free rules in the Act, as it confirms that a secured party cannot argue that later security interests or transfers of the collateral were ineffective (and so could not defeat its security interest) because the terms of its security agreement had prohibited them.[174] That, it seems to me, is a further good reason for retaining the section.

7.11.1.3 ***Recommendation***

> **Recommendation 269:** *That s 79 be retained, and that it amended so that it applies to the grant of a security interest over collateral, as well as a transfer.*

171 The secured party lessor would presumably also be able to sue the transferor for damages,

172 For example Sask PPSA, s 33.

173 NZ PPSA, s 87.

174 AFC, CP2 page 20.

7.11.2 Section 80 – rights of parties on transfer of an account[175]

7.11.2.1 ***The issue***

Section 80(3) provides that the transferor of an account can agree with the obligor on the account to amend the terms of the contract that gives rise to the account, even after the transfer, and whether or not the transferee agrees. A similar provision can be found in most of the Canadian PPSAs,[176] but not in the NZ PPSA.

There are some restrictions on the extent to which the transferor can do this. In particular, the modification to the terms of the contract must not have a material adverse effect on the transferee's rights, or on the transferor's ability to perform on the contract. Despite this, s 80(3) might be seen to be an unnecessary erosion of a transferee's ability to control the terms of the account that it has purchased.

As discussed earlier in this report in Section 2.1.2, the primary objective of the Act was to replace the overlapping and inconsistent sets of rules that previously governed secured transactions with a single set of rules that apply consistently to all types of grantor and all types of property. While s 80 relates to the legal effectiveness of the terms of an account that is the subject of a security interest, Consultation Paper 2 suggested that it might be thought to stray beyond the Act's primary objective, in that the Act could achieve that objective perfectly well without including the section (as it deals with a related but distinct topic).

To my knowledge, the policy behind s 80(3) and the reason for including it in the Act have not been widely articulated. A leading Canadian commentary suggests that the purpose of the corresponding Canadian provisions is to allow for situations where a change in circumstances may make appropriate to allow the transferor to amend the contract,[177] but it is not clear to me that this is a sufficiently compelling reason for including s 80, particularly as the transferee of an account in the Australian market would usually want to oblige the transferor not to amend the terms of the account without the transferee's consent.

Consultation Paper 2 invited stakeholders to comment on whether s 80(3) is appropriate.

7.11.2.2 ***Discussion of stakeholder feedback***

A substantial number of respondents were of the view that s 80(3) should be deleted. A slightly greater number were of the view, however, that it should be retained. On that basis, I do not propose to recommend that s 80(3) be deleted.

7.11.2.3 ***Recommendation***

Recommendation 270: *That s 80(3) be retained.*

175 I discuss other aspects of s 80 in Section 8.2.3.

176 For example Sask PPSA, s 41(3).

177 Cuming Walsh & Wood, pages 665 to 666.

7.11.3 Section 81 – transfer prohibitions in a transferred account

7.11.3.1 ***The issues***

Section 81 allows accounts to be transferred in some circumstances even if the account itself contains a restriction or prohibition on transfers. A similar provision can be found in the Canadian PPSAs,[178] but not in the NZ PPSA.

It might be asked whether it is appropriate to statutorily deny an account obligor the freedom of contract to determine who it should be obliged to make payments to. It could also be asked whether this is an appropriate provision to include in a secured transactions law, as it deals with matters of general contracts law, not just security.

There does seem to have been a clear trend internationally toward negating the effect of contractual prohibitions on transfers of payment intangibles. In addition to the fact that provisions similar to s 81 can be found in the Canadian PPSAs, a similar provision is in Article 9,[179] and legislation addressing the issue has recently been introduced into Parliament in the United Kingdom.[180] Provisions of this type can also be found in some international Conventions.[181]

It may well be appropriate for Australia to follow this trend. Because the provision was included in the Act rather than in legislation that applies to contractual rights more generally, though, it is not apparent whether the proposed enactment of the provision had been considered by all relevant stakeholders.

Consultation Paper 2 invited stakeholders to comment on this.

Drafting issues

If it is appropriate to retain s 81, then a number of drafting problems or other questions should be addressed. For example, the fact that s 81(1)(b) only overrides a restriction on prohibition of a transfer "for currency due or to become due" arguably robs the section of most of its effect, as very few transfer restrictions are worded in this way. Secondly, it is not clear why s 81(1)(b)(ii) excludes accounts that arise from granting rights under construction contracts or from providing financial services. Thirdly, as one submission pointed out, the section should only invalidate the restriction on transfers to the extent that it relates to the account or chattel paper (if that concept is retained).[182] And finally, it must be asked whether it makes sense to limit the section to "transfers", or whether it should apply to the grant of a security interest as well.

Consultation Paper 2 invited stakeholders to comment on these questions as well.

The meaning of "currency"

One submission also suggested, in the context of s 81, that the definition of "currency" in s 10 be expanded to include "money" in the commercial sense as well as currency in the strict sense of notes and coins.[183]

178 For example Sask PPSA, s 41(9).

179 Article 9, §9-406(d).

180 *Small Business, Enterprise and Employment Bill 2014-15* (UK), clause 1.

181 The UNIDROIT *Convention on International Factoring*, Article 6, and the 2001 UN *Convention on the Assignment of Receivables in International Trade*, Article 18.3.

182 JLF, S2 page 17.

183 DIFA, S2 att A page 4.

The term "currency" is used in a number of places in the Act, not just s 81. Consultation Paper 2 noted that the term may be too limiting for the purposes of s 81, but expressed the preference that this be dealt with in the context of the section, rather than by amending the definition of "currency" for all purposes of the Act.

7.11.3.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that s 81 should be deleted. The great majority of respondents were of the view, however, that the section should be retained.

All respondents agreed, if the section is to be retained, that it should apply to the grant of a security interest over an account as well as to a transfer of it. All respondents also agreed (subject to the same caveat) that the section should be amended to overcome the limitation that is currently imposed on the reach of the section by the narrow meaning of "currency".

I agree that s 81 should be retained, and that it should be amended as described above. I am also of the view that it should be amended to confirm that it only invalidates a restriction on transfers to the extent it applies to an account, and that further consideration should be given to:

- the appropriateness of the carve-outs for construction contracts and financial services; and
- whether it needs to be made clear that the transfer may not adversely affect the obligor on the account.

7.11.3.3 ***Recommendations***

Recommendation 271: *That s 81 be retained.*

Recommendation 272: *That s 81(1) be amended:*

- *so that it applies to the grant of a security interest over an account, not just a transfer;*
- *by deleting "for currency due or to become due" from line 2 of s 81(1)(b); and*
- *to make it clear that it only invalidates the restriction to the extent that it applies to an account.*

Recommendation 273: *That Government consider further whether:*

- *the exclusion from s 81 of construction contracts and financial services contracts is appropriate; and*
- *s 81 should be amended to make it clear that the transfer may not adversely affect the obligor on the account.*

Chapter 8

Enforcement of security interests; insolvency of a grantor

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8.1 The reach of Chapter 4

8.1.1 Should Chapter 4 be mandatory, where it applies?

8.1.1.1 ***The issue***

Chapter 4 sets out rules for the enforcement of security interests. The Canadian PPSAs[1] and the NZ PPSA[2] also contain enforcement rules for security interests. The rules under those PPSAs are for the most part mandatory in nature – if a secured party wants to enforce its security interest, it must do so in accordance with those rules.[3]

It is not entirely clear whether Chapter 4 of the Act operates in the same way. Chapter 4 states that it does not apply to the enforcement of some types of security interests. Even where it can apply, however, some practitioners take the view that the rules in the Chapter are not mandatory, in that parties to a security agreement are free to agree on their own enforcement remedies, even if the agreed remedies parallel ones that are provided for in the Chapter. Other practitioners take a different view.

It was put to me, at the time that Government was taking submissions on drafts of the Bill for the Act, that Chapter 4 was simply intended to provide a back-up set of rules that a secured party could use if it had not negotiated its own enforcement remedies with the grantor. Some support for that proposition can be found in the text of Chapter 4. For example, s 134(1) appears to acknowledge that a secured party's right to seize collateral on default could arise outside the right to do so in Chapter 4 itself – presumably, under the security agreement. Section 110 also appears to acknowledge this more expressly. It provides as follows:

> This Act does not derogate in any way from the rights and remedies the following parties to a security agreement have, apart from this Act, against each other in relation to a default by the debtor under the security agreement:
>
> (a) the debtor;
>
> (b) the grantor;
>
> (c) a secured party.

The effect of s 110 is not as clear as it might appear to be on a first read, however, as the section only preserves the rights that the debtor, grantor and secured party have "against each other". It is not clear whether this extends to a secured party's rights against the collateral, or to its rights against third parties in relation to the collateral.

Some other aspects of Chapter 4 also weigh against the argument that a secured party can ignore Chapter 4 and rely on its own contractual enforcement remedies instead. For example, s 109(3) states that the Chapter does not apply to a person who has perfected a security interest either in an investment instrument by possession or control, or in an intermediated security by control. If the Chapter does not apply, then the secured party will need to rely on the enforcement remedies in its security agreement instead. But if the secured party has its own contractual enforcement remedies and the Chapter already allows the secured party to use them despite the content of the Chapter, why does s 109(3) need

1 For example Sask PPSA, Part V.

2 NZ PPSA, Part 9.

3 See Cuming Walsh & Wood, pages 616 to 620; Gedye Cuming & Wood, pages 379 to 380.

to say that the Chapter does not apply? Indeed, the discussion of s 109(3) in the Replacement Explanatory Memorandum appears to assume that the secured party would have been obliged to comply with Chapter 4, despite having its own contractual remedies, if s 109(3) had not been included.[4]

The same argument can be made by reference to s 115. That section allows the parties to a security agreement to contract out of aspects of Chapter 4. If the parties to the security agreement include enforcement provisions in their security agreements, and Chapter 4 allows those enforcement provisions to operate despite the content of Chapter 4, then what is the point of allowing the parties separately to contract out of some (but not all) of the Chapter? Rather than contract out of Chapter 4 to the extent possible, the parties could instead bypass Chapter 4 completely, by just agreeing on their own remedies.

This lack of clarity is unsatisfactory, and should be addressed. Before the position can be clarified, however, it needs to be determined what the policy outcome should be. Consultation Paper 3 suggested that the main options appear to be these.

(a) **Mandatory application of the Chapter, where it applies**

Under this approach, the Chapter would be mandatory except to the extent that particular circumstances are expressly excluded. A secured party would be required to enforce its security interest in accordance with the Chapter, and any enforcement remedies in its security agreement would be negated, at least as they affect the collateral.

(b) **Enforcement rules in the Chapter are just a fall-back**

Under this approach, parties to a security agreement would be free to negotiate their own enforcement remedies, and the secured party could use those remedies on default even if they contradicted similar remedies in Chapter 4.

If this approach is adopted, thought would need to be given to the impact that it would have on third parties, such as other secured parties. Thought might also need to be given to the extent to which it would be appropriate to allow parties to agree on enforcement remedies that might otherwise offend basic requirements of the general law, such as a grantor's right to redeem collateral by performing the secured obligation.5

(c) **Mandatory application of the Chapter, where it applies, to security interests that are granted by particular types of grantor, such as individuals**

This approach would make the Chapter mandatory, in whole or in part, for security interests that are granted by particular types of grantor or in particular situations. (This appears to be the thinking behind s 115.)

As noted earlier in this Section, the Canadian PPSAs and the NZ PPSA take the first of these approaches. That approach is said to be a logical extension of the substance-over-form principle that underpins the concept of a security interest – if the legislation applies a common set of rules for the creation of security interests and to determine their legal effect, then arguably it makes sense to provide a common set of rules for their enforcement as well.

4 Replacement Explanatory Memorandum, para 4.5.

5 See Section 8.6.2 below.

Consultation Paper 3 invited respondents to comment on this. In doing so, it observed that there may not be a strong consensus of support for approach (a)'s legislative intervention in the freedom of parties to negotiate the terms of the arrangements between them, except perhaps in relation to categories of grantor that might be deserving of particular protection, such as individuals. It acknowledged that a full adoption of the *laissez faire* approach of approach (b) may not be appropriate either, however, because some steps may need to be taken to protect the rights of third parties such as other secured parties. It would also need to be considered in relation to approach (b) whether some of the rules in Chapter 4 (such as s 140, dealing with the application of proceeds) should be mandatory, even if the balance of the Chapter is disengaged.

8.1.1.2 ***Discussion of stakeholder feedback***

Respondents had wide-ranging views on this question.

Some respondents were of the view that the enforcement rules in Chapter 4 should be mandatory. They argued that this is a natural and inevitable consequence of the unitary nature of security interests under the Act, and of the way in which the Act establishes a consistent set of rules for their creation and legal effect. The benefits of having a consistent set of priority rules for all security interests risk being compromised, for example, if a secured party can erode the effect of those rules through the terms of its contractual enforcement remedies.

Other respondents argued that the rules in Chapter 4 should only function as a back-up, for situations where a secured party had not negotiated its own set of remedies. Those respondents placed greater weight on the principle of freedom of contract, than on the unitary nature of security interests under the Act. A number of those respondents accepted, however, that it might be appropriate for Chapter 4 to be mandatory where the grantor is an individual.

One respondent pointed out that the concept of mandatory enforcement rules for security interests is not entirely novel in Australia.[6] The now-repealed Hire-Purchase Acts,[7] for example, contained a mandatory set of enforcement remedies for hire-purchase and instalment purchase agreements that applied for all hirers, whether they were individuals or companies. So the suggestion that Chapter 4 should be mandatory is not as radical as might otherwise be thought to be the case.

It would nonetheless be quite a break from traditional legal thinking to require secured parties to accept that they could no longer craft their own enforcement remedies for any type of security agreement, and that they were required instead to follow all the enforcement rules in Chapter 4. The majority of respondents were also not in favour of making Chapter 4 mandatory in all cases.

It is clear to me that the market would not want to accept a change that made Chapter 4 mandatory in all situations. Despite this, I do believe that there should be an irreducible core of requirements that a secured party must comply with, whether it enforces its security interest through Chapter 4 or through its own contractual mechanisms. For example, Section 5.1.2 discusses the fact that the Act treats the grantor of a security interest as if it were the owner, even if that is not the case at general law. If that proposition is accepted, then it should also be

6 AD, CP3 page 2.

7 Such as the *Hire-Purchase Act 1959* (Vic).

accepted that any value in collateral that exceeds the amount owing to a secured party should belong to the grantor, not to the secured party. It would follow from this that a secured party should not be able to rely on a contractual right to repossess the collateral and then simply keep it – rather, the secured party should be obliged to realise the collateral and then apply the recoveries in accordance with s 140, or foreclose on the collateral under s 136 or an equivalent remedy under the general law. There may be other aspects of Chapter 4 that should be mandatory as well, for similar reasons.

Having considered the competing views, I am of the view that Chapter 4 as a whole should not be mandatory, but that there may be specific requirements in Chapter 4 that should be. Subject to any such specific mandatory requirements, a secured party should be able to enforce its security interest using remedies in its security agreement or at general law, without being required to follow all the notice and other procedures that are set out in the Chapter. If a secured party does elect to rely on a remedy in Chapter 4, however, it must comply with the associated requirements in the Chapter, except to the extent that the secured party and the grantor agree otherwise in accordance with s 115. (I discuss s 115 further in Section 8.1.9 below.)

8.1.1.3 ***Recommendation***

Recommendation 274: *That Chapter 4 be amended to make it clear that the following principles apply:*

1. *A secured party may use enforcement remedies in its security agreement or under laws outside the Act (even if they parallel remedies contained in Chapter 4) without needing to comply with any corresponding notice or other requirements in Chapter 4, except to the extent that a provision in Chapter 4 expressly states that it applies to the exercise of remedies outside the Chapter.*
2. *If a secured party elects to rely on a remedy provided by Chapter 4, it must comply with the associated notice or other requirements in the Chapter, except to the extent that the secured party and the grantor agree otherwise in accordance with s 115.*

8.1.2 The meaning of "default"

8.1.2.1 ***The issue***

Chapter 4 provides that a secured party is only entitled to exercise the enforcement rights set out in the Chapter if there has been a "default by the debtor". For example, a secured party can only seize collateral under s 123(1), dispose of collateral under s 128(1) or retain collateral under s 134(1) "on default by the debtor". The concept of the "debtor's default" is also used in other parts of the Act, such as ss 54, 95(5) and 275(7)(b).

While the debtor is the person who owes the obligations that are secured by the security interest, a security agreement will typically include default triggers that do not relate to the debtor, but rather to the grantor. A security agreement might also allow the secured party to accelerate and enforce even if there is no default by either the debtor or the grantor – for example, if market circumstances change in a materially adverse way. This suggests that the current formulation is too narrow.

The Canadian PPSAs and the NZ PPSA deal with this differently. For example, the Sask PPSA[8] and the NZ PPSA[9] also provide that a secured party can exercise the enforcement remedies set out in the legislation if "the debtor is in default". Under both the Sask PPSA and the NZ PPSA, however, the term "debtor" covers both the "debtor" and the "grantor" under our Act, even when they are different persons. Also, the term "default" is given a wide meaning in both Acts, as it is defined to include the occurrence of any event that gives the secured party the right under the security agreement to enforce the security interest.[10]

Consultation Paper 3 suggested that the current language of the Act, which restricts the enforcement of a security interest under Chapter 4 to circumstances where the debtor is in default, is too narrow. Rather than refer just to "default by the debtor", the Act should refer in the relevant places to simply "default", or "default under the security agreement", and the term "default" should be defined in s 10 along the lines of the corresponding definition in the NZ PPSA.

8.1.2.2 ***Discussion of stakeholder feedback***

All respondents agreed with this recommendation.

8.1.2.3 ***Recommendation***

> **Recommendation 275:** *That the Act be amended by replacing references to "default by the debtor" (or similar) with "default" or "default under the security agreement", and that the term "default" be defined in s 10 along the lines of the corresponding definition in the NZ PPSA.*

8.1.3 Section 109(1)(b) – incidental security interests

8.1.3.1 ***The issue***

Section 109(1) provides as follows:

> (1) This Chapter does not apply to security interests that are provided for by the following:
>
> (a) a transfer of an account or chattel paper that does not secure payment or performance of an obligation;
>
> (b) a security interest that is incidental to a security interest referred to in paragraph (a);
>
> (c) a PPS lease that does not secure payment or performance of an obligation;
>
> (d) a commercial consignment that does not secure payment or performance of an obligation.

Section 109(1) excludes deemed security interests from the enforcement rules in Chapter 4 because, as only deemed security interests, there is no underlying payment or other obligation that is secured by the security interest. In other words, there is no "principal amount" that can be recovered by an enforcement process. Section 109(1)(b) extends the exclusion, however, in the case of a transfer of an

8 Sask PPSA, s 56(2)(a).

9 NZ PPSA, s 109(1)(a).

10 Sask PPSA, s 2(1)(n); NZ PPSA s 16.

account or chattel paper, to a security interest that is "incidental" to the security interest that the transfer is deemed to give rise to.

The Canadian PPSAs[11] and the NZ PPSAs[12] contain a provision that corresponds to ss 109(1)(a), (c) and (d). However, none of them contains a provision that corresponds to s 109(1)(b).

Consultation Paper 3 noted that it is not clear why s 109(1)(b) was included in the Act, and invited stakeholders to comment.

8.1.3.2 ***Discussion of stakeholder feedback***

A number of respondents were in favour of retaining s 109(1)(b). An equivalent number of respondents were of the view that it should be deleted.

The respondents in favour of retaining the section explained its relevance in a number of ways. One respondent argued that it was there to accommodate the fact that a transferred account might itself be secured, and that it would cause complexity if Chapter 4 applied to the security interest that secured the account, when the Chapter did not apply to the transfer.[13] I do not see why that is the case, however. If a person takes a transfer of an account and then needs to recover the amount owing on the account by enforcing a security interest that secures it, then they should do so in accordance with Chapter 4, in the same way as any other secured party would do when enforcing an in-substance security interest.

That respondent may have been suggesting that s 109(1)(b) is there in order to ensure that the secured party did not need to enforce the transfer of the benefit of the associated security interest in accordance with Chapter 4 (rather than to ensure that the secured party could enforce the associated security interest itself). If that is the concern, though, then I do not think that s 109(1)(b) is needed to address it, as the transfer of the benefit of the associated security interest will not itself have given rise to a security interest.

Two other respondents suggested that the section is intended to protect a turnover trust associated with the transfer – that is, if the transferor has agreed to hold any collections on the transferred account on trust for the transferee.[14] According to this line of analysis, the section is intended to ensure that the transferee does not need to apply Chapter 4 to the enforcement of that trust, if the trust otherwise gives rise to a security interest. In my view, though, such a trust is highly unlikely to be a security interest in the first place, as the transferor is simply agreeing to hold on trust for the transferee an amount of money that belongs to the transferee. And if that is the purpose of the section, then it should be spelt out more clearly.

In summary, I am not satisfied that there is a clear and appropriate explanation for the existence of s 109(1)(b). It is also instructive to note that there is no equivalent to the section in the Canadian PPSAs or the NZ PPSA. In my view, the provision has no clear purpose and generates uncertainty, and should be deleted.

8.1.3.3 ***Recommendation***

Recommendation 276: *That s 109(1)(b) be deleted.*

11 For example Sask PPSA, s 55(2)(a).

12 NZ PPSA, s 105(b).

13 DIFA, CP3 page 3.

14 ASF, CP3 page 1; JLF, CP3 page 3.

8.1.4 Section 109(2) – property located outside Australia

8.1.4.1 ***The issue***

Section 109(2) provides that Chapter 4 does not apply to goods that are located outside Australia.

There is no corresponding provision in the Canadian PPSAs or the NZ PPSA.

The Replacement Explanatory Memorandum sheds no light on why s 109(2) was included.[15] The section may have been included in recognition of the practical difficulties that could be encountered in applying Australian enforcement remedies to collateral that is located in another sovereign jurisdiction. If that is the case, however, it must be asked why the section is limited to goods – that is, why it does not apply to all types of collateral with a physical presence, such as negotiable instruments or chattel paper (if the latter concept is retained).

So if s 109(2) is retained, consideration should be given to extending it to all types of tangible property, not just goods. It must be asked, however, whether s 109(2) should be retained in the Act, or whether it should be deleted. The fact that it may be difficult as a practical matter to apply the Act's enforcement rules in another jurisdiction does not necessarily mean that the Act should always disengage them. Also, there could be circumstances in which a secured party needs to rely on the Act's enforcement rules in another jurisdiction – for example, if the secured party has not also taken local security.[16]

Consultation Paper 3 suggested for these reasons that s 109(2) should be deleted.

As one submission noted, it is also unclear whether the result of s 109(2) is that an Australian court should apply the general law, or the relevant foreign law, in these circumstances.[17] That uncertainty is undesirable as well.

8.1.4.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 109(2) should be deleted.

8.1.4.3 ***Recommendation***

Recommendation 277: *That s 109(2) be deleted.*

8.1.5 Section 109(3) – investment instruments and intermediated securities

8.1.5.1 ***The issue***

Section 109(3) provides that the bulk of Chapter 4 does not apply to a person who has perfected a security interest in:

(a) an investment instrument by taking possession or control of the instrument; or

(b) an intermediated security by taking control of the intermediated security.

There is no corresponding provision in the Canadian PPSAs or the NZ PPSA.

15 Replacement Explanatory Memorandum, para 4.4.

16 By way of comparison, the appointment of a receiver under Part 5.2 of the Corporations Act can apply to property outside Australia. See the definition of "property" in s 416 of the Corporations Act.

17 LCA, S2 page 14.

According to the Replacement Explanatory Memorandum, s 109(3) is intended to "allow a secured party to trade in the market without having to comply with the procedures and time limits of the [Act]".[18] If this is the reason for the section, then it must be asked whether the section is both too wide and too narrow. It could be too wide, for example, because not all intermediated securities, and only some investment instruments, will be market-traded instruments. It could also be too narrow, because it does not assist a secured party who has perfected over the investment instrument or intermediated security by registration, rather than by possession or control. It could also be too narrow because it does not protect a secured party who has security over other market-traded types of collateral, such as commodities.

Consultation Paper 3 invited stakeholders to comment on this.

8.1.5.2 ***Discussion of stakeholder feedback***

One respondent suggested that s 109(3) was limited to security interests that were perfected by possession or control because those modes of perfection made it easy for the secured party to undertake a swift sale of the collateral.[19] That is no doubt true, but a secured party that had only perfected by registration and then seized the collateral would want to be able to undertake a swift sale of the collateral as well. It would also want (in the words of the Replacement Explanatory Memorandum) to be able to "trade in the market without having to comply with the procedures and time limits" of Chapter 4.

I discuss a range of other questions relating to intermediated securities and investment instruments in Sections 5.3.4 and 5.3.5. As I discuss there, these types of investment assets can be complex and the law and practice associated with them can be very specialised, and a number of stakeholders had not felt that they were sufficiently familiar with the area to be able to comment on some questions. For this reason, some respondents indicated that they would have greater confidence in the proposed recommendations relating to intermediated securities and investment instruments if they could be the subject of further consultation with relevant industry specialists, before they are implemented.

A number of respondents made the same observation in relation to my proposed changes to s 109(3). I am satisfied that the recommendation that I propose to make is appropriate, but also can see that the recommendation would carry further weight if Government were to confirm that with industry before implementing it.

8.1.5.3 ***Recommendation***

Recommendation 278: *That Government consider, in further consultation with industry, whether s 109(3) should be amended to provide that Chapter 4 (other than ss 110, 111, 113 and 140) does not apply to an intermediated security or an investment instrument that is held on a prescribed financial market within the meaning given to that term by the Corporations Act.*

18 Replacement Explanatory Memorandum, para 4.5.

19 LM, CP3 page 3.

8.1.6 Section 109(5) – personal, domestic or household collateral

8.1.6.1 ***The issue***

Section 109(5) says that some rules in Chapter 4 do not apply to collateral that is used by the grantor predominantly for personal, domestic or household purposes.

The National Credit Code regulates the enforcement of security interests that secure a consumer credit contract. It does this whether or not the collateral is used for personal, domestic or household purposes.

There is clearly the potential for overlap between the enforcement rules in the National Credit Code and Chapter 4. To address this, s 119(2) allows for the Regulations to provide that specified requirements in Chapter 4 are deemed to have been complied with, if the secured party has complied with a corresponding provision in the National Credit Code.[20]

The National Credit Code does not regulate a security interest over collateral, even if the collateral is used for personal, domestic or household purposes, if the security interest secures business finance. In that respect, s 109(5) introduces new restrictions on secured parties.

The section is clearly intended to be a consumer protection measure. Consultation Paper 3 questioned, however, whether it is necessary. While some of the provisions listed in s 109(3) give a secured party powers that it did not previously enjoy at general law (at least to the same extent), some of them are not new, and I am not aware that there was a recognition before the commencement of the Act that this was seen as an area that required reform.

8.1.6.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that s 109(5) should be retained. The majority of respondents, however, were of the view that the National Credit Code provided the appropriate level of consumer protection, and that s 109(5) should be deleted. I agree.

8.1.6.3 ***Recommendation***

Recommendation 279: *That s 109(5) be deleted.*

8.1.7 Section 111 – exercise of rights under Chapter 4

8.1.7.1 ***The issue***

Section 111 says this:

> (1) All rights, duties and obligations that arise under this Chapter must be exercised or discharged:
>
> (a) honestly; and
>
> (b) in a commercially reasonable manner.
>
> (2) A person does not act dishonestly merely because the person acts with actual knowledge of the interest of some other person.

20 See reg 4.1 of the Regulations.

The Canadian PPSAs[21] and the NZ PPSA[22] contain a similar provision. Unlike s 111, however, the Canadian and New Zealand provisions apply to rights, duties and obligations that arise under the legislation "or under a security agreement".[23]

One submission suggested that s 111 should be amended to follow the overseas approaches more closely – that is, so that the section applies to the exercise or discharge of rights, duties and obligations under a security agreement, as well as under the Act.[24]

This provision was the subject of considerable discussion during the public consultation process that preceded the enactment of the Act. The section was originally cast along the same lines as the NZ PPSA,[25] but was brought back to its current narrower form as a result of representations from industry. Consultation Paper 3 acknowledged that stakeholders may not want to expand the reach of the section along the lines proposed in the submission, but went on to invite stakeholders to express their views on this.

8.1.7.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that the reach of s 111 should be extended to include rights, duties and obligations under the security agreement, particularly if Chapter 4 is not mandatory. The majority of respondents argued, however, that s 111 should apply only to the exercise of rights, duties and obligations under Chapter 4, and that the general law should continue to regulate the exercise of rights, duties and obligations under security agreements. As I see it, no clear case has been made at this stage for expanding the reach of s 111, so I do not propose to recommend that it be changed.

8.1.7.3 ***Recommendation***

Recommendation 280: *That s 111 not be amended.*

8.1.8 Section 112(3) – licences

8.1.8.1 ***The issue***

Section 112(1) states that a secured party can only deal with collateral under Chapter 4 to the same extent as the grantor would be entitled to. Section 112(3) then says this:

> (3) Without limiting subsection (1), under this Chapter a secured party may only seize, purchase or dispose of a licence subject to:
>
> (a) the terms and conditions of the licence; and
>
> (b) any applicable law of the Commonwealth, a State or a Territory.

It is not clear that s 112(3) adds anything to the general principle in s 112(1).

21 For example Sask PPSA, ss 65(3) and (4).

22 NZ PPSA, s 25.

23 The Canadian PPSAs also extend this to rights, and duties and obligations under "any other law".

24 DT, S2 page 9.

25 *Personal Property Securities Bill 2008*, May 2008 Consultation Draft, cl 239.

I have recommended that Government explore with the States and Territories whether the currently-excluded statutory licences could be brought within the Act.[26] It might be thought that it would assist States and Territories to agree to this if they can see clearly that they would still retain control over the identity of the persons who hold their licences, even on enforcement of a security interest. If that is the case, then it might be helpful to retain s 112(3), to put this point beyond doubt.

Consultation Paper 3 pointed out however that s 112(1) achieves this already, and that s 112(3) is not necessary. For this reason, and because s 112(3) adds unnecessary complexity to the Act, Consultation Paper 3 suggested that s 112(3) should be deleted.

8.1.8.2 ***Discussion of stakeholder feedback***

One respondent was not in favour of deleting s 112(3). All other respondents agreed, however, that the section should be deleted.

Two respondents raised a separate point about ss 112(1) and (2).[27] They were concerned that those sections might prevent a secured party from disposing of collateral on an enforcement if neither it nor the grantor had title to the collateral – for example, if the grantor held the collateral under a PPS lease, and the enforcing secured party had taken a general security interest from the lessee. That is because the sections state that the secured party can only deal with the collateral to the same extent as the grantor would be entitled to, unless the secured party itself has title.

As I see it, the answer to this point lies in the fact that the Act treats the grantor under a title-based security interest as if the grantor were the owner of the collateral, not the secured party. That is how the Act conceptualises the fact that a grantor can sell the collateral under a taking free rule in Part 2.5, for example, whether or not the grantor is technically the owner.[28] This treatment of the grantor as if it were the owner will give the secured party the necessary capacity to deal with the collateral for the purposes of ss 112(1) and (2).

8.1.8.3 ***Recommendation***

Recommendation 281: *That s 112(3) be deleted.*

8.1.9 Section 115 – contracting out

Section 115(1) provides that the parties to a security agreement relating to collateral that is not used predominantly for personal, domestic or household purposes may contract out of specified provisions in Chapter 4. The section raises a number of questions.

26 See Section 4.4.6.

27 ABA, CP3 page 6; AFC, CP3 page 6.

28 See the discussion of this in Section 5.1.2. The current drafting deals with the point less satisfactorily, however, under the alternative "possession" model, and this point would need to be reconsidered if Government decides to endorse that model. Again, see Section 5.1.2.

8.1.9.1 **When should the "use" be determined, and how?**

8.1.9.1.1 ***The issue***

Section 115(1) only applies to collateral that is not used predominantly for personal, domestic or household purposes. It is not entirely clear whether this should be tested at the time the security interest is granted, or on an ongoing basis. Common sense suggests that it should be tested when the security agreement is entered into, as that is the point in time at which the secured party needs to know what it can or cannot contract out of. At that point in time, however, the grantor may not yet own the collateral, and so may not be using it at all.

Consultation Paper 3 suggested that this be clarified, by replacing "is not used" in line 2 with wording along the lines of "the grantor does not intend, at the time it entered into the security agreement, to use".

8.1.9.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were concerned that the proposed alternative drafting could give rise to different uncertainties, as it may not be clear what the grantor's intention was when the grantor entered into the security agreement. I had anticipated, however, that secured parties would ask the grantor to make a statement in the security agreement as to their intended use of the collateral, and that secured parties would then rely on that.

The majority of respondents were in favour of the proposed change.

8.1.9.1.3 ***Recommendation***

Recommendation 282: *That the words "is not used" in line 2 of s 115(1) be replaced with "the grantor does not intend, at the time it enters into the security agreement, to use".*

8.1.9.2 **The expression "contract out"**

8.1.9.2.1 ***The issue***

The expression "contract out" has also caused some difficulty. It has a ring of finality to it, in that it suggests that the parties need to agree that a provision must or must not apply. It does not clearly allow for the possibility that the parties might want to agree that the secured party can comply with a provision if it wishes, but that the secured party is not obliged to.

Consultation Paper 3 suggested this be clarified by replacing "may contract out of" in s 115(1) with "may agree that a party need not comply with", and by making a corresponding amendment in s 115(7).

8.1.9.2.2 ***Discussion of stakeholder feedback***

All respondents were in favour of this change.

8.1.9.2.3 ***Recommendation***

> **Recommendation 283:** *That s 115(1) be amended by replacing "may contract out of" in s 115(1) with "may agree that a party need not comply with", and that a corresponding amendment also be made to s 115(7).*

8.1.9.3 **Section 115(1)(q) – the right of redemption in s 142**

8.1.9.3.1 ***The issue***

One submission argued that parties should not be allowed to contract out of the grantor's right to redeem collateral under s 142, and that s 115(1)(q) should be deleted.[29] The submission described the current position under the section as unfair and unjust, and as amounting to a potential confiscation of the grantor's property.

Consultation Paper 3 invited stakeholders to comment on this.

8.1.9.3.2 ***Discussion of stakeholder feedback***

The views of respondents were evenly divided on this question. A number were in favour of deleting s 115(1)(q), and a similar number were in favour of retaining it.

One of the hallmarks of a security at general law is that the grantor of the security can recover the collateral, free of the security, by paying out the amount owing. This right is referred to as an "equity of redemption". As a general proposition, a provision in a contract that blocks or limits the exercise of the equity of redemption will be ineffective.[30] That might suggest that it is not appropriate for the Act to do so either. Against that, though, it must be asked to what extent the Act should include provisions that are designed to shelter grantors (more particularly, non-consumers) from the consequences of making what might otherwise be poor business decisions.

A grantor that waives its right under s 142 to redeem its collateral will lose the ability to get the collateral back. However, it should not lose the economic value of the collateral, as the secured party will still be required to apply the enforcement proceeds in accordance with s 140. That, it seems to me, is arguably a sufficient backstop protection for a grantor who might otherwise waive its redemption right under s 142. I see no clear case for change on this point.

8.1.9.3.3 ***Recommendation***

> **Recommendation 284:** *That s 115(1)(q) continue to allow parties to contract out of the grantor's right to redeem collateral under s 142.*

8.1.9.4 **Section 115(2) – who is affected by the contracting out?**

8.1.9.4.1 ***The issue***

One submission drew attention to the fact that s 115(2) limits the value of the ability of a secured party under s 115(1) to contract out of some provisions in Chapter 4, as s 115(2) says that contracting out by the grantor does not affect the

29 DT, S2 page 10.

30 There is some controversy as to the circumstances in which courts will strike down such a clause, however – see *Sun North Investments Pty Ltd (as trustee of the Sun Development Trust) v Dale* [2014] Qld R 369.

rights and obligations of a person who is not party to the security agreement.[31] So even if a grantor contracts out of its right to receive a notice under a provision, for example, the secured party must still give the notice to any other person that the provision requires it to give a notice to.

The submission suggested that s 115 should be amended to provide, if a grantor contracts out of a provision, that all other parties claiming through the grantor should be taken to have contracted out of the provision as well.

8.1.9.4.2 ***Discussion***

The concern identified in the submission is ameliorated to some extent by s 115(3). That section provides, if the grantor contracts out of its right to redeem collateral in s 142, that no other party can then rely on s 142 either. Even allowing for s 115(3), though, it is fair to say that s 115(2) significantly erodes the benefit of s 115(1).

Despite that, I do not propose to recommend that s 115(2) be amended along the lines proposed in the submission. There are two reasons for this. First, the "other persons" who might be affected by such an amendment might have a claim in the collateral that is superior to the claim of the enforcing secured party. I do not see that it would be appropriate to allow the grantor to waive its rights under Chapter 4. Secondly, it seems to me that the potential for s 115(2) to impact adversely on a secured party is reduced by the fact that parties are free to negotiate their own contractual remedies outside the Chapter (assuming my recommendation in Section 8.1.1 is accepted), and a secured party that exercises its contractual enforcement rights, rather than the statutory ones in Chapter 4, would not need to comply with Chapter 4's notice requirements.

For these reasons, I do not see a clear need to amend the section.

8.1.9.4.3 ***Recommendation***

Recommendation 285: *That s 115(2) not be amended.*

8.1.10 Section 116 – property in the hands of a controller

8.1.10.1 The meaning of the section

8.1.10.1.1 ***The issue***

Section 116 regulates the extent to which Chapter 4 will apply to property that is in the hands of a receiver or other controller. The drafting is somewhat convoluted, largely as a consequence of the fact that the section was reshaped during the public consultation process for the Bill that ultimately became the Act. The intention behind the section appears to be, however, to achieve the following outcomes:

- Chapter 4 does not apply to property if the property is in the hands of a receiver, or a receiver and manager, unless the grantor of the security interest is an individual.
- Section 131 does not apply in relation to property while a person is a controller of the property. While the section does not say this clearly, the intention seems again to be that s 131 is not to be disengaged if the grantor of the security interest is an individual.

31 JLF, S2 page 21.

- The parties to a security agreement can also agree that any provision of Part 4.3 will not apply to property if it is in the hands of a controller other than a receiver or receiver and manager. Again, while the section does not say this clearly, the intention seems to be that this should not apply if the grantor of the security interest is an individual.

Consultation Paper 3 suggested that it would aid in the interpretation of the Act if this could be spelt out more clearly and succinctly than at present.

8.1.10.1.2 ***Discussion of stakeholder feedback***

All respondents agreed that it would be valuable to clarify s 116 in this way (if the section is retained).

8.1.10.1.3 ***Recommendation***

Recommendation 286: *If s 116 is retained, that it be amended to reflect these principles more clearly:*

- *Chapter 4 does not apply to property if the property is in the hands of a receiver, or a receiver and manager, unless the grantor of the security interest is an individual.*
- *Section 131 does not apply in relation to property while a person is a controller of the property, unless the grantor of the security interest is an individual.*
- *The parties to a security agreement can also agree that any other provision of Part 4.3 will not apply to property that is in the hands of a controller other than a receiver or receiver and manager, unless the grantor of the security interest is an individual.*

8.1.10.2 **Should s 116 be retained?**

8.1.10.2.1 ***The issue***

The Replacement Explanatory Memorandum states that s 116 is designed to avoid overlap with provisions in the Corporations Act that regulate company receivers.[32] In this respect the Act follows the NZ PPSA.[33] The Canadian PPSAs take the opposite approach, and make it clear that their enforcement provisions do apply to receivers.[34]

Two submissions suggested that Chapter 4 should apply to corporate receivers in the same way as other secured parties.[35]

Chapter 4 was amended to exclude corporate receivers in response to submissions from industry. Consultation Paper 3 suggested that it is likely that industry would continue to be of the view that the current policy setting is appropriate, but invited stakeholders to comment.

32 Replacement Explanatory Memorandum, para 4.18.

33 NZ PPSA, s 106.

34 For example Sask PPSA, s 55(1).

35 LCA, S2 page 15; DT, S2 page 10.

8.1.10.2.2 ***Discussion of stakeholder feedback***

There was no clear consensus view among respondents on this question. A substantial number of respondents were of the view that company receivers should remain outside Chapter 4. The majority of respondents did not agree, though, and were of the view that enforcement processes by company receivers should be conducted in accordance with Chapter 4 to the same extent as any other enforcement procedure.

In my view, company receivers should be subject to the same enforcement rules as secured parties generally, unless there are aspects of the nature of a company receivership that dictate otherwise. It has been put to me, for example, that it would be difficult to apply Chapter 4 to a company receiver, because a receiver is normally an agent of the grantor, not of the secured party. It is also common for a receiver to take over the conduct of the business of the defaulting company and to continue to operate that business, rather than sell it – either in order to recoup the amount owing over a period of time from the ongoing cashflows of the business, or to improve the business with an view to selling it at a later time. Either way, this common outcome would be difficult to reconcile with the requirement in Chapter 4 that the secured party either dispose of the collateral or take steps to retain it.

These could well be valid reasons for continuing to provide that company receivers are outside Chapter 4. I do not have sufficient information at this stage to be able to express a concluded view on this. A final decision on this would also need to be taken in tandem with the broader discussion in Section 8.1.1 of the extent to which Chapter 4 should be mandatory, as there may be some requirements (such as the requirement that recoveries be applied in accordance with s 140) that should apply to receiverships as much as any other enforcement process.

8.1.10.2.3 ***Recommendation***

> **Recommendation 287:** *That Government consider further whether the nature of company receiverships is such that they need to remain outside Chapter 4, taking into account Government's deliberations on the extent to which provisions in Chapter 4 should be mandatory to all enforcement processes, and that s 116 be retained or deleted in accordance with Government's conclusion.*

8.1.11 Section 119 – overlap with the National Credit Code

8.1.11.1 ***The issue***

Section 119 says this:

> (1) This Chapter, except sections 117 and 118, applies in relation to a security interest in collateral to which the National Credit Code applies.
>
> (2) The regulations may provide that a specified provision of this Chapter is taken to have been complied with in specified circumstances if a specified provision of the National Credit Code has been complied with in those circumstances.

Regulation 4.1 of the Regulations contains a table that identifies which sections of the National Credit Code are to be taken to correspond to particular sections of the Act for this purpose.

A number of commentators have put to me that this is an unnecessarily complex manner of dealing with the interface between Chapter 4 and the National Credit Code. They have suggested that the Act should simply say that Chapter 4 does not apply to an enforcement that is governed by the National Credit Code.

8.1.11.2 ***Discussion***

This could be a valuable simplification of the way that the Act interacts with the National Credit Code. I am not in a position to assess it in detail, but agree that it should be given further consideration.

8.1.11.3 ***Recommendation***

> **Recommendation 288:** *That Government consider whether s 119 could be amended to simply say that Chapter 4 does not apply to an enforcement process that is regulated by the National Credit Code.*

8.2 Sections 120 and 121 – enforcement against liquid assets

8.2.1 Terminology

8.2.1.1 ***The issue***

The headings to ss 120 and 121 refer to the enforcement of security interests in "liquid assets".

In market parlance, a "liquid asset" is an asset that can be sold readily for cash. Sections 120 and 121, however, provide a secured party with a mechanism for collecting payments that are due under certain types of payment obligations. They do not provide the secured party with a mechanism for selling those obligations.

Consultation Paper 3 suggested that it would assist in the understanding of the Act (albeit modestly) if the headings to ss 120 and 121 referred instead to the enforcement of security interests "in certain payment obligations" (or similar).

8.2.1.2 ***Discussion of stakeholder feedback***

All respondents agreed with this proposal.

8.2.1.3 ***Recommendation***

> **Recommendation 289:** *That the headings to ss 120 and 121 be amended to refer to security interests in "certain payment obligations" (or a similar expression), rather than to security interests in "liquid assets".*

8.2.2 Collateral to which the sections apply

8.2.2.1 ***The issue***

Sections 120 and 121 provide a secured party with a mechanism for recovering amounts owed to it by a grantor or debtor, by collecting amounts that are owed to the grantor by third parties. This is a statutory equivalent of a garnishee order.

The Canadian PPSAs[36] and the NZ PPSA[37] contain a similar provision.

The sections do not allow a secured party to collect all types of payments. Rather, the sections only apply to payments owing on accounts, chattel paper and negotiable instruments. It is not clear why the provisions need to be limited in this way. Most of the Canadian PPSAs, in contrast, allow a secured party to collect payments under a broader range of obligations.

Consultation Paper 3 invited stakeholders to indicate whether they thought ss 120 and 121 should be expanded to apply to some other types of payment obligations as well, or perhaps even to payment obligations generally.

One submission took this thought one step further, and suggested that the Act simply acknowledge that a secured party may exercise any of a grantor's rights in relation to any collateral that is subject to the security interest.[38] Again, Consultation Paper 3 invited stakeholders to comment on this suggestion.

8.2.2.2 ***Discussion of stakeholder feedback***

One respondent did not agree with the suggestion that ss 120 and 121 should be extended. All other respondents were of the view, however, that it would be appropriate to apply the sections to all payment obligations, not just accounts, chattel paper and negotiable instruments.

A number also favoured the view that the sections should be broadened further, to simply state that a secured party is able to exercise all of the grantor's rights in relation to the collateral. As this was not supported by the majority of respondents, however, I believe that the better approach is to leave secured parties to include this in their security agreements, if that is their wish.

8.2.2.3 ***Recommendation***

Recommendation 290: *That the Act be amended so that the garnishee mechanism in ss 120 and 121 can apply to any payment obligation.*

8.2.3 Are the sections unfair on the obligor?

8.2.3.1 ***The issue***

Some submissions made the point that s 120 presented practical difficulties for an obligor that receives a notice under the section.[39] The obligor may have no way to determine whether the secured party that gave the notice was entitled to do so. This is exacerbated by the fact that the secured party is not even obliged to back its claim up with documentation. The submission observed that it may not be possible for an obligor to form a view on these matters, particularly within the period of 5 business days that is allowed by the section. The obligor may also struggle within that timeframe to determine what amounts are in fact owing on the specific payment obligations that are claimed by the secured party.

36 For example Sask PPSA, s 57(2).

37 NZ PPSA, s 108.

38 JLF, S2 page 21.

39 JLF, S2 page 21; DIFA, S1 att B page 2.

In addition, it is not clear what the consequences are for an obligor, if it pays the amount to the claiming secured party when the claim was not valid, or if an obligor does not accept the validity of a claim and pays the amount to the grantor, when the secured party's claim was in fact a valid one.

Consultation Paper 3 observed that the corresponding provisions in the Canadian PPSAs and the NZ PPSA did not appear to deal with this either.

Consultation Paper 3 acknowledged that the provision has the capacity to adversely affect obligors in an inappropriate way, and asked stakeholders to make suggestions as to how this could be addressed – whether by extending the period of 5 business days to a longer period, or by restructuring the section more generally.

8.2.3.2 *Discussion of stakeholder feedback*

A small number of respondents were of the view that s 120 did not need to be amended to mitigate its impact on an obligor who receives a notice under the section. The majority agreed, however, that it was appropriate to do so.

One respondent suggested that this point is covered under the Canadian PPSAs by their equivalent of s 80(7).[40] Section 80(7) provides, broadly, that the obligor on a transferred account or chattel paper may continue to make payments to the transferor until it receives a notice of the transfer that contains information that helps the obligor to identify the contract under which the amount is payable. The section also allows the obligor to ask for proof of the transfer.

Unlike the Canadian PPSAs,[41] however, s 80(7) only applies where a secured party has taken an assignment of an account or chattel paper, and does not apply where a secured party has instead taken a security interest in the broader sense.

It seems to me that s 80(7) is a tidy way of dealing with this issue. For it to do so, however, s 80(7) would need to apply to all grants of a security interest rather than just transfers, and should include the 5 business day grace period that is currently in s 120(3). And if the reach of s 120 is broadened to cover payment obligations generally, as discussed in Section 8.2.2, then s 80(7) would need to be broadened in the same way.

8.2.3.3 *Recommendation*

Recommendation 291: *That s 80(7) be expanded:*

- *to apply to a grant of any security interest over an account, not just a transfer;*
- *to give the obligor a further 5 business days after receipt of the notice within which it must make the payment; and*
- *to apply to payment obligations generally, if Recommendation 290 is adopted.*

40 AD, CP3 page 6.

41 For example Sask PPSA, s 41(7).

8.2.4 Effect of the 5 business day period in s 120(3)

8.2.4.1 ***The issue***

Section 120(3) says this:

> (3) A person who receives a notice under paragraph (2)(a) must pay, to the secured party, any amount that the person owes to the grantor on the collateral before the end of 5 business days after the later of:
>
> (a) the day the notice is received; or
>
> (b) the day the amount becomes due and payable.

One submission noted that s 120(3) appears to give the obligor an extra 5 business days to make all of its payments.[42] The submission queried whether this was appropriate.

I anticipate that the objective of the 5 business day period was to give the obligor an opportunity to assess the claim of the secured party. If that is thought to be important, then some grace period may be unavoidable. The way the section is currently structured, though, the 5 business days are added in for each payment, no matter how far in the future the payment is due. Consultation Paper 3 suggested that this was not necessary, and that the 5 business days should only be added to the date on which the obligor receives the notice. This would have the result that the section would read in this way:

> (3) A person who receives a notice under paragraph (2)(a) must pay, to the secured party, any amount that the person owes to the grantor on the collateral before the later of:
>
> (a) the end of 5 business days after the day the notice is received; or
>
> (b) the day the amount becomes due and payable.

Consultation Paper 3 invited stakeholders to comment on this proposal.

8.2.4.2 ***Discussion of stakeholder feedback***

As a number of respondents pointed out, this change becomes unnecessary if s 80(7) is amended as discussed in Section 8.2.3 above. Subject to that caveat, all respondents agreed with the proposal.

If s 80(7) is amended as discussed in Section 8.2.3, then s 120(3) can be deleted.

8.2.4.3 ***Recommendations***

Recommendation 292: *That s 120(3) be deleted, if s 80(7) is amended in accordance with Recommendation 291.*

Recommendation 293: *That s 120(3) be amended, if s 80(7) is not amended in accordance with Recommendation 291, to read:*

> *"(3) A person who receives a notice under paragraph (2)(a) must pay, to the secured party, any amount that the person owes to the grantor on the collateral before the later of:*
>
> *(a) the end of 5 business days after the day the notice is received; or*
>
> *(b) the day the amount becomes due and payable."*

42 JLF, S2 page 21.

8.2.5 Sections 120(4) and (5) – the application of amounts collected

8.2.5.1 ***The issue***

Sections 120(4) and (5) say this:

> (4) The secured party must apply any amount received under paragraph (2)(b) or subsection (3) towards the secured obligation.
>
> (5) If any amount is received under paragraph (2)(b) or subsection (3) in the form of currency, then the amount must be distributed in accordance with section 140.

Section 120(4) requires a secured party to apply the amount recovered towards its secured obligation. If the amount is received in currency (ie notes and coins), however, then s 120(5) says that the payment must be applied in accordance with s 140. This is confusing or unfair (or both) in a number of ways. For example, if the secured party receives payment in currency, it must treat its secured obligation as being reduced by the amount of the payment (under s 120(4)). If it is not the most senior secured party, however, it must pay the currency over to the most senior secured party under s 140 (because of s 120(5)). So the amount owing to the secured party is reduced, even though it does not get to keep the payment.

The intention may have been that the enforcing secured party does not "receive" enforcement proceeds for the purposes of the section if it is obliged to turn them over to a more senior secured party. That is not apparent, however, from the language of the section.

It is also not clear why s 140 should only be engaged if the payment is in currency (that is, in notes and coins), and not if the payment is made in some other way (eg electronically). One submission proposed that all amounts recovered under s 120 be applied in accordance with s 140.[43] Consultation Paper 3 suggested that this proposal had considerable merit, and that a secured party that recovers an amount under s 120 should be obliged to apply the amount in exactly the same way as would be the case if it had seized the collateral and disposed of it under Part 4.3 – that is, in accordance with s 140.

8.2.5.2 ***Discussion of stakeholder feedback***

All respondents agreed with this suggestion.

8.2.5.3 ***Recommendation***

Recommendation 294: *That s 120(4) be deleted, and that s 120(5) be amended to require that all amounts recovered under s 120 be applied in accordance with s 140.*

43 LCA2, S2 page 15.

8.3 Sections 123 to 127 – seizing collateral

8.3.1 Sections 123(2) and (3) – seizing intangible property

8.3.1.1 ***The issues***

A secured party cannot commence enforcing a security interest over intangible property by seizing it in the conventional sense, because the property cannot be physically "seized". Sections 123(2) and (3) respond to this problem by providing that the secured party can "seize" intangible property by giving a notice to the grantor, or by any other agreed method.

These provisions raise two issues.

The meaning of "intangible property"

The first issue with ss 123(2) and (3) is that they only apply to "intangible property".

The term "intangible property" is defined in s 10 in this way:

> ***intangible property*** means personal property (including a licence) that is not any of the following:
>
> (a) financial property;
>
> (b) goods;
>
> (c) an intermediated security.

One submission pointed out that the exclusions in paragraphs (a) and (c) of this definition have the effect that it is not clear how a secured party with a security interest over financial property or an intermediated security can seize the collateral for the purposes of s 123.[44] This gap is covered to some extent by s 124 (discussed further below), but that section does not close the gap completely.

Consultation Paper 3 suggested that it would help to clarify the operation of Chapter 4 if this gap could be closed more completely, for example by amending ss 123(2) and (3) so that they apply to all personal property other than goods, rather than just to "intangible property".

Licences

If the intangible property in question is a licence, s 123(2) requires that the secured party give the notice not just to the grantor, but also to the licensor or the licensor's successor. Section 123(3) similarly requires that the licensor or the licensor's successor agree to any alternative method of seizure.

The Canadian PPSAs contain a similar provision.[45] The NZ PPSA does not.

It is not clear why licences have been picked out for special treatment in this way. While it is true that an enforcement against a licence is likely to involve the licensor at some stage, the same is also true for an enforcement process against any obligation owed by a third party to the grantor.

Consultation Paper 3 asked whether stakeholders could explain why licences have been singled out in this way.

44 JLF, S2 page 22.

45 For example Sask PPSA, s 57(3).

8.3.1.2 ***Discussion of stakeholder feedback***

All respondents agreed that the drafting of ss 123(2) and 123(3) should be expanded along the lines described above.

A number of responses suggested that ss 123(2)(b) and (3)(b) are appropriate, on the basis that the licensing authority that issued the licence will have a legitimate interest in being informed that a secured party may have taken over control of the use of the licence. That, it seems to me, is a sufficient justification for retaining the provisions.

8.3.1.3 ***Recommendations***

Recommendation 295: *That the Act be amended so that ss 123(2) and (3) apply to all personal property that is not in tangible form.*

Recommendation 296: *That ss 123(2)(b) and 123(3)(b) be retained.*

8.3.2 Section 124 – security interests that are perfected by possession or control

8.3.2.1 ***The issue***

A secured party who has perfected by possession or control cannot seize the collateral in the conventional sense because it already has possession or control. For this reason s 124 provides, if a secured party has perfected its security interest by possession or control, that it can "seize" the collateral for the purposes of s 123 by giving a notice to the grantor.

Similar to ss 123(2) and (3) (see Section 8.3.1 above), s 124(2)(b) requires that the notice also be given to the licensor or its successor, if the collateral in question is a licence. For the reasons discussed in Section 8.3.1, Consultation Paper 3 queried whether this was appropriate. Consultation Paper 3 went on to observe that it is difficult in any event to conceive of circumstances in which this would be relevant to s 124 as it is not possible to perfect over a licence by possession or control, and proposed for these reasons that s 124(2)(b) simply be deleted.

8.3.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 124(2)(b) could be deleted.

8.3.2.3 ***Recommendation***

Recommendation 297: *That s 124(2)(b) be deleted.*

8.3.3 Accessions

8.3.3.1 ***The issue***

A number of submissions pointed out that the Act assumes that a secured party with a security interest over an accession has a right to remove the accession, but that the Act does not expressly provide such a right.[46] The submissions suggested that this should be rectified.

46 For example: JLF, S2 page 21; LCA, S2 page 14.

It might be thought this was implicit in s 123(1). Section 92 also appears to assume that s 123 may entitle a secured party to remove an accession from the host goods. Consultation Paper 3 agreed however that it would be helpful to clarify the point.

8.3.3.2 ***Discussion of stakeholder feedback***

All respondents agreed that it would be helpful for the Act to be amended to clarify this point.

8.3.3.3 ***Recommendation***

> **Recommendation 298:** *That the Act be amended to provide that a secured party with a security interest in an accession can remove that accession when enforcing its security interest.*

8.3.4 Section 126 – disposal of collateral from the grantor's premises

8.3.4.1 ***The issue***

Section 126(2) provides, if collateral cannot be readily removed from the grantor's premises or if adequate storage facilities are not readily available, that the secured party can dispose of the collateral on the grantor's premises. However, s 126(2) says that the secured party must not cause the grantor any greater cost or inconvenience "than is necessarily incidental to the disposal".

One submission queried why the section uses this formulation.[47] Elsewhere, the Act uses the concept of what is "reasonable", rather than the apparently stricter test of what is "necessary". The submission suggested that the phrase "necessarily incidental" in s 126(2) should be replaced with "reasonably required".

The corresponding provisions in the Canadian PPSAs[48] and the NZ PPSA[49] also use the term "necessary". This is presumably the source of the word as used in s 126(2).

Consultation Paper 3 acknowledged that there could be some benefit in making this change, and invited stakeholders to comment.

8.3.4.2 ***Discussion of stakeholder feedback***

A number of respondents agreed with this change. The majority of respondents were of the view, however, that it should not be made. One of those respondents made the fair point that the test should be stricter because the disposal is being undertaken from the grantor's premises.[50] It also made the point that a looser test could become very problematic if more than one secured party were trying to dispose of collateral from the grantor's premises at the same time. I am satisfied that there is no clear case to change the current wording.

47 JLF, S2 page 22.

48 For example Sask PPSA, ss 57(2)(b) and (c).

49 NZ PPSA, s 111(2).

50 LCA, CP3 page 7.

8.3.4.3 ***Recommendation***

> **Recommendation 299:** *That s 126(2) continue to provide that a secured party that disposes of collateral on the grantor's premises must not cause the grantor any greater cost or inconvenience than is "necessarily incidental to the disposal".*

8.3.5 Section 127 – seizure by higher-priority parties

8.3.5.1 Priority agreements

8.3.5.1.1 ***The issue***

The Act allows any secured party with a security interest in collateral to enforce its security interest against the collateral. If the security interest is not the highest-ranking security interest in relation to that collateral, however, the secured party runs the risk in this situation that a higher-ranking secured party may elect to take over the enforcement process.

This is provided for by s 127. That section states that a higher-ranking secured party may take over the enforcement process at any time, by giving the enforcing secured party a notice to that effect.

The Canadian PPSAs and the NZ PPSA do not contain an equivalent provision.[51]

One submission noted that it is not uncommon for secured parties to agree in a priority agreement that the senior secured party will allow a junior secured party to conduct the enforcement process, even if the senior secured party retains priority over any recoveries.[52] The submission expressed concern that s 127 could override such an agreement, because it gives the senior secured party a statutory right to take over the enforcement process. The submission suggested that it be made clear that the senior secured party can agree to waive its rights under the section.

It might be thought that this was not necessary, on the basis that it should always be open to the senior secured party to agree to this as a matter of contract. The Act does however clarify this type of question in some other contexts – see, for example, s 61.

Consultation Paper 3 invited stakeholders to indicate whether they thought that a clarification of this point would be worthwhile.

8.3.5.1.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree that this was necessary. All other respondents were of the view, however, that it would be desirable to clarify the point.

8.3.5.1.3 ***Recommendation***

> **Recommendation 300:** *That the Act be amended to make it clear that s 127 cannot override an agreement to a different effect as between secured parties.*

51 The point is not relevant under the NZ PPSA, as it only allows the first-ranking secured party to enforce.

52 JLF, S2 page 22.

8.3.5.2 Competitions with non-security interests

8.3.5.2.1 *The issue*

One submission queried what the position should be if a person holds a superior interest in the collateral, but that interest is not a "security interest".[53] This could arise, for example, if collateral is also subject to an encumbrance that arises by operation of law (as that encumbrance would not be a "security interest" under the Act), and the encumbrance had priority over a security interest under s 73.

The Act does not provide a rule for this type of fact pattern. This question is also not addressed in the Canadian PPSAs or the NZ PPSA.

A competing encumbrance could take a number of forms, and this may make it difficult for the Act to provide a comprehensive set of rules. Consultation Paper 3 suggested for this reason that the Act should not be amended to deal with this.

8.3.5.2.2 *Discussion of stakeholder feedback*

One respondent thought that it would be helpful to include rules to this effect in the Act. All other respondents were of the view, however, that this was not desirable.

8.3.5.2.3 *Recommendation*

> **Recommendation 301:** *That the Act not be amended to include rules that determine, as between a security interest and a non-security interest in relation to the same collateral, which has the superior right to conduct enforcement proceedings.*

8.3.5.3 Section 127(4) – the hand-over period

8.3.5.3.1 *The issue*

If an enforcing secured party receives a notice from a senior secured party that the senior secured party proposes to take over the enforcement proceedings, s 127(4) requires the enforcing secured party to hand the collateral over within 5 business days. One submission queried why the Act gives the enforcing secured party 5 business days to do this.[54] The submission contrasted this with the position of the grantor, who would need to comply immediately.

The Canadian PPSAs and the NZ PPSA do not deal with this point.

Consultation Paper 3 expressed the view that it might be appropriate to provide the enforcing secured party with a period of time within which it can comply with the senior secured party's notice, as s 127(4) currently does, but invited stakeholders to comment.

8.3.5.3.2 *Discussion of stakeholder feedback*

A small number of respondents were of the view that the enforcing secured party should not be given a 5 business day window to hand over the enforcement proceedings. All other respondents agreed, however, that the current provision is appropriate, and should not be changed.

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53 JLF, S2 page 22.

54 JLF, S2 page 22.

8.3.5.3.3 ***Recommendation***

Recommendation 302: *That s 17(4) not be amended.*

8.3.5.4 **Section 127(6) – recovery of costs**

8.3.5.4.1 ***The issue***

Section 127(6) provides, if a senior secured party takes over enforcement proceedings, that it must pay the reasonable expenses that had been incurred by the enforcing secured party in enforcing its security interest.

One submission said that this provision should be deleted.[55] It made the point that the enforcing secured party may have incurred costs that would not have been incurred by the senior secured party. The submission also suggested that the position under the section differs from the general law, and that the general law may require the enforcing secured party to meet its own costs, unless it is able to recover them in due course from enforcement proceeds once the senior secured party had been paid out. The submission also noted that the provision could enable a junior secured party to exert undue pressure on a senior secured party, for example in the context of a workout.

The Canadian PPSAs and the NZ PPSA do not deal with this point.

The same submission suggested, if s 127(6) is retained, that the timeframe in s 127(9) within which the senior secured party must reimburse the enforcing secured party be made longer than 20 business days. This would then allow the senior secured party more opportunity to check the veracity and the reasonableness of the enforcing secured party's reimbursement claims.

It has been put to me separately that a lower-ranking secured party may in fact be entitled at general law to recover some of its costs ahead of a more senior secured party's secured amount.[56] This means that s 127(6) may not be quite so at odds with the general law.

Consultation Paper 3 invited stakeholders to comment on whether they thought s 127(6) should be deleted or amended.

8.3.5.4.2 ***Discussion of stakeholder feedback***

A number of respondents argued that s 127(6) should be deleted. The majority of respondents were of the view, however, that it should remain in its current form.

I am not satisfied that a clear case has been made for s 127(6) to be deleted or amended, and so do not propose to make a recommendation to that effect.

8.3.5.4.3 ***Recommendations***

Recommendation 303: *That ss 127(6) to (11) be retained.*

Recommendation 304: *That the reference in s 127(9) to "20 business days" not be changed.*

55 JLF, S2 page 22.

56 See *Ronald John Dean-Willcocks v Nothintoohard Pty Ltd (in Liq)* [2006] NSWCA 311.

8.4 Sections 128 to 133 – disposing of collateral after default

8.4.1 Section 128 – disposing of collateral

8.4.1.1 Section 128(1) – need for seizure?

8.4.1.1.1 *The issue*

One submission queried whether it should be necessary for a secured party to have seized collateral before it can dispose of it.[57] A secured party might not want to seize collateral that had liabilities (such as environmental liabilities) attached to it, for example, so that it did not become personally liable. In a situation like this, the secured party might want to arrange a sale of the collateral without seizing it first.

It is apparently not necessary under the Canadian PPSAs for a secured party to seize collateral before selling it.[58]

Consultation Paper 3 invited stakeholders to comment on this question.

8.4.1.1.2 *Discussion of stakeholder feedback*

One respondent did not believe that any change needed to be made. All other respondents agreed, however, that it should not be necessary for a secured party to formally "seize" the collateral before it commences enforcement action.

8.4.1.1.3 *Recommendation*

> **Recommendation 305:** *That the Act be amended to make it clear that a secured party is able to enforce its security interest against collateral without first having to seize the collateral.*

8.4.1.2 Sections 128(2), (3) and (4) – method of disposal

8.4.1.2.1 *The issue*

Sections 128(2), (3) and (4) provide that a secured party may dispose of collateral by sale, by lease or (if the collateral is intellectual property) by licence.

One submission queried whether it is desirable to refer to a licence as being a "disposal" of the intellectual property to which the licence relates.[59] Depending on the meaning that the Act should attach to the word "dispose" (as to which, see Section 7.1), the same question could also be asked in relation to the use of the word "lease".

Consultation Paper 3 suggested that this may be a drafting convenience for which there is no easy alternative.

8.4.1.2.2 *Discussion of stakeholder feedback*

One respondent was of the view that the language should be tidied up. All other respondents were of the view, however, that this was not necessary.

57 JLF, S2 page 23.

58 See Cuming Walsh & Wood, page 631.

59 JLF, S2 page 23.

In my view, this should be resolved as part of the broader point I make in Section 7.1, about the need to ensure that the terminology that is used by the Act to describe different types of dealings with collateral needs to be used clearly and consistently.

8.4.1.2.3 ***Recommendation***

> **Recommendation 306:** *That the description in ss 128(2), (3) and (4) of a lease or licence as a "disposal" be considered in the context of Recommendation 168, to ensure that the language of the sections does not inadvertently expand the meaning of the term "dispose" as used elsewhere in the Act.*

8.4.1.3 **Section 128(3) – timing of disposal**

8.4.1.3.1 ***The issue***

Section 128(3) says this:

> (3) For the purposes of this Act, if collateral is disposed of by lease or licence, the disposal occurs at the time the lease or licence is entered into.

One submission queried the relevance of this provision, and the role it is intended to play.[60] Consultation Paper 3 invited stakeholders to comment.

8.4.1.3.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that s 128(3) is not needed. The majority of respondents, however, were in favour of retaining it. They made the point that the time at which a secured party disposes of collateral can be relevant for a number of provisions, such as s 130, and that the section helps to identify the relevant time for a form of disposal that is not a "disposal" in the traditional sense of the word.

8.4.1.3.3 ***Recommendation***

> **Recommendation 307:** *That s 128(3) be retained.*

8.4.2 Section 129 – disposal by purchase

8.4.2.1 **Should the secured party be required to pay market value?**

8.4.2.1.1 ***The issue***

Section 129 allows a secured party to purchase the collateral itself. This right is however subject to a number of limitations. In particular, s 129(3) provides that a secured party can only purchase the collateral:

> (a) by public sale (including auction or closed tender); and
>
> (b) by paying at least the market value at the time of the purchase.

60 JLF, S2 page 23.

Consultation Paper 3 queried whether s 129(3)(b) is necessary, or whether a grantor might be adequately protected (even without s 129(3)(b)) by a combination of:

- s 129(3)(a);
- the secured party's duty under s 131 to exercise all reasonable care to obtain market value for collateral (if there is a market value), or otherwise to obtain the best price reasonably obtainable;
- the secured party's duty under s 111 to act honestly and in a commercially reasonably manner; and
- the grantor's right to object to the sale under s 137 (if that right is retained – see the discussion below).

Consultation Paper 3 invited stakeholders to comment on whether s 129(3)(b) is appropriate, or whether it should be deleted.

8.4.2.1.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that s 129(3)(b) could be deleted. The majority of respondents were of the view, however, that it should be retained. In light of the recommendation that I propose to make in relation to s 129(2)(b) (see Section 8.4.2.2 below), I am comfortable with recommending that majority view.

8.4.2.1.3 ***Recommendation***

Recommendation 308: *That s 129(3)(b) be retained.*

8.4.2.2 **Should the grantor or another secured party be able to block the disposal?**

8.4.2.2.1 ***The issue***

If a secured party wants to purchase the collateral itself, it must notify the grantor and each higher-ranking secured party of its intention to do so. This is provided for by s 130(1). The secured party cannot purchase the collateral, despite the protections that are provided by s 129(3) as just discussed, if any of those persons objects. This is provided for by s 129(2)(b).

The Canadian PPSAs do not have an equivalent procedure.[61]

Consultation Paper 3 queried whether the grantor or a higher-ranking secured party should be able to block a sale in this way.

8.4.2.2.2 ***Discussion of stakeholder feedback***

A number of respondents favoured retaining the right for a grantor or a higher-ranking secured party to object to a secured party purchasing the collateral itself. The majority of respondents agreed, however, that the grantor and other secured parties were sufficiently protected by s 129(3), and that s 129(2)(b) could be deleted.

61 Nor does the NZ PPSA, because it does not give a secured party an express right to purchase the collateral.

8.4.2.2.3 ***Recommendation***

Recommendation 309: *That s 129(2)(b) be deleted.*

8.4.3 Section 130 – notice of disposal

8.4.3.1 Section 130(1) – notice to the debtor

8.4.3.1.1 ***The issue***

As just discussed, s 130(1) requires a secured party that proposes to dispose of collateral to give notice of this to the grantor and to any higher-ranking secured party.

One submission suggested that the secured party should also be required to give the notice to the debtor.[62] The submission noted that the debtor will have an interest in monitoring the sale process, because the price that the secured party receives from a disposal of the collateral will affect the size of any deficiency for which the secured party might later want to pursue the debtor.

This approach would be consistent with the position under the Canadian PPSAs.[63]

Consultation Paper 3 suggested that this seemed a sensible proposal.

8.4.3.1.2 ***Discussion of stakeholder feedback***

A slight majority of respondents supported this proposal. A substantial proportion of respondents, however, did not.

One of the respondents that was not in favour made the fair point that the general law had not required a beneficiary of a third-party security to keep its debtor informed about the progress it was making in enforcing the third-party security.[64] That respondent also pointed out that the debtor may not have a legitimate interest in the amount recovered under a third-party security, because the debtor would usually be required to reimburse the third party for any amount that the secured party recovered from the third party instead of from the debtor directly – in other words, the amount recovered by enforcement against the third-party security would not reduce the debtor's aggregate liability. I can see some force in this.

On balance, I am not satisfied that a clear case has been made for expanding s 130(1) to require the secured party to give notice to the debtor as well.

8.4.3.1.3 ***Recommendation***

Recommendation 310: *That s 130(1) not be amended to require that the secured party also provide the notice contemplated by that section to the debtor.*

62 LCA, S2 page 15.

63 See Cuming Walsh & Wood, page 646. It is likely that the same position would apply under the NZ PPSA as well.

64 JLF, CP3 page 9.

8.4.3.2 Sections 130(1) and 144 – notice to higher-ranking secured parties

8.4.3.2.1 *The issue*

As discussed above, s 130(1) requires a secured party to give notice of its intention to dispose of collateral to every higher-ranking secured party.

It is not clear how the secured party is expected to do this, however, if it is not aware of a particular higher-ranking secured party's existence. For example, a higher-ranking secured party might be perfected by control or be temporarily perfected, and this might not be apparent to the enforcing secured party. This is an issue that arises in relation to some other provisions in Chapter 4 as well.

Section 144 sets out circumstances in which a secured party is relieved of an obligation to give a notice under specified provisions in Chapter 4.

Consultation Paper 3 suggested that it may be appropriate to expand s 144 to include a situation in which it is not apparent to the secured party that another secured party also has security in the collateral.

8.4.3.2.2 *Discussion of stakeholder feedback*

All respondents agreed that a secured party should not need to give notice to a secured party that it is not able to locate. A number of respondents suggested that a secured party should only be required to give the notice to another secured party that was perfected by registration or possession. In my view, that would address the issue neatly.

8.4.3.2.3 *Recommendation*

> **Recommendation 311:** *That s 144 be expanded to provide that a secured party is only required to give a notice to another secured party if the other secured party is perfected by registration or possession.*

8.4.3.3 Section 130(2) – the contents of the notice

8.4.3.3.1 *The issue*

Section 130(2) sets out in some detail what a notice under s 130(1) needs to say. Among other things, s 130(2)(c) requires that the notice:

> (c) state that the secured party proposes to dispose of the collateral, unless an obligation is performed, or an amount is paid, to satisfy the obligation secured by the security interest in the collateral, on or before the day specified in accordance with subsection (3); …

Section 130(2)(c) seems to require that the notice needs to state the amount that will be owing on the specified day. In the case of some security agreements, though, it will not be possible to say in advance exactly what the amounts will be on that future day (for example, if the security interest secures amounts owing under a derivative or if the interest rate fluctuates). It is not clear how the section can accommodate this.

Consultation Paper 3 invited stakeholders to comment on this.

8.4.3.3.2 ***Discussion of stakeholder feedback***

A number of respondents did not think that s 130(2)(c) needed to be amended. The majority of respondents agreed, however, that some clarification would be useful.

A number of respondents suggested that the section be amended to allow the secured party to explain how the amount is to be calculated, if it cannot be identified as a fixed sum. I agree with that approach.

8.4.3.3.3 ***Recommendation***

> **Recommendation 312:** *That s 130(2) be amended to say that the notice must set out either the amount to be paid on or before the day specified in s 130(3), or the manner in which the amount is to be calculated.*

8.4.3.4 **Section 130(5) – exclusions**

8.4.3.4.1 ***The issue***

Section 130(5) describes circumstances in which a secured party does not need to give a notice under s 130(1). Under ss 130(5)(b) and (c), the secured party does not need to give the notice if:

(b) the secured party believes on reasonable grounds that the collateral might perish before the end of 10 business days after the day the collateral is seized; or

(c) the secured party believes on reasonable grounds that there will be a material decline in the value of the collateral if it is not disposed of immediately after the day the collateral is seized;….

These exclusions reflect provisions in the Canadian PPSAs[65] and the NZ PPSA[66].

Consultation Paper 3 queried what s 130(5)(b) adds to s 130(5)(c), and suggested that s 130(5)(b) was perhaps unnecessary and could be deleted.

Consultation Paper 3 also questioned why s 130(5)(c) only applies if there would be a material decline in value if the collateral is not disposed of "immediately". Consultation Paper 3 suggested that this could be too abrupt, and that it might make more sense if the section instead allowed the secured party to dispose of collateral without giving the notices under s 130(1) if it believed on reasonable grounds that the collateral would materially decline in value before the end of the period for which the secured party would otherwise need to wait after giving the notice. It should arguably also be sufficient for the secured party to believe on reasonable grounds that there "may" be a material decline in the value of the collateral over that period.

Consultation Paper 3 invited stakeholders to comment on these questions.

8.4.3.4.2 ***Discussion of stakeholder feedback***

A small number of respondents did not think that s 130(5)(b) should be deleted. The great majority of respondents agreed, however, that it could. The great majority of respondents also agreed that s 130(5)(c) should be amended along the lines described above.

65 For example Sask PPSA, ss 59(16)(a) and (b).

66 NZ PPSA, ss 114(2)(a) and (b).

8.4.3.4.3 ***Recommendations***

Recommendation 313: *That s 130(5)(b) be deleted.*

Recommendation 314: *That s 130(5)(c) be amended to provide that it applies if the secured party believes on reasonable grounds that there will be a material decline in the value of the collateral if it is not disposed of before the end of the period that would have applied under s 130(3) if the notice had been given (rather than "immediately").*

8.4.4 Section 132 – statements of account

8.4.4.1 Section 132(1) – timing of the statements

8.4.4.1.1 ***The issue***

Section 132(1) requires a secured party to provide the grantor or a secured party on request with a statement of account, if it has disposed of collateral. One submission queried whether this could be unfairly burdensome for the secured party, if the collateral is disposed of in increments over time.[67] The submission suggested that the obligation in s 132(1) should only apply when all the collateral has been disposed of.

Consultation Paper 3 noted that this may be the intention behind s 132(1) in any event. It went on to suggest that the grantor and other secured parties should also not be unduly inconvenienced by a clarification along these lines, because s 132(4) separately allows them to require the secured party to provide them with a statement of account every 6 months, if the collateral has not been (fully) disposed of.

8.4.4.1.2 ***Discussion of stakeholder feedback***

A number of respondents did not agree that the notice under s 132(1) should only need to be given when all the collateral had been disposed of. The majority of respondents were however in favour of this approach. The effect of this change would be that a secured party would need to give a statement of account (if it is requested) either when it has disposed of all the collateral (under s 132(1)), or at 6-monthly intervals if it has not (under s 132(4)). That seems to me to be a reasonable balance.

8.4.4.1.3 ***Recommendation***

Recommendation 315: *That s 132(1) be amended to clarify that it only applies when the secured party has disposed of all the collateral it is enforcing against.*

8.4.4.2 Section 132(3) – content of the statements

8.4.4.2.1 ***The issue***

One submission queried whether the potential effort involved for the secured party in preparing a statement of account was appropriate, for example because s 132(3) requires the secured party to make forward projections of the

67 JLF, S2 page 23.

amounts that are likely to be received in the future under a lease or licence.[68] The submission suggested that the content of a statement of account should be limited to reporting what has been received or incurred to date, and not require predictions of amounts that might be received in the future.

Consultation Paper 3 invited stakeholders to comment on this suggestion.

8.4.4.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that the secured party should be required to provide forward projections. All other respondents agreed, however, that this should not be necessary.

8.4.4.2.3 ***Recommendation***

> **Recommendation 316:** *That s 132(3)(a) be amended by deleting ", and expected to be received,".*

8.4.5 Section 133 – interplay with s 140(2)

8.4.5.1 ***The issue***

Section 133 provides, if collateral is sold on enforcement, that the buyer takes the collateral subject to any security interests that ranked ahead of the enforcing secured party's security interest. One submission pointed out that this sits somewhat uncomfortably with s 140(2), which requires that any recoveries be applied first to pay out senior-ranking secured parties.[69] That is because the effect of s 140(2) is likely to be that the senior-ranking secured party will be paid out in full – in which case there is little point in providing that its security interest remains attached to the collateral.

The submission suggested that the solution might be to amend s 133 to provide that the buyer takes the collateral free of higher-ranking security interests. However, it is possible (albeit unlikely) that an enforcement action by a junior-ranking secured party might not produce sufficient recoveries to pay out the senior-ranking secured party in full. If that were to happen, then the senior-ranking secured party's security interest should not be released by the sale. Allowing a junior secured party to sell collateral free of more senior security interests could also significantly alter the relative bargaining positions of senior and junior secured parties in a restructuring.

Another option might be to follow the Canadian approach, and not require a junior-ranking secured party to use its recoveries to pay out the senior-ranking secured parties first.[70] That could have other consequential effects (for example, in relation to amounts collected under s 120), however, and would need to be thought through carefully. A third option might be just to accept the potential incongruity between ss 133 and 140, and to leave the provisions in their current form.

Consultation Paper 3 invited stakeholders to comment on these options.

68 JLF, S2 page 24.

69 LCA, S2 page 16.

70 For example Sask PPSA, s 59(1).

8.4.5.2 ***Discussion of stakeholder feedback***

There was no clear consensus among respondents on this question. It also is not clear to me that any of the alternatives to the current position is demonstrably superior. For those reasons, I see no clear case for change.

8.4.5.3 ***Recommendation***

Recommendation 317: *That s 133 not be amended.*

8.5 Sections 134 to 138 – retaining collateral

8.5.1 Section 135(1) – notice requirements

8.5.1.1 ***The issue***

Section 134 provides a secured party with a form of statutory foreclosure remedy, in that it allows a secured party to retain collateral in satisfaction of the obligations secured by the collateral, rather than requiring the secured party to dispose of the collateral and recover what it is owed from the disposal proceeds.

One of the conditions to this remedy is that the secured party has given notice of its intention to retain the collateral to the grantor and to certain secured parties, and that none of them has objected to the retention. The secured parties to which the retaining secured party must give the notice are identified in ss 135(1)(b) and (c) in this way:

> (b) if the security interest of the retaining party is not a purchase money security interest—a secured party who, at the time the retaining party gives the notice, has a registration that describes the collateral; and
>
> (c) if the security interest of the retaining party is a purchase money security interest—a secured party over whom (or which) the retaining party has priority under section 62 or 63, but only if, at the time the retaining party gives the notice, the secured party has a registration that describes the collateral.

It is not clear why these paragraphs treat PMSIs and non-PMSIs differently. Consultation Paper 3 suggested that might be simpler if s 135(1) just required the retaining secured party to give the notice to a secured party if it has a registration that describes the collateral. This would be reflective of the approach in the NZ PPSA.[71]

8.5.1.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 135(1) should be simplified along the lines described above.

Two respondents suggested as a further enhancement to the section that it adopt the approach taken in the corresponding provision in the Sask PPSA.[72] The corresponding provision in the Sask PPSA states that the secured party must also give the notice to any other person with an interest in the collateral who has given notice to the secured party.[73] I expect that the thinking behind this additional requirement is that other parties (that is, non-secured parties)

71 NZ PPSA, s 120(2).

72 AD, CP3 page 11; DT, CP3 page 10.

73 Sask PPSA, s 61(1)(c).

who have an interest in the collateral will also have an interest in the prospect that the secured party might retain the collateral, particularly if that retention could extinguish their interest.

The effect of a notice of retention is set out in s 136. It says that the secured party that retains collateral is entitled to take steps to have title to the collateral pass to the third party, free of the interest of the grantor and certain other security interests. It is not clear what effect it has, if any, on other interests in the collateral.

If the effect of a retention of collateral is that it can affect the non-security interests of third parties, then I agree that it would be appropriate for the secured party to notify those third parties (and so to give them an ability to block the retention, by objecting to it). If the retention mechanism does not affect non-security interests of third parties, however, then it is less desirable to impose this additional notification requirement on the secured party.

I believe that the current intention of s 136 is that it does not affect the non-security interests of third parties. It might be helpful, however, to make that clearer. On that basis, I do not propose to recommend that s 135(1) be expanded to require a secured party to send its notice of retention to a third party who has informed the secured party that it has an interest in the collateral.

8.5.1.3 *Recommendations*

Recommendation 318: *That s 135(1) be amended so that it requires the retaining secured party to give the notice to:*

- *the grantor; and*
- *any other secured party that is perfected by registration or possession.*

Recommendation 319: *That s 136 be amended to confirm that it only allows the secured party to retain the grantor's interest in the collateral, free of the interest of the grantor and the security interests listed in s 136(2), and not free of the interests of other third parties.*

8.5.2 Section 135(3)(b) – statement of amount secured

8.5.2.1 *The issue*

Section 135(2) provides that a notice under s 135(1) must state what the amount secured will be (or at least, the amount that the secured party would accept in satisfaction of the amount secured), on a day that is at least 10 business days after the notice is given. Consultation Paper 3 noted that this may not be practicable, because a secured party might not be able to provide a statement of the exact amount that will be owing on a future date. See the discussion in Section 8.4.3.3 above in relation to a similar point arising out of s 130(2)(c).

8.5.2.2 *Discussion of stakeholder feedback*

A number of respondents did not think that s 135(3)(b) needed to be amended. The majority of respondents agreed, however, that it would be helpful to clarify how a secured party should comply with the section if it cannot predict an exact amount owing.

Similar to the position in relation to s 130(2)(c) (see Section 8.4.3.3 above), a number of respondents suggested that s 135(3)(b) could be amended to allow the secured party to explain how the amount is to be calculated, if it cannot be identified as a fixed sum. Again, I agree with that approach.

8.5.2.3 ***Recommendation***

> **Recommendation 320:** *That s 135(3)(d) be amended to say that the notice must set out either the amount to be paid, or the manner in which the amount is to be calculated.*

8.5.3 Sections 136 and 141 – transfer of title on enforcement

8.5.3.1 ***The issue***

Sections 136 and 141 are mechanical provisions that assist a secured party to complete a transfer of title to collateral that may be required to give effect to the enforcement remedies. The provisions are drafted on the assumption that the grantor, and not the secured party, has title to the collateral. That may not be the case, however – for example, if the secured party is a lessor under a PPS lease, or a seller of goods under a retention of title clause. Consultation Paper 3 suggested that it would remove a potential source of confusion if the sections were amended to clarify this.

8.5.3.2 ***Discussion of stakeholder feedback***

A small number of respondents did not think this was necessary. All other respondents agreed, however, that this would be a useful clarification.

8.5.3.3 ***Recommendation***

> **Recommendation 321:** *That ss 136 and 141 be amended to accommodate the fact that title to the collateral may already be with the secured party, rather than the grantor.*

8.5.4 Sections 137 and 138 – notice of objection

8.5.4.1 ***The issue***

Section 137 provides that a person who receives a notice of a proposed retention of collateral can object to the retention. If a person objects, the secured party cannot retain the collateral, and must sell or lease it instead.

Section 138 says that the secured party can require an objector to provide "proof of that person's interest". One submission pointed out, however, that this does not require the objector to explain why it objects, or that its objection be reasonable.[74] The section also provides the secured party with no mechanism for challenging an objection.

74 LCA, S2 page 15.

The submission contrasted this with the position under the Sask PPSA. Section 61(2) of the Sask PPSA limits objections to persons whose interest in the collateral would be adversely affected by the retention. Section 61(6) of the Sask PPSA also allows a secured party to apply to a court for an order that an objection is ineffective.

The submission suggested that ss 137 and 138 be amended to reflect the approach under s 61 of the Sask PPSA. Consultation Paper 3 agreed that there is merit in this proposal, and invited stakeholders to comment.

8.5.4.2 ***Discussion of stakeholder feedback***

A small number of respondents did not agree with this suggestion. All other respondents agreed, however, that ss 137 and 138 should be amended to incorporate the mechanisms in ss 61(2) and (6) of the Sask PPSA.

8.5.4.3 ***Recommendation***

Recommendation 322: *That ss 137 and 138 be amended to incorporate provisions that are reflective of ss 61(2) and (6) of the Sask PPSA.*

8.6 Sections 140 to 144 – rules applying after enforcement

8.6.1 Section 140 – application of recoveries

8.6.1.1 ***The issue***

Section 140(1) says this:

> (1) This section applies if any amount, personal property or proceeds (within the ordinary meaning of that term) of collateral is received by or on behalf of a secured party as a result of enforcing a security interest in collateral (whether or not under section 120 or 128).

The balance of s 140 then continues to use the expression "amount, personal property or proceeds", or a similar word string.

These word strings are quite cumbersome. Consultation Paper 3 suggested that the section would be easier to work with if they were removed, perhaps by referring instead in s 140(1) to "any personal property", and then defining that personal property to be a "recovery". If this were done, s 140(1) would read in this way:

> This section applies if any personal property (a ***recovery***) is received by or on behalf of a secured party as a result of enforcing a security interest in collateral (whether or not under section 120 or 128).

The balance of s 140 could then just refer to "recoveries".

8.6.1.2 ***Discussion of stakeholder feedback***

All respondents agreed with this proposal.

8.6.1.3 ***Recommendation***

> **Recommendation 323:** *That:*
>
> - *s 140(1) be amended to read:*
>
> *"This section applies if any personal property (a **recovery**) is received by or on behalf of a secured party as a result of enforcing a security interest in collateral (whether or not under section 120 or 128)."; and*
>
> - *each subsequent reference in s 140 to an "amount, personal property or proceeds" (or similar) be replaced with "recoveries".*

8.6.2 Section 142 – right to redeem collateral

8.6.2.1 ***The issue***

Section 142 provides that a grantor or another secured party can redeem collateral at any time before a secured party disposes of the collateral under s 128, by paying out the secured party.

Consultation Paper 3 proposed that s 142 be clarified in three ways.

- **What should the cut-off time be?**

  The section applies at any time before the secured party disposes of the collateral under s 128. It should cut off earlier, however, if the secured party has committed to dispose of the collateral, even if the disposal has not yet been completed. This would be consistent with the position under the Canadian PPSAs[75] and, as I understand it, under our general law.

- **Should the redemption right cut off when the secured party retains the collateral, or sells it under a power of sale in its security agreement?**

  The right to redeem collateral only terminates when the secured party has disposed of its collateral under s 128. It is not clear what the position is, if the secured party has exercised its right to retain the collateral, or if the secured party has sold the collateral under a power of sale in its security agreement (rather than under the statutory power of sale in s 128).

  Consultation Paper 3 suggested that the right to redeem collateral should terminate in these circumstances as well. Again, that would be consistent with the position at general law.

- **Should the redemption right only apply if the secured party is enforcing?**

  It is not clear from s 142 that the right to redeem the collateral only applies if the secured party is enforcing its security interest. On its face, the section arguably allows the right to redeem to be exercised at any time, whether or not the grantor is in default.

  Consultation Paper 3 suggested that the section is only intended to apply to a security interest that is being enforced, but that it might be helpful to clarify this.

75 For example Sask PPSA, s 62(1).

8.6.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were of the view that not all these changes were necessary. All other respondents agreed, however, that it would be appropriate to amend s 140 in the three ways described above.

8.6.2.3 ***Recommendation***

> **Recommendation 324:** *That s 142 be amended so that it only permits the grantor or another secured party to redeem collateral if:*
>
> - *the secured party is enforcing its security interest; and*
> - *the secured party has not yet disposed or committed to dispose of the collateral (whether under s 128 or otherwise), or retained that collateral under s 134.*

8.6.3 Section 143 – reinstatement of security agreement

8.6.3.1 ***The issue***

Section 143 allows "a person" to reinstate a security agreement at any time before the secured party disposes of or retains the collateral, by paying the amounts in arrears (ignoring any amount that was accelerated because of the breach), and the secured party's secured enforcement expenses.

The Canadian PPSAs[76] and the NZ PPSA[77] contain equivalent provisions.

This provision was the source of considerable concern among the business community when it appeared in the Bill that ultimately became the Act. It was seen by many as an inappropriate intrusion on a secured party's ability to exit a lending relationship with a borrower that had defaulted.

Secured parties ultimately took some comfort from the fact that a secured party can contract out of s 143 (under s 115), unless the collateral is used predominantly for personal, domestic or household purposes. Consultation Paper 3 asked, however, whether the provision should be deleted, both as a matter of principle and also because of the extent to which it could adversely affect the secured party. It could adversely affect the secured party, for example, if the security interest secures obligations under a derivative, and the secured party has closed the derivative out as an early step in the enforcement process. Allowing a grantor to reinstate the agreement by catching up on the overdue payment would not keep the secured party whole in such a situation.

Consultation Paper 3 also queried why the reinstatement right should be available to "a person", and suggested, if the section is retained, that the right should be limited to the grantor or the debtor. That would be consistent with the Canadian and New Zealand provisions. Consultation Paper 3 also suggested, for the reasons discussed in Section 8.6.2 above, that the word "disposes" in the first line of s 143(1) should be replaced with "commits to dispose".

Consultation Paper 3 invited stakeholders to comment.

76 For example Sask PPSA, ss 62(1)(b) and 62(2).

77 NZ PPSA, ss 133 and 134.

8.6.3.2 ***Discussion of stakeholder feedback***

The views of respondents were evenly divided on these questions.

It has been pointed out to me that the real property legislation in some States and Territories already contains a provision that is equivalent to s 143.[78] This means that a provision along these lines is not quite as radical a proposition for Australian law as might otherwise be thought to be the case. Despite this, some practitioners continue to regard s 143 as an unwarranted intrusion into the capacity of parties to agree their own commercial arrangements.

As I noted above, secured parties have taken some comfort from the fact that they can contract out of the effect of s 143, unless the grantor is using the collateral for predominantly personal, domestic or household purposes. That takes the sting out of the section for most transactions where it could unfairly prejudice the secured party. On that basis, I am of the view that there is no clear case for deleting the section.

I am of the view, however, that it should be amended to address the drafting issues referred to above.

8.6.3.3 ***Recommendations***

Recommendation 325: *That s 143 be retained.*

Recommendation 326: *That s 143 be amended:*

- *so that the reinstatement right may only be exercised by the grantor, not by any "person"; and*
- *by replacing "disposes" in line 1 of s 143(1) with "commits to dispose".*

8.6.4 Section 144 – when notices are not required

Section 144 of the Act is discussed in Section 8.4.3.2 above.

8.6.5 Deficiency claims

8.6.5.1 ***The issue***

One submission pointed out that the Act does not make it clear that a secured party is entitled to pursue its debtor for any shortfall between what it is owed, and what it recovers by enforcing against the collateral.[79] The submission suggested that this should be clarified.

This would reflect the approach taken in the Canadian PPSAs.[80]

It might be thought that this was a fairly self-evident proposition, and that it would not be necessary to state this expressly. The submission pointed out, however, that the proposition might not be self-evident in relation to some "non-traditional" security interests such as a sale of goods subject to retention of title, where the seller/secured party's right to receive the purchase price could terminate if it repossesses the goods.

Consultation Paper 3 invited stakeholders to comment on this.

78 See, for example, s 95 of the *Property Law Act 1974* (Qld).

79 LCA, S2 page 16.

80 For example Sask, PPSA, s 60(5).

8.6.5.2 ***Discussion of stakeholder feedback***

A number of respondents did not think that this change was necessary, or were concerned that it could override the terms of the agreement reached between the secured party and the grantor (for example, if it were a limited-recourse security). All other respondents, however, were in favour of the change.

I agree that the Act should not allow a secured party to recover an enforcement shortfall from a grantor if the secured party has agreed not to. Apart from that, though, I am of the view that it would be appropriate to include a provision along these lines.

8.6.5.3 ***Recommendation***

> **Recommendation 327:** *That the Act be amended to make it clear that a secured party is entitled to pursue its debtor for any shortfall between what it is owed, and what it recovers by enforcing against the collateral, unless the secured party has agreed otherwise.*

8.7 Sections 267 and 267A – vesting of security interests on a grantor's insolvency

8.7.1 The provisions

Section 267 provides, broadly, that a security interest will "vest in the grantor" if the grantor becomes insolvent, and the security interest was not perfected at the time of the trigger event that commenced the insolvency process. Section 267A provides a corresponding rule for a security interest in collateral that does not attach until after the trigger event has occurred.

Section 268(1) provides that these two sections do not apply to a transfer of an account or chattel paper, or to a commercial consignment, if it does not secure payment or performance of an obligation. Section 268(1)(a)(ii) also provides that the sections do not apply to a transaction that is a PPS lease solely because of the "90-day" option for serial-numbered goods in the definition of "PPS lease" in s 13(1) (again, as long as the PPS lease is not also an in-substance security interest). If the *Personal Property Securities Amendment (Regulatory Measures) Bill 2014* is enacted, however, s 268(1)(a)(ii) will be deleted, with the result that the rules in ss 267 and 267A will apply to all PPS leases, whether or not they secure payment or performance of an obligation.

Section 268(2) provides that ss 267 and 267A do not apply to certain subordination arrangements.

8.7.2 The policy behind the provisions

8.7.2.1 ***The issue***

The idea behind ss 267 and 267A (that a security interest should vest in the grantor if the security interest is not perfected and the grantor becomes insolvent) is not a new one. Provisions with a similar intent were previously found, for example, in the Corporations Act[81] and in bills of sale legislation.[82]

81 Corporations Act, s 266 (prior to its repeal by the *Personal Property Securities (Corporations and Other Amendments) Act 2011)*. Section 266 was however rather different to s 267, in that it allowed a charge to be registered after onset of the chargor's insolvency, if the registration was made within 45 days of the charge being granted.

82 For example *Bills of Sale Act 1898* (NSW), s 4(2).

The Canadian PPSAs[83] also contain a provision that is similar in intent to s 267. In New Zealand, however, the decision was taken not to include a corresponding provision in the NZ PPSA. This makes it appropriate to ask what the policy basis is for including ss 267 and 267A in the Act, and whether that policy basis is a sound one.

As one commentator has observed, there appears to be "no conceptually clear basis for unperfected security interests to be avoided against liquidators".[84] The arguments for and against the approach are based in part on history, and in part on principle. The arguments that have been made in favour of the approach include these:[85]

- The common law has traditionally disliked non-possessory or "secret" liens.
- An unsecured creditor may be misled by the absence of a registration on the Register into believing that it can advance funds and not rank behind secured creditors when the time comes to recover the amount owed to it.
- The registration requirement can make it more difficult for parties to engage in inappropriate practices, such as fabricating or backdating security agreements in the face of an impending insolvency.
- Perfection serves a general publicity function, and the threat posed by s 267 supports that function by giving secured parties a powerful incentive to register.
- The section is a continuation of a principle in statutory provisions that were replaced by the Act.

The arguments against avoiding unperfected security interests in a liquidation include these:

- While the common law may have originally disliked secret liens, that is no longer the case.
- Most unsecured creditors do not search the Register before extending credit, as they just assume that they will rank behind all secured creditors. Also, a search of the Register will not be particularly useful for an unsecured creditor, even if it reveals no registrations, as the borrower could always grant security over its assets (to secure either an existing or a future debt) at any later time, and the unsecured creditor would rank behind that debt even though the grant of the security and the registration all took place after the unsecured creditor had provided its funds.
- It is not clear as a factual matter whether the rule really does constrain the practice of fabricating or backdating security agreements in the face of insolvency.
- Secured parties have sufficient other reasons to perfect their security interests promptly (in particular, in order to preserve their priority position), and are likely not to perfect only out of inadvertence.

83 For example Sask PPSA, s 20(2).

84 D Brown, *The New Zealand Personal Property Securities Act 1999*, in John de Lacy (ed), *The Reform of UK Personal Property Security Law* (Routledge Cavendish, 2010), page 340.

85 See Gedye Cuming & Wood, pages 8 to 10; R Goode, *Principles of Corporate Insolvency Law* (4th Ed) (Sweet & Maxwell, 2011), para 13.124.

- The alleged antecedents to s 267 did not all operate as broadly as that section. For example, s 266 of the Corporations Act did not void a charge just because it had not been registered before insolvency – if a charge was granted shortly before insolvency, the chargee could still register after insolvency, if it did so within 45 days of the charge being granted. Section 267 also has a far broader reach than the antecedent provisions, because of the breadth of the concept of a "security interest".

The justification for the corresponding provisions in the Canadian PPSAs is said to be different again, and to relate to the rights of execution creditors.[86] The argument goes that an execution creditor can take priority over an unperfected security interest if the execution creditor has seized the collateral. However, an execution creditor's right to pursue collateral is suspended on commencement of the insolvency process, so an unsatisfied execution creditor will be in a worse position (and the unperfected secured creditor will be better off) after the insolvency has commenced, as the execution creditor will no longer be able to defeat the unperfected secured creditor by seizing collateral, and the unperfected secured creditor will rank ahead of unsecured creditors including would-be execution creditors. The Canadian equivalents of s 267 are designed to prevent this outcome.

This is an intriguing explanation for s 267. Consultation Paper 3 suggested, however, that it might be something of an over-reaction to vest all unperfected security interests in the grantor, on the off-chance that an enforcing execution creditor could have been thwarted in its attempts to complete execution by the intervention of the insolvency process. Also, if an execution creditor is able to complete execution against an asset prior to insolvency, then it defeats not only an unperfected secured creditor, but other unsecured creditors as well. If that is the case, why are the interests of other unsecured creditors not also suspended post-insolvency, until the would-be execution creditor has received what it is owed?

Somewhat to my surprise, none of the submissions suggested that ss 267 and 267A should be repealed. A number of submissions suggested however that the sections applied too broadly, and proposed in particular that the sections should not apply to a PPS lease unless it is also an insubstance security interest.[87]

Consultation Paper 3 invited stakeholders to comment on these matters.

8.7.2.2 *Discussion of stakeholder feedback*

A small number of respondents argued that ss 267 and 267A should be deleted. One respondent argued in particular that the sections should not apply to the hiring industry (a point to which I return, to some extent, in Section 8.7.4 below).[88]

All other respondents, however, were in favour of retaining the sections. While it is fair to say that there was no obvious consensus across those respondents as to the policy basis for retaining the sections, it is clear that the majority view is that they should not be deleted, and that there is no clear case for change.

8.7.2.3 *Recommendation*

Recommendation 328: *That ss 267 and 267A be retained.*

86 See Duggan & Brown, para 5.48.

87 For example: Manlift, S1; Chalkwest, S1; Payne, S1.

88 HRIA, CP3 page 11.

8.7.3 Terminology – "vests in the grantor"

8.7.3.1 ***The issue***

Section 267 says that an unperfected security interest "vests in the grantor" on insolvency. In contrast, the Canadian PPSAs[89] (and previous s 266 of the Corporations Act) talk of the security interest being "void" or "not effective" as against a liquidator. One submission suggested that s 267 should also refer to the security interest being "void" or "ineffective", rather than referring to the security interest "vesting in the grantor".[90]

While the terminology "vests in the grantor" is indeed different to the Canadian PPSAs and previous s 266 of the Corporations Act, I am not aware that this has caused any issues in the understanding of the section. Also, the formulation may in fact be more suitable than the proposed alternatives. To the extent that an unperfected security interest is a security in the traditional sense (in that the grantor has given security over an asset that it owns), the language "vests in the grantor" should achieve the same outcome as saying that the security interest is "void" or "ineffective", as the effect of the vesting will be that the grantor continues to own the collateral, now free of the security interest. The formulation "vests in the grantor" may be more useful however in the context of title-based security interests such as leases, where the grantor does not own the collateral. In such a case, if the security interest were simply "void" or "ineffective" as against the liquidator, it might not be clear what the practical outcome was – the lessor's title might be "void" or "ineffective" as against the liquidator, but that might not mean that the liquidator could deal with the collateral as if the grantor owned it.[91] In contrast, the effect of the security interest "vesting in the grantor" indicates perhaps more clearly that the secured party's title to the collateral vests in the grantor, again with the result that the grantor now owns the collateral free of the secured party's interest.

Consultation Paper 3 suggested that the current terminology of "vests in the grantor" might not need to be changed, and invited stakeholders to comment.

8.7.3.2 ***Discussion of stakeholder feedback***

A number of respondents were of the view that the "vests in the grantor" language should be replaced, for example with a statement that the unperfected security interest is simply "ineffective" as against the insolvency administrator. The majority of respondents said, however, that the meaning of the current language is clear, and that there was no need for the language to be changed. I agree.

8.7.3.3 ***Recommendation***

> **Recommendation 329:** *That ss 267 to 269 continue to use the expression "vests in the grantor".*

89 For example Sask PPSA, s 20(2).

90 LCA, S2 page 20. Similarly, see DT, S2 page 12.

91 It could be argued, based on the discussion in Section 5.1.2, that the alternative language would work as well. That is because the Act treats the grantor of a security interest as if they were the owner of the collateral, and the secured party, even if the owner at general law, as only having a security interest in it. However, the "vests in the grantor" formulation side-steps the question discussed in that Section of whether that line of analysis is indeed correct.

8.7.4 Application to PPS leases

8.7.4.1 ***The issue***

It was argued in a number of submissions from the hiring industry that ss 267 and 267A should not apply to a PPS lease if it is not also an in-substance security interest under s 12(1) of the Act.[92] Those submissions suggested that the current regime is a major risk and source of concern for the hiring industry, particularly because the concept of a PPS lease currently captures short-term hiring arrangements of an indefinite term.

The breadth of the concept of a PPS lease was discussed in Section 4.3.5 above If my recommendation in that Section is adopted, then that would significantly ameliorate this particular concern. It is anomalous, however, that the Act excludes all transfers of an account or chattel paper and all commercial consignments from the application of ss 267 and 267A (as long as they are not in-substance security interests), but only some PPS leases (and potentially no PPS leases at all, if the *Personal Property Securities Amendment (Regulatory Measures) Bill 2014* is enacted).

The Replacement Explanatory Memorandum says that the Act excluded some short-term leases from the operation of s 267 because "it would be onerous to require the registration of short-term PPS leases to protect them from a grantor's insolvency".[93] However, the Act excludes all transfers of an account or chattel paper and all commercial consignments that are only deemed security interests from ss 267 and 267A, not just a subset of them, and it is not clear why PPS leases should not enjoy the same protection.

Consultation Paper 3 proposed that s 268(1)(a) be amended so that all PPS leases should be outside ss 267 and 267A unless they are in-substance security interests under s 12(1).

8.7.4.2 ***Discussion of stakeholder feedback***

The views of respondents were mixed on this question. A number of respondents argued that ss 267 and 267A should apply to PPS leases, on the basis either that there is no good policy reason for treating them differently to in-substance security interests, or because the proposal would reintroduce the difficulty of distinguishing between a lease that is an in-substance security interest, and one that is not.

Other respondents argued that the sections should not apply to PPS leases that are not in-substance security interests. This view was put particularly energetically by a response on behalf of the hiring industry.[94] The view is based on the argument that applying the sections to a PPS lease that is not in substance a security interest can result in significant and unfair loss to the lessor, and a substantial and unanticipated windfall to the unsecured creditors.

I have sympathy with this latter view. It is true that excising unperfected PPS leases from ss 267 and 267A would not necessarily provide PPS lessors with much protection, as their security interest would still be vulnerable to competing claims from other perfected security interests. This suggests that excluding PPS

92 For example: Manlift, S1; Chalkwest, S1; Payne, S1. Other submissions argued that the hiring industry should be outside the whole Act – see Section 4.3.5.1 above.

93 Replacement Explanatory Memorandum, para 8.9.

94 HRIA, CP3 page 12.

leases might only improve the lessor's position if the lessor was the only secured creditor to the insolvent lessee – perhaps an unlikely proposition. It is telling in my view, however, that ss 267 and 267A do not apply to the other types of deemed security interest, namely transfers of accounts or chattel paper and commercial consignments, and I see no good policy reason for excluding those types of deemed security interests and not PPS leases as well.

8.7.4.3 ***Recommendation***

> **Recommendation 330:** *That s 268(1)(a)(ii) be amended to read:*
>
> *"(ii) a PPS lease;".*

8.7.5 Serial-numbered property

8.7.5.1 ***The issue***

One submission suggested that s 267 should not apply to a security interest in goods if, at the time of insolvency, there is any registration on the Register that identifies the specific goods.[95] That identification could be by way of serial number, and the submission suggested that the categories of collateral that can be identified by way of serial number could be widened, to extend the reach of this proposed protective measure. The submission also suggested that it might be possible to introduce a new collateral class, called "Other goods identified", and that the proposed protective measure could extend to collateral in that class as well.

This suggestion was made as a way to address the risk that a secured party faces if its grantor leases the collateral to a third party under a lease that is a security interest, and the third party becomes insolvent before the secured party's grantor has perfected its security interest under the lease. The intention behind the proposal is that the secured party's registration against the collateral would be sufficient to perfect all security interests in that collateral, at least for the purposes of avoiding the "vesting on insolvency" rule in s 267.

This proposal squarely raises the question of what the policy rationale is for including s 267 in the Act. If the purpose is to avoid secret liens, or to alert unsecured creditors to the potential existence of a security interest over collateral, then the proposal might be thought to be appropriate. However, if the objective of the section is to curb the risk of last-minute security interests, to spur secured parties into registering, or to continue principles derived from antecedent legislation, then it is perhaps less clear that this proposal would be desirable. If the objective of the section is to protect the position of unsatisfied execution creditors, then it is also less clear that the proposal would be appropriate.

If the proposal were to be adopted, then it should be limited in my view to serial-numbered goods. The breadth of that concept is considered in Section 6.6.1 above. Whatever the breadth of the concept, however, the proposal necessarily assumes that it will be possible for a liquidator or administrator who searches the register by reference to the collateral to find the registration (as the registration will only be against the secured party's immediate customer, not any lessee). It is difficult to see how this would work if the collateral did not have a serial number.

95 AFC, S1 page 3.

It also concerns me that the adoption of this proposal would be tantamount to an admission of defeat. It would be accepting that s 267 produces inappropriate outcomes, but that it was too difficult to fix this generally, and so it was only being fixed for those secured parties who were fortunate enough to be financing serial-numbered property. It would be desirable to avoid this if possible.

Consultation Paper 3 invited stakeholders to comment on these matters.

8.7.5.2 ***Discussion of stakeholder feedback***

A number of respondents were in favour of the suggestion that s 267 should not apply to a security interest in goods if, at the time of insolvency, there is any registration on the Register that identifies the specific goods. The majority of respondents, however, were not.

I am also not in favour of this suggestion, for a number of reasons. First, it is inconsistent with the general principle under the Act that a security interest should only be treated as perfected by registration if the registration properly identifies the grantor. Secondly, the protection afforded by the suggestion may be more perceived than real, because the security interest under the lease would still be unperfected for purposes other than ss 267 and 267A, and so would rank behind any perfected security interests. In other words, the suggestion would only help the secured party if the grantor/lessor were the insolvent lessee's only secured creditor.

Thirdly, the concern only arises, as I understand it, if the insolvent lessee has taken the collateral free of the secured party's security interest. If the secured party's security interest remains attached to the collateral in the hands of the lessee, then it will not be unperfected, but rather temporarily perfected under s 52, so ss 267 and 267A would not be engaged. And even if it could be argued that s 52 does not apply, ss 267 and 267A should not affect the secured party's security interest (again, assuming it remains attached to the collateral), because the sections only vest security interests that are "granted by the [insolvent grantor]" – see the first two lines of s 267(1)(b).

And finally, the potential adverse impact of the sections will be ameliorated for the leasing industry if they are amended in accordance with my recommendation in Section 8.7.4, so that they do not apply to a PPS lease that is not in substance a security interest.

8.7.5.3 ***Recommendation***

Recommendation 331: *That s 267 not be amended to provide that a security interest over collateral does not vest in the grantor under the section if there is any registration on the register that describes that particular collateral.*

8.7.6 Turnover trusts

8.7.6.1 ***The issue***

One submission pointed out that the language of the exclusion for turnover trusts in s 268(2) does not reflect the way turnover trusts are typically structured in practice.[96] In particular, s 268(2)(c)(iv) has the effect that the exclusion will only

96 JLF, S2 page 26.

apply if the junior creditor grants a security interest over the subject matter of the trust to the senior creditor, and this is not a usual component of a turnover trust arrangement.

Section 267 is of course only engaged if a turnover trust arrangement gives rise to a security interest. The concern in the context of turnover trust arrangements is that the declaration of trust itself could give rise to a security interest under the Act. If it does not, then the Act (and s 267) will not be relevant. If it does, then the proper effect of s 268(2) should be to exclude it from the operation of s 267, whether or not the arrangement also contains an additional grant of a security interest over the subject matter of the trust. For similar reasons, the requirement in s 268(2)(c)(ii), that the arrangement also oblige the junior creditor to transfer property to the senior creditor, is not a necessary feature of a turnover trust arrangement, and arguably not a necessary ingredient for the exclusion.

Consultation Paper 3 proposed that s 268(2)(c) be amended to reflect these comments.

8.7.6.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 268(2)(c) should be amended as proposed.

8.7.6.3 ***Recommendation***

Recommendation 332: *That sub-paragraphs (ii) and (iv) be deleted from s 268(2)(c).*

8.7.7 Deeds of company arrangement

8.7.7.1 ***The issue***

The application of s 267 relies, in the case of a grantor that is a company or body corporate, on three types of trigger events:

- the making of an order or the passage of a resolution for its winding up;
- the appointment of an administrator; and
- the execution of a deed of company arrangement.

One submission pointed out that the references to the execution of a deed of company arrangement are unnecessary.[97] A security interest will only vest upon execution of a deed of company arrangement if the security interest was unperfected at the "section 513C day," as defined in the Corporations Act. The relevant section 513C day, in the context of a deed of company arrangement, will be either the date of the appointment of an administrator, or the date on which a winding up will have been taken to have commenced. This means that any security interest that was unperfected on that day will have already vested on that day, as a result of the trigger events that are the appointment of the administrator or the occurrence of the winding up.

The submission suggested that the references in s 267 to a deed of company arrangement are not only unnecessary but also confusing, and recommended that they be deleted.

97 JLF, S2 page 26.

Consultation Paper 3 agreed that this would make the operation of s 267 and its related provisions less confusing.

8.7.7.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 267 did not need to refer to a "deed of company arrangement".

8.7.7.3 ***Recommendation***

> **Recommendation 333:** *That s 267(1)(a)(iii) be deleted.*

8.7.8 Innocent purchasers

8.7.8.1 ***The issue***

Sections 267(3) and 267A(2) provide that a purchaser of property from a secured party with an unperfected security interest can take good title to that property despite the operation of ss 267 and 267A, if the person had no actual or constructive knowledge of the occurrence of the trigger event that led to the grantor's insolvency. However, both sections only refer in this context to the trigger events for corporate grantors, and not to the bankruptcy-related trigger events that the sections otherwise apply for individual grantors. This appears to be an oversight.

Consultation Paper 3 proposed that this be corrected.

8.7.8.2 ***Discussion of stakeholder feedback***

All respondents agreed that this should be corrected.

8.7.8.3 ***Recommendation***

> **Recommendation 334:** *That ss 267(3)(b) and 267A(2)(b) be expanded to include the bankruptcy-related events referred to in ss 267(1)(a)(iv) and (v).*

8.7.9 Foreign security interests

8.7.9.1 ***The issue***

Section 268(1)(aa) states that ss 267 and 267A do not apply to a security interest for which the rules relating to its perfection are governed by a foreign law. As one submission pointed out, however, the provision is not really necessary, as the sections will simply not apply to the security interest because it is governed by a foreign law.[98] The submission suggested that s 268(1)(aa) be deleted.

The approach I am taking to "avoidance of doubt" provisions is that they should only be included in the Act where there is real doubt regarding what the effect of the Act would be in the absence of the provision. It seems to me that the effect of the Act on this point is clear, even without s 268(1)(aa).

For this reason, Consultation Paper 3 agreed that it would clarify and streamline the Act to make this change.

98 LCA, S2 page 22.

8.7.9.2 ***Discussion of stakeholder feedback***

A small number of respondents argued that s 268(1)(aa) is helpful, and should be retained. The great majority of respondents agreed, however, that the section was not necessary, and should be deleted.

That is my view as well. Sections 267 and 267A describe what can happen to "unperfected" security interests to which the sections apply. The governing law rules in Part 7.2 determine which laws govern the "perfection, and the effect of perfection or non-perfection" of security interests, and if those rules specify that the laws of a jurisdiction other than Australia are to apply to the "perfection, and the effect of perfection or non-perfection" of a security interest, then it seems clear to me that ss 267 and 267A will not be engaged. I do not think that the Act needs s 268(1)(aa) to confirm that.

8.7.9.3 ***Recommendation***

Recommendation 335: *That s 268(1)(aa) be deleted.*

Chapter 9

Interaction with other laws; other matters relating to the content of the Act

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9.1 Governing law rules

9.1.1 Section 6 – the gateway to the Act

9.1.1.1 ***The issue***

Section 6 provides a set of rules that determine when the Act will apply. Broadly, s 6 says that the Act will apply to a security interest if:

- the grantor is an Australian entity;
- the collateral is goods or financial property, and the goods or financial property are located in Australia;
- the collateral is an intermediated security, and the intermediary is located in Australia;
- the collateral is an intangible that arises by operation of Australian law;
- the collateral is an ADI account;
- the collateral is an account that is payable in Australia; or
- the security interest arises under a transfer of an account or chattel paper, and the account or chattel paper is payable in Australia.

Even if the effect of s 6 is that the Act "applies" to a security interest, this does not mean that the whole of the Act is engaged. Part 7.2 sets out a further series of "choice of law" rules that determine whether the Act, or the laws of another jurisdiction, are to apply to questions concerning the validity and perfection of the security interest, and the consequences of this.

The Canadian PPSAs[1] and the NZ PPSA[2] also contain choice of law rules. However, they do not include an equivalent of s 6. Chapter X of the UNCITRAL Guide contains a useful discussion of the principles that need to be taken into account in the construction of choice of law rules for secured transactions, together with specific drafting recommendations. Those recommendations do not include an equivalent of s 6 either.

One submission pointed out a number of inconsistencies between the operation of s 6 and of Part 7.2.[3] The interaction between s 6 and Part 7.2 can also have the result that they provide no rule at all, forcing users to resort to the general law to fill the gap.[4]

Consultation Paper 3 queried whether s 6 is necessary, or whether the Act should simply rely on the rules in Part 7.2 to determine whether the Act applies.

9.1.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of retaining s 6, as they felt it was a useful guide to the circumstances in which the Act would be engaged.

The majority of respondents were of the view, however, that s 6 did not serve a useful purpose and in some circumstances could be unhelpful, and should be deleted. That is my view as well.

1 For example Sask PPSA, ss 5 to 8.1.

2 NZ PPSA, ss 26 to 33.

3 LCA, S2 page 20.

4 See for example Duggan & Brown, para 14.6.

While it is not uncommon for Commonwealth legislation to include a provision that sets out when the legislation applies, my understanding is that this is usually done for constitutional reasons. That is not relevant for the Act, as constitutional issues are dealt with in Part 7.3.

As I understand it, if a matter comes before an Australian court, then the court would apply the Act as an Australian law, unless the Act itself dictates that another jurisdiction's laws be used, ie because of the operation of Part 7.2. It may be, however, that s 6 was intended to avoid the risk that a court might not apply any of the Act, if the general law's choice of law rules dictated that another jurisdiction's laws should apply instead. In other words, the intent of s 6 may have been to direct a court to apply the Act, notwithstanding what the general law choice of law rules might say, if the matter before the court was of a type described in the section. If that was the intent, though, it might have been easier for s 6 to simply say that the Act always applies notwithstanding the general law's choice of law rules, and then allow the rules in Part 7.2 to redirect the court to another jurisdiction's laws in appropriate circumstances.

9.1.1.3 ***Recommendation***

Recommendation 336: *That Government consider further whether s 6 is needed, and that it be either deleted, or simplified so that it facilitates the application of the Act, rather than have the potential to impede it.*

9.1.2 Part 7.2 – terminology

9.1.2.1 Equivalent concepts in other jurisdictions

9.1.2.1.1 ***The issue***

For the most part, the rules in Part 7.2 determine what laws apply to the validity, the perfection, and the effect of perfection or non-perfection, of a security interest. In some cases, the application of the rules will depend on whether or not a security interest has attached, or is perfected, under the laws of another jurisdiction.

The words "attach" and "perfect" are terms of art under the Act, and have very specific meanings. Those meanings (particularly the meaning of "perfect") rely on other definitions, concepts and processes (such as registration on the Register) that will not necessarily be available under the laws of other jurisdictions. This raises the question of how it can be possible for a security interest to attach or be perfected under the laws of another jurisdiction, unless perhaps that jurisdiction has legislation that is equivalent to the Act.

The approach taken to this question in Canada, at least in relation to the word "attach", is one of functional equivalence.[5] The attachment rules in the Act determine whether or not a security interest has been created, so a security interest should be taken to have "attached" to collateral under the laws of another jurisdiction, if the security interest has been validly created under those laws.

Canadian courts have applied the same functional equivalence approach to the question of perfection.[6] However, most of the Canadian PPSAs have also been amended to spell this out. For example, s 8(2) of the Sask PPSA says this:

5 Cuming Walsh & Wood, page 190.

6 Cuming Walsh & Wood, page 192.

(2) For the purposes of sections 5, 6, 7 and 7.1, a security interest is perfected pursuant to the law of a jurisdiction if the secured party has complied with the law of the jurisdiction with respect to the creation and continuance of a security interest with the result that the security interest has a status in relation to other secured parties, buyers and judgment creditors and a trustee in bankruptcy of the debtor similar to that of an equivalent security interest created and perfected pursuant to this Act.

Consultation Paper 3 suggested that it would be helpful to include a corresponding provision in the Act, in relation to both "attach" and "perfect".

9.1.2.1.2 ***Discussion of stakeholder feedback***

All respondents agreed with this suggestion.

9.1.2.1.3 ***Recommendation***

Recommendation 337: *That the Act make it clear that a reference in Part 7.2 to "attachment" or "perfection" under laws of another jurisdiction is a reference to the functional equivalent of those concepts under those other laws.*

9.1.2.2 **Consistency with other parts of the Act**

9.1.2.2.1 ***The issue***

Part 7.2 provides choice of law rules to determine questions regarding the "validity" and "perfection" of a security interest. In contrast, the balance of the Act refers (almost always) to "attachment", "enforceability against a third party" and "perfection". It is not clear how the two sets of terms should be aligned – does "validity" equate to attachment and enforceability against third parties, or is the latter concept instead part of "perfection" for the purposes of Part 7.2?

Sections 39 and 40 are also relevant to the governing law rules. However, they use a different terminology set again – "effective", "enforceable against third parties", and "perfected".

Some provisions in Part 7.2 take yet another approach. They refer to a security interest being "governed" by the laws of a particular jurisdiction. It may be that this is simply a short-hand reference to questions affecting the validity and perfection of a security interest, and is not intended to broaden the effect of the provision to matters (such as enforcement) that are not otherwise covered by Part 7.2. That is not entirely clear, however.

A similar variability in terminology can be found in the Canadian PPSAs[7] and the NZ PPSA.[8] It should nonetheless be asked whether it is desirable for Part 7.2 (and ss 39 and 40) to use different terminology to other parts of the Act to describe what should be the same concepts.

Consultation Paper 3 asked whether the language used in Part 7.2 (and ss 39 and 40) should be aligned with the language used in other parts of the Act.

7 For example Sask PPSA, ss 5 to 8.1.

8 NZ PPSA, ss 28 to 33.

9.1.2.2.2 ***Discussion of stakeholder feedback***

One respondent observed that particular care would need to be taken with the drafting of this change, and did not regard it as a high priority. All other respondents were in favour of aligning the language in the governing law provisions with the language used elsewhere in the Act.

9.1.2.2.3 ***Recommendation***

> **Recommendation 338:** *That the terminology used in Part 7.2, and in ss 39 and 40, be aligned with the terminology used elsewhere in the Act.*

9.1.2.3 **The meaning of "effect of perfection or non-perfection"**

9.1.2.3.1 ***The issue***

Part 7.2 provides choice of law rules for the validity, the perfection and "the effect of perfection or non-perfection" of a security interest.

The view that is taken in Canada is that the "effect of perfection or non-perfection" encompasses the effect of all the priority and taking free rules, even though not all those rules are determined by whether or not a security interest is perfected.[9]

It may be that Australian courts will take the same approach.[10] Consultation Paper 3 asked, however, whether it would be desirable to clarify this.

9.1.2.3.2 ***Discussion of stakeholder feedback***

One respondent did not think this was a high priority. All other respondents, however, were in favour of making this clarification.

9.1.2.3.3 ***Recommendation***

> **Recommendation 339:** *That Part 7.2 be amended to clarify that references to "the effect of perfection or non-perfection" of a security interest include the effect of all the priority and taking free rules in the Act, including rules that do not turn on whether a security interest is perfected.*

9.1.3 Part 7.2 – should it have a rule to determine what laws govern the enforcement of a security interest?

9.1.3.1 ***The issue***

The rules in Part 7.2 relate to the validity, perfection and effect of perfection or non-perfection of security interests. The rules do not provide any guidance on what laws should be applied to the enforcement of a security interest.

Section 109(2) of the Act speaks to this topic in relation to goods, by providing that Chapter 4 does not apply to a security interest in goods that are located outside Australia. I have however recommended that s 109(2) be deleted.[11]

9 See Cuming Walsh and Wood, pages 192 to 193.

10 See Duggan & Brown, para 14.12.

11 See Section 8.1.4.

Apart from s 109(2), the Act is silent on how to choose what law governs the enforcement of a security interest.

The Canadian PPSAs do provide a rule for this. As an example, s 8(1) of the Sask PPSA says this:

> 8(1) Notwithstanding sections 5, 6, 7 and 7.1:
>
> (a) procedural issues involved in the enforcement of the rights of a secured party against collateral are governed by the law of the jurisdiction in which the enforcement rights are exercised; and
>
> (b) substantive issues involved in the enforcement of the rights of a secured party against collateral are governed by the proper law of the contract between the secured party and the debtor.

The UNCITRAL Guide takes a different approach. It suggests that the appropriate law for the resolution of substantive issues on the enforcement of a security interest should depend on whether the collateral is a tangible or intangible asset. In the case of a tangible asset, the Guide suggests that the governing law should be the law of the jurisdiction where the enforcement takes place. If the collateral is an intangible asset, the Guide suggests that the governing law should be the law that is applicable to the security interest's priority.[12]

Consultation Paper 3 asked whether stakeholders thought that the Act should provide a governing law rule in the Act for the enforcement of security interests and, if so, what that rule should be.

9.1.3.2 *Discussion of stakeholder feedback*

A small number of responses preferred the Canadian model, or not including any rule at all. The great majority of respondents, however, were of the view that the Act should adopt the model that is recommended by the UNCITRAL Guide. I agree.

9.1.3.3 *Recommendation*

Recommendation 340: *That the Act adopt a choice of law rule for the enforcement of security interests that reflects Recommendation 218 of the UNCITRAL Legislative Guide on Secured Transactions.*

9.1.4 Part 7.2 – should it have a rule for intermediated securities?

9.1.4.1 *The issue*

One submission pointed out that Part 7.2 does not provide a rule to determine what laws should be used to resolve issues relating to a security interest over intermediated securities.[13]

It has been suggested to me that intermediated securities are not dealt with in Part 7.2 because Australia had not yet decided, at the time of drafting the Act, whether it would accede to the Hague Securities Convention, and because it was thought to be premature to include choice of law rules for intermediated securities in the Act until that decision had been taken.

12 UNCITRAL Guide, Recommendation 218.

13 JLF, S2 page 24.

As the submission noted, however, the absence of a choice of law rule for intermediated securities is unsatisfactory. Under s 6, the Act will apply to a security interest over intermediated securities if the grantor is an Australian entity, or if the intermediary is located in Australia. This means that the full rigour of the Act will apply to all such security interests, as there is no rule in Part 7.2 that could bring any of those security interests back out of the Act. In contrast, the Canadian PPSAs provide that the rules for a security interest over an intermediated security are determined only by the laws of the location of the intermediary.[14]

The submission suggested that an appropriate choice of law rule should be included in Part 7.2, even if only as an interim solution until Australia determines its position in relation to the Hague Securities Convention. Consultation Paper 3 supported this proposal, and invited stakeholders to comment.

9.1.4.2 ***Discussion of stakeholder feedback***

All respondents supported this proposal as well.

9.1.4.3 ***Recommendation***

> **Recommendation 341:** *That Part 7.2 be amended to provide that questions relating to the validity, perfection and effect of perfection or non-perfection of a security interest over an intermediated security be determined by the law (other than the law relating to conflict of laws) of the jurisdiction in which the intermediary maintains the securities account.*

9.1.5 Section 235 – the meaning of "located"

9.1.5.1 Section 235(5) – individual grantors

9.1.5.1.1 ***The issue***

One submission drew attention to the fact that an individual grantor is taken by s 235(5) to be located at their "principal place of residence", and to the fact that this could change.[15] If an individual grantor relocates from overseas to Australia after it has granted a security interest over collateral, the Act will be engaged even though it did not initially apply. The secured party may benefit from being temporarily perfected under s 40 for an initial period, but would need to take further steps to protect its security interest before the temporary perfection expired.

The submission pointed out that this exposes a secured party to risk, if it takes security from an individual overseas who may relocate to Australia. The submission pointed out that this may prompt the secured party to make protective filings in Australia, whether or not the grantor has in fact relocated, in case the grantor does subsequently move to Australia without the secured party's knowledge.

Consultation Paper 3 expressed the view that this may be a consequence of the operation of the Act that secured parties will simply need to be prepared for, but invited stakeholders to comment.

14 For example Sask PPSA, s 7.1.

15 JLF, S2 page 24.

9.1.5.1.2 ***Discussion of stakeholder feedback***

One respondent was in favour of amending the Act to address this point. All other respondents, however, were of the view that this issue was not sufficiently material to warrant that the Act be amended to deal with it.

9.1.5.1.3 ***Recommendation***

> **Recommendation 342:** *That s 235(5) not be amended.*

9.1.5.2 **Sections 235(1) and (2)(a) – certificated investment instruments, chattel paper and negotiable instruments**

9.1.5.2.1 ***The issue***

One submission pointed out that the combined effect of ss 235(1) and (2)(a) is to suggest that the "location" of a certificated investment instrument, chattel paper or negotiable instrument is determined by the physical location of the instrument.[16] The submission suggested that this was not appropriate, and that the position under the Act should be clarified.

I agree that the location of a certificated share should not be determined by the location of the share certificate. That would be inconsistent with the Corporations Act, which provides that a share is taken to be located in the place of the share register.[17] It would also be inconsistent with principle, as a share certificate is merely a convenient record of the existence and ownership of the share, not a physical embodiment of it.

I am not so sure, however, that the same argument applies in relation to chattel paper (if that concept is retained in the Act) or negotiable instruments, as in those cases the instrument is a physical embodiment (or reification) of the rights that it represents. In those cases, it could well be appropriate to accept that the right is located where the instrument is physically located.

Consultation Paper 3 invited stakeholders to comment on this.

9.1.5.2.2 ***Discussion of stakeholder feedback***

One response appeared to suggest that the physical location of a negotiable instrument should not influence where the instrument is taken to be located for governing law purposes. I have since ascertained, however, that that was not the intention of the response. On that basis, all respondents agreed that the location of a share should be determined by the location of the share register (in accordance with the Corporations Act), and that the location of chattel paper (if the concept is retained)[18] and of a negotiable instrument (if the meaning of the term is returned to its general law meaning)[19] should be determined by its physical location (again, as would be the case under the law outside the Act).

I believe that the effect of this conclusion, and of other changes that I have recommended, is that s 235(2) could be deleted.

16 JLF, S2 page 24.

17 Corporations Act, s 1070A(4).

18 See Section 4.3.3.

19 See Section 7.6.13.1.

9.1.5.2.3 ***Recommendation***

Recommendation 343: *That s 235(2) be deleted.*

9.1.6 Section 237 – express choice of Australian law

9.1.6.1 Is s 237 appropriate?

9.1.6.1.1 ***The issue***

Section 237(1) provides the parties to a security agreement with an ability to choose Australian law over a foreign law (in other words to opt in to the Act) if:

(a) the grantor is an Australian entity at the time the security interest attaches to the collateral; and

(b) the security agreement that provides for the security interest expressly provides that the law of the Commonwealth, or that law as it applies in a particular State or Territory, governs the security interest.

Section 237(2) goes on to say, however, that this is not possible for a security interest in an account, in a transfer of an account or chattel paper, or in intellectual property or an intellectual property licence.

The NZ PPSA also contains a provision that allows parties in some circumstances to apply New Zealand law to transactions.[20] The Canadian PPSAs do not. The UNCITRAL Guide does not either – indeed, it suggests that such a provision is not appropriate:

> … the conflict-of-laws rules applicable to the property aspects of secured transactions are matters that are outside the domain of freedom of contract. For example, the grantor and the secured creditor are normally not permitted to select the law applicable to priority, since this could not only affect the rights of third parties, but could also result in a priority contest between two competing security rights being subject to two different laws leading to opposite results.[21]

One leading commentary on the Act suggests that the practical impact of s 237 is limited, because it only applies if the grantor is an Australian entity, and because its main application will be in relation to non-mobile goods.[22] Despite this, it should be asked whether the rule is appropriate.

The Replacement Explanatory Memorandum notes that one of the objectives of Part 7.2 is to provide rules that "meet the reasonable expectations of all interested parties to a security agreement".[23] This objective should extend beyond the immediate parties to the security agreement to include other relevant stakeholders as well.[24] It could be asked whether s 237, by allowing the parties to a security agreement to change the law that affects the validity of a security interest over goods in a way that will not be transparent to third parties, is appropriate.

Consultation Paper 3 asked stakeholders to comment on this.

20 NZ PPSA, s 26(1)(c).

21 UNCITRAL Guide, Chapter X, para 13.

22 Duggan & Brown, para 14.14.

23 Replacement Explanatory Memorandum, para 7.1.

24 UNCITRAL Guide, Chapter X, para 6.

9.1.6.1.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of retaining s 237. The majority of respondents, however, were of the view that it should be deleted. For the reasons given above, that is my view as well.

9.1.6.1.3 ***Recommendation***

> **Recommendation 344:** *That s 237 be deleted.*

9.1.6.2 **Amendments to s 237, if retained**

9.1.6.2.1 ***The issue***

Section 237(2) imposes some limitations on the rule in s 237(1). It says that s 237(1) does not apply to a security interest in:

(a) an account;

(b) a transfer of:

(i) an account; or

(ii) chattel paper;

(c) intellectual property or an intellectual property licence.

Consultation Paper 3 suggested, if Government decides to retain s 237 (despite my recommendation in Section 9.1.6.1), that the purpose and scope of the exclusions in s 237(2) should be reconsidered. In particular, Consultation Paper 3 queried whether s 237(2) should simply exclude all non-tangible property.

9.1.6.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 237(2) should be amended so that it simply excludes all non-tangible property from the rule in s 237(1).

9.1.6.2.3 ***Recommendation***

> **Recommendation 345:** *If s 237 is retained, that s 237(2) be amended so that s 237(1) only applies to tangible personal property.*

9.1.7 Section 238 – goods

9.1.7.1 Section 238(2) – goods intended for another jurisdiction

9.1.7.1.1 ***The issue***

The general choice of law rules for goods are that the validity of a security interest in goods is governed by the law of the jurisdiction in which the goods are located when the security interest attaches, and that questions relating to the perfection of that security interest are determined by the location of the goods from time to time.[25]

25 Sections 238(1) and (1A).

Section 238(2) provides a different rule for goods that are to be relocated to another jurisdiction after the security interest attaches. If it was reasonable to believe at the time of attachment that the goods would be moved to another jurisdiction, and the goods are in fact located in that jurisdiction, then questions relating to validity and perfection of the security interest are all to be determined by the laws of that other jurisdiction.

The purpose of this rule is to relieve the secured party from the need to register a financing statement in Australia, if the goods are to be moved to another country.

One submission pointed out that the section is very open-ended, in that it does not require that the goods be shipped within any particular timeframe.[26] The submission noted that this can cause complications if another person takes an interest in the goods before they have been shipped. The submission suggested that this be addressed, by providing that the rule only applies if the goods are shipped within 30 days. This would reflect the position under the corresponding rule in the Canadian PPSAs.[27]

It is not entirely clear that this is a material issue. If there is a risk that an intervening interest could arise before the goods are shipped, then it is always open to the secured party to perfect by registration in the exporting jurisdiction as an interim measure.

Consultation Paper 3 asked, however, whether stakeholders supported the concept of a 30-day cap for s 238(2).

9.1.7.1.2 *Discussion of stakeholder feedback*

A small number of respondents argued that s 238(2) should be amended to include a 30-day cap, in line with the corresponding Canadian provisions. All other respondents were of the view that this was not needed. That is my view as well.

9.1.7.1.3 *Recommendation*

Recommendation 346: *That s 238(2) not be amended.*

9.1.7.2 Section 238(2A)

9.1.7.2.1 *The issue*

Section 238(2A) states that s 238(2) applies to a security interest from the time at which it attaches. It is not clear what this provision is aimed at, as a security interest does not come into existence until it has attached.

Consultation Paper 3 asked whether stakeholders could provide an explanation for s 238(2A) and proposed, if it is not possible to explain its role, that s 238(2A) be deleted.

9.1.7.2.2 *Discussion of stakeholder feedback*

One respondent suggested that the purpose of the section might be to remove the need for the secured party to double up on registrations.[28] No other respondent offered an explanation for the provision.

26 LCA, S2 page 21.

27 For example Sask PPSA, s 6(1).

28 LM, CP3 page 18.

All respondents that expressed a view on this question agreed, in any event, that s 238(2A) could be deleted.

9.1.7.2.3 ***Recommendation***

Recommendation 347: *That s 238(2A) be deleted.*

9.1.7.3 **Section 238(3) – mobile goods**

9.1.7.3.1 ***The issue***

Section 238(3) provides another exception for goods, in this case for goods that are "of a kind that is normally used in more than one jurisdiction" and that are not used predominantly for personal, domestic or household purposes. Section 238(3) provides that questions relating to the validity and perfection of a security interest over such goods are governed by the law of the jurisdiction in which the grantor is located when the security interest attaches.

One of the challenges of any choice of law regime is the risk that the choice of law rules of jurisdiction A may direct a dispute to the laws of jurisdiction B, only for the laws of jurisdiction B to send the dispute back to jurisdiction A – which would again want to send it to jurisdiction B, and so on. This is known as *renvoi*.

The choice of law rules in Part 7.2 generally exclude *renvoi*. The one provision where it is not excluded, but instead is expressly included, is s 238(3). This reflects the position under the Canadian PPSAs[29] and the NZ PPSA.[30]

One submission suggested that the reasons for including *renvoi* in s 238(3) are historical in nature, and no longer relevant.[31] I am inclined to agree with this. It would simplify the Act, and make it internally more consistent, if the reference to *renvoi* in s 238(3) were deleted. This would also be consistent with the recommendations in the UNCITRAL Guide.[32]

For these reasons, Consultation Paper 3 proposed that the reference to *renvoi* in s 238(3) be deleted.

It is also not clear why the rule in s 238(3) should not apply to a security interest over goods just because the goods are used predominantly for personal, domestic or household purposes. Consultation Paper asked whether stakeholders could provide an explanation for this and proposed, there is no good reason for the limitation, that it be removed.

9.1.7.3.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 238(3) should be amended to exclude *renvoi*.

One respondent suggested that s 238(3)(c) had been included because the primary governing law rules for goods should apply if the goods are used for personal, domestic or household purposes, and not the "goods … of a kind that is normally used in more than one jurisdiction" rule in s 238(3).[33] It means, in effect,

29 For example Sask PPSA, s 7(2).

30 NZ PPSA, s 30.

31 LCA, S2 page 21. For an explanation of the reasons, see Duggan & Brown, para 14.28.

32 UNICTRAL Guide, Recommendation 221.

33 AD, CP3 page 22.

that the governing law would be determined by the location of the goods, rather than by the location of the grantor.

I suspect that this will not be an issue very often, under the Act. It may be a more important point in Canada, which has a separate Canadian PPSA in each relevant province, because the provision could be relevant for motor vehicles (as a type of consumer goods that are of a kind that can cross provincial borders). In Australia, however, the types of goods that are most likely to be subject to the rule in s 238(3) will be business assets such as aircraft or transport pallets, and they are unlikely to be used for personal, domestic or household purposes.

Having said that, this is a meaningful explanation for retaining s 238(3)(c). The explanation leads me to the view that there is no clear case for deleting the section.

9.1.7.3.3 ***Recommendations***

Recommendation 348: *That the words "(including the law relating to conflict of laws)" in s 238(3) be replaced with "(other than the law relating to conflict of laws)".*

Recommendation 349: *That s 238(3)(c) be retained.*

9.1.8 Section 239(5) – ADI accounts

9.1.8.1 ***The issue***

The general choice of law rule for a security interest over an ADI account is that the security interest is governed by the law that governs the ADI account.[34] That rule is in s 239(4). However, s 239(5) says that the parties to a security agreement can agree that a different law should govern the security interest, if:

(a) the ADI consents in writing; and

(b) applying the law of that other jurisdiction would not be manifestly contrary to public policy.

It is not clear why s 239(5) was included in the Act. As one submission pointed out, it compromises the Act's publicity objective, because a third party checking for security interests in an ADI account will not be aware of the agreement, and so will not know in which jurisdiction it should look.[35] The submission suggested for this reason that s 239(5) be removed.

Consultation Paper 3 expressed support for this suggestion.

9.1.8.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of retaining s 239(5). The great majority of respondents agreed, however, that it should be deleted.

9.1.8.3 ***Recommendation***

Recommendation 350: *That s 239(5) be deleted.*

34 See Section 9.1.2.2 regarding the use of the word "governed".

35 LCA, S2 page 21.

9.1.9 Section 240 – financial property

9.1.9.1 Section 240(2) – letters of credit

9.1.9.1.1 *The issue*

Section 240(1) provides that the validity of a security interest in financial property, and of property covered by s 240(2), is generally governed by the law of the jurisdiction in which the grantor is located when the security interest attaches to that property.

Section 240(2) says this:

> (2) This subsection covers property that is a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation.

It is not clear that s 240(2) is necessary. Section 240(1) already covers "financial property", and that term is defined in s 10 to include a "negotiable instrument". That expression is in turn defined in s 10 to include a letter of credit that states that it must be presented on claiming payment. On this basis, s 240 already covers letters of credit as described in s 240(2), without the need for the subsection.

Consultation Paper 3 suggested that it would simplify the Act if s 240(2) and accompanying references to it were removed.

I have separately recommended that the definition of negotiable instrument in s 10 be amended so that it no longer includes letters of credit.[36] Consultation Paper 3 suggested that it may be appropriate to delete s 240(2) even if that recommendation is adopted, particularly if s 240(3) is deleted (see Section 9.1.9.2 below). That would mean that governing law issues for letters of credit would no longer be regulated by s 240, and instead would be regulated by s 239.

9.1.9.1.2 *Discussion of stakeholder feedback*

All respondents agreed that s 240(2) should be deleted. I note in passing that this will require that s 239(6) be deleted as well.

9.1.9.1.3 *Recommendation*

Recommendation 351: *That ss 239(6) and 240(2) be deleted.*

9.1.9.2 Section 240(3)

9.1.9.2.1 *The issue*

Section 240(3) contains an exception to the rule in s 240(1). It provides that the validity of a security interest will be governed by Australian law if:

> (a) the security interest has attached under the law of a place in Australia; and
>
> (b) at the time of attachment:
>
> (i) the property is located in Australia; and
>
> (ii) the secured party has possession or control of the property sufficient to perfect the security interest under this Act.

36 See Section 7.6.13.1.

One submission made a number of observations regarding s 240(3).[37] First, it pointed out that the reference in s 240(3)(a) to "the law of a place in Australia" is misconceived, and should just refer to the Act. More substantively, the submission also pointed out that the exception appears to be self-defeating, because a security interest will only be valid if it has in fact attached, so the fact that it has attached cannot be used to choose the laws that determine whether the security interest is valid.[38]

Consultation Paper 3 asked whether stakeholders could explain the purpose behind s 240(3), and whether stakeholders considered that s 240(3) is needed.

9.1.9.2.2 *Discussion of stakeholder feedback*

The great majority of respondents were of the view that s 240(3) should not be deleted, but that it needed to be amended. A number of responses suggested that the section might have its genesis in provisions in the Canadian PPSAs[39] and the NZ PPSA[40] that state that the governing law for a possessory security interest in negotiable instruments and other financial assets is the law of the jurisdiction in which the asset is physically located. Those responses proposed that s 240(3) be reworked to reflect those provisions.

I can see good sense in that proposal. Section 240(3) should be amended to provide that the validity of a possessory security interest in a negotiable instrument, or any other tangible instrument that is regarded by the law as embodying the payment obligation that it represents, should be governed by the law of the place where the instrument is located, consistent with the primary governing law rules for goods. A similar change should be made to s 240(5) as well.

9.1.9.2.3 *Recommendation*

> **Recommendation 352:** *That ss 240(3) and (5) be amended to provide that the choice of law rules for a security interest in a negotiable instrument, or any other tangible instrument that is regarded by the law as embodying the payment obligation that it represents, should be governed by the law of the place where the instrument is located, consistent with the primary governing law rules for goods.*

9.1.9.3 Section 240(7)

9.1.9.3.1 *The issue*

Section 240(7) provides a special rule for a security interest in "a negotiable instrument that is not evidenced by a certificate". I have separately recommended that Government consider deleting the concept of "a negotiable instrument that is not evidenced by a certificate" from the Act, on the basis that it is inconsistent with the concept of a negotiable instrument under Australian law.[41] The outcome of that recommendation may be that s 240(7) can be deleted as well.

37 LCA, S2 page 21.

38 See also Duggan & Brown, para 14.43.

39 For example, Sask PPSA, s 5(1)(b).

40 NZ PPSA, s 26(1).

41 See Section 5.3.8.

9.1.9.3.2 ***Recommendation***

> **Recommendation 353:** *If Government decides pursuant to Recommendation 75 to delete ss 21(2)(c)(iv) and 29, that s 240(7) be deleted as well.*

9.1.10 Section 241 – proceeds

9.1.10.1 ***The issue***

Section 241(1) provides that the validity of a security interest in proceeds is governed by the law of the jurisdiction that governs the validity of the security interest in the original collateral. Section 241(2) provides a similar rule in relation to the perfection of a security interest in proceeds.

One submission queried whether this is appropriate.[42] The submission drew attention to the fact that the Canadian PPSAs do not contain a separate rule for proceeds, but simply allow the primary choice of law rules to apply. This would mean, for example, that the validity of a security interest in goods that are proceeds would be determined by the law of the jurisdiction in which those goods are located at the time the security interest attaches to them, not by the law of the jurisdiction in which the original collateral was located at the time the security interest attached to the original collateral.

The UNCITRAL Guide recommends a third approach, which is a hybrid of the approach currently applied by the Act and the approach taken in the Canadian PPSAs.[43] Under this third approach, questions regarding the validity of the security interest over proceeds are regulated by the law that determined the validity of the security interest in the original collateral that gave rise to the proceeds. Questions regarding third-party effectiveness and priority are determined, however, by the law that would apply to a security interest that was taken over the proceeds as original collateral. The UNCITRAL Guide recommends this approach because it is seen to best balance the interests of the affected stakeholders – it gives the secured party comfort as to the rules that will determine whether its security interest will grip the proceeds, and gives confidence to third parties who take a competing interest in the proceeds as to the rules that will determine the priority position of the interest that they take.

Consultation Paper 3 invited stakeholders to comment on the relative attractiveness of these options.

9.1.10.2 ***Discussion of stakeholder feedback***

All respondents were in favour of amending the Act to incorporate the model that is recommended by the UNCITRAL Guide. I am in favour of that approach as well.

9.1.10.3 ***Recommendation***

> **Recommendation 354:** *That s 241 be amended to reflect Recommendation 215 of the UNCITRAL Legislative Guide on Secured Transactions.*

42 LCA, S2 page 22.

43 UNCITRAL Guide, Recommendation 215.

9.1.11 Section 40(5) – property that is relocated to Australia – temporary perfection

9.1.11.1 *The issue*

Section 40 provides a period of temporary perfection for a security interest in intangible property or financial property that has become subject to Australian law because the grantor has relocated to Australia. Section 40(5) provides however that the section does not apply to intellectual property, an intellectual property licence, an ADI account or a negotiable instrument.

It is not clear why s 40(5) provides that the temporary perfection rule in s 40 is not available for these types of collateral. Consultation Paper 3 asked whether stakeholders could provide an explanation for this and suggested, if there is no compelling explanation for the exclusion, that it be deleted.

9.1.11.2 *Discussion of stakeholder feedback*

No respondent offered an explanation for s 40(5). All respondents agreed that it could be deleted.

9.1.11.3 *Recommendation*

Recommendation 355: *That s 40(5) be deleted.*

9.2 Interaction between the Act and other legislation

9.2.1 Sections 340 to 341A – circulating assets

9.2.1.1 **The concept of a "circulating asset"**

9.2.1.1.1 *The issue*

Before the Act took effect, it was common for a lender to a corporate borrower to take a fixed and floating charge over the borrower's assets. The charge would typically be a fixed charge over the company's major assets such as plant and equipment, and a floating charge over the company's inventory or other assets that the lender expected the company to turn over in the course of its business. The floating nature of the charge over those assets meant that the company could dispose of those assets without breaching the terms of the charge, and could give clear title to those assets to the disponee.

The distinction between fixed and floating charges was also relevant to a number of provisions in the Corporations Act. For example, a floating charge granted before 23 June 1993 and within 6 months of a company's insolvency was void, except to the extent that it secured fresh money.[44] The Corporations Act also provided that employees and some other unsecured creditors had a statutory priority that enabled them to be paid what they were owed out of the proceeds of enforcement of a floating charge, ahead of the chargee.[45]

The Act has done away with the distinction between fixed and floating charges.

44 Section 566 of the Corporations Act.

45 Section 561 of the Corporations Act, prior to its amendment by the *Personal Property Securities (Corporations and Other Amendments) Act 2011*.

Rather than abolish the provisions in the Corporations Act that relied on the concept of a floating charge, however, the Act has created the concept of a "circulating asset", and the Corporations Act in turn has been amended to use that term in a new definition, a "circulating security interest".[46] The Corporations Act now uses the term "circulating security interest" in provisions that previously referred to a floating charge.

The meaning of the term "circulating asset" is set out in ss 340 to 341A. Those sections are very detailed and technical, and at times difficult to apply. A number of submissions described these provisions as being "unnecessarily complicated", and suggested that they be restructured.[47]

The same submissions pointed out that the concepts of "circulating asset" and "circulating security interest" draw distinctions that are based on whether the grantor or the secured party has title to the affected assets, or has "control" of them. The submissions noted that this is inconsistent with the general approach of the Act, which is to de-emphasise the location of title and to look more to the underlying commercial substance of an arrangement to determine its legal effect. The submissions also noted that this reliance on title and on "control", together with the technical nature of these provisions generally, has had the effect of adding significantly to the complexity of security documentation.

The submissions suggested that an entirely different approach should be considered for determining the scope of the concept of a "circulating asset". They suggested that an alternative approach might be for the relevant provisions in the Corporations Act to focus on security interests in inventory and their traceable proceeds, and only to distinguish for these purposes between security interests that are or are not a PMSI. Using this approach, the concept of a "circulating security interest" (or whatever replacement term might be used) would simply capture inventory that is not subject to a PMSI, and its proceeds.

The submissions observed that it should be possible to develop a similar streamlined alternative in relation to accounts and ADI accounts, if it was determined as a policy matter that the statutory priority should be available in relation to these types of assets as well.

My understanding is that the original policy objective behind the statutory priority that is afforded to employees over floating charge assets was developed in England during the Industrial Revolution, in the context of a manufacturing business that granted a fixed and floating charge over its assets to its bank. The view was taken that factory workers, whose labours produced the inventory that the company would subsequently sell, should be entitled to priority in relation to the inventory to recover their unpaid wages, rather than leave them exposed to the risk that their efforts could produce the inventory but that they might not be paid for their work because the proceeds of sale of the inventory had been claimed by the bank that held the security. It is also said that employees deserve particular protection because of their vulnerability, and their inability to protect themselves from the consequences of the insolvency of their employer.[48]

46 Section 51C of the Corporations Act.

47 For example: AICM, S1 page 21; LCA, S1 page 10; QLS, S1 page 8; CW, S1 page 7.

48 See for example: L.C.B. Gower, *Principles of Modern Company Law* (5th ed) (Sweet & Maxwell, 1992), pages 420 to 422; C.F. Symes, *Do Not Dismiss the Employee as a Statutory Priority Creditor in Corporate Insolvency* (1998) 26 ABLR 450.

The desirability or otherwise of protecting employee entitlements from an employer's insolvency, and the most appropriate way of doing this, continues to be a topic of discussion as a matter of corporations law policy.

I do not believe that it is the role of this review to express a view on the policy behind s 561 of the Corporations Act. It is however within the remit of this review to consider the content of ss 340 to 341A, because they are in the Act.

9.2.1.1.2 ***Discussion of stakeholder feedback***

All respondents agreed with the suggestion that ss 340 to 341A be restructured in the way described above. I also agree that this is a very worthwhile proposal.

9.2.1.1.3 ***Recommendation***

> **Recommendation 356:** *That ss 340 to 341A be amended so that collateral is only a "circulating asset" of a grantor if it is inventory (in the ordinary meaning) of the grantor (other than inventory that is subject to a PMSI), or its proceeds.*

9.2.1.2 **Should the provisions be moved to the Corporations Act?**

9.2.1.2.1 ***The issue***

Even though ss 340 to 341A are located in the Act, they have no consequences for the operation of the Act itself. Rather, the provisions appear to be relevant only to the operation of provisions in the Corporations Act, as just described above in Section 9.2.1.1. For this reason, a number of submissions recommended that the provisions, in whatever form they might ultimately take, should be removed from the Act and relocated to the Corporations Act.[49]

There appears to be no good reason why ss 340 to 341A should be in the Act, rather than the Corporations Act. For that reason, Consultation Paper 3 proposed that ss 340 to 341A, in whatever form they may ultimately take, be relocated to the Corporations Act.

9.2.1.2.2 ***Discussion of stakeholder feedback***

One respondent was of the view that it was helpful to keep ss 340 to 341A in the Act. All other respondents agreed, however, that they should be relocated to the Corporations Act.

9.2.1.2.3 ***Recommendation***

> **Recommendation 357:** *That ss 340 to 341A, in whatever form they may ultimately take, be removed from the Act and relocated to the Corporations Act.*

9.2.1.3 **Detailed comments on the provisions**

One submission also made comments on specific aspects of ss 340 to 341A.[50]

49 For example: AICM, S1 page 21; LCA, S1 page 9.

50 JLF, S1 page 40.

Those comments may cease to be relevant, if the provisions are restructured in accordance with my recommendation above in Section 9.2.1.1. For completeness, and in case that recommendation is not adopted, those more detailed comments are discussed below.

9.2.1.4 ADI accounts – registration to indicate control

9.2.1.4.1 *The issue*

The rules in ss 340 to 341A provide that an asset that might otherwise be a circulating asset will be taken out of the grip of the sections (that is, that it will not be a circulating asset) if the secured party has "control" of the asset. The term "control" for these purposes is not limited to the technical meaning of "control" that determines whether a secured party is perfected over certain types of collateral. Rather, the concept of "control" is given a quite extensive meaning, as set out in the sections. Even if a secured party does have control of collateral, however, the collateral will only not be a circulating asset if the secured party has registered a financing statement in relation to the collateral, and that financing statement discloses that the secured party has control.

One category of collateral that is capable of being a circulating asset is an ADI account (unless it is a term deposit). If an ADI has a security interest over an ADI account with it, the security interest will be automatically perfected by control over the account. Despite this, the ADI account will still be at risk of being a circulating asset, unless the ADI takes the further step of registering a financing statement and disclosing in that financing statement that it has control.

One submission suggested that this additional registration step was unnecessary, and should be removed.[51]

Consultation Paper 3 agreed that this is a reasonable proposition. The underlying concern may be resolved by other means, if the decision is taken to remove the "control" box from the Register as discussed above in Section 6.2.3. If the "control" box is retained, however, it should not be necessary for an ADI to make a registration purely for the purposes of indicating that it has control.

9.2.1.4.2 *Discussion of stakeholder feedback*

A small number of respondents were not able to express a concluded view on this question. All other respondents agreed, however, that an ADI should not be required to register a financing statement where it is perfected by control over an ADI account, solely in order to indicate in the registration that it has control.

9.2.1.4.3 *Recommendation*

Recommendation 358: *If ss 340 to 341A are not amended in accordance with Recommendation 356, and the Register continues (despite Recommendation 89) to allow a person registering a financing statement to indicate whether or not the secured party may have control, that s 340(2) be amended to make it clear that an ADI that is perfected by control over an ADI account does not need to register a financing statement and indicate that it has control, in order to cause that ADI account not to be a circulating asset for the purposes of s 340.*

51 JLF, S1 page 40.

9.2.1.5 Control of an account

9.2.1.5.1 *The issue*

Section 340 provides that an "account" can also be a circulating asset for the purposes of the section. Again, s 341 provides a secured party with a mechanism for bringing accounts over which it has security out of the concept of a circulating asset, by taking "control" of the account.

One of the requirements for this is that the parties have agreed that amounts received in payment of the account are to be deposited into a specified ADI account, and that the "usual practice" of the parties is for this to be done. This produces a very uncertain outcome for a secured party, however, particularly in relation to a "one-off" payment or where the obligation to deposit amounts into the ADI account is new, as there will not be a "usual practice" in place at that time.

One submission suggested that it would be clearer, and that the provision would be more meaningful, if this requirement were expressed the other way around: that is, that the secured party would have control unless it is shown that the grantor's usual practice is not to deposit the proceeds into the ADI account and that it has the express or implied consent of the secured party to not do so.[52]

Consultation Paper 3 invited stakeholders to comment on this proposal.

9.2.1.5.2 *Discussion of stakeholder feedback*

One respondent did not agree with this suggestion. All other respondents were of the view, however, that it was appropriate to reverse the requirement in the way described above.

9.2.1.5.3 *Recommendation*

> **Recommendation 359:** *If ss 340 to 341A are not amended in accordance with Recommendation 356, that s 341(3)(b) be amended so that a secured party will have control of an account if it satisfies the other requirements of the section, unless it is shown that the grantor's usual practice is not to deposit the proceeds into the ADI account and that it has the express or implied consent of the secured party to not do so.*

9.2.1.6 Control of an ADI account

9.2.1.6.1 *The issue*

Sections 341(3)(d) and 341A(1)(b) state that a secured party will only have "control" of an ADI account[53] or an account if the secured party is able to demonstrate that:

> depositing any such amounts into the specified ADI account does not result in any person coming under a present liability to pay:
>
> (i) the person to whom the relevant account is owed; or
>
> (ii) if the person to whom the relevant account is owed is a body corporate – a related body corporate (within the meaning of the Corporations Act 2001).

52 JLF, S1 page 41.

53 Unless the secured party is the ADI itself.

This appears to be intended to be an anti-avoidance measure. I am not aware, however, of any particular mischief that the provisions are designed to address. The meaning of the provisions is also quite unclear – for example, it could be argued that any deposit into an ADI account results in the ADI coming under a present liability to pay the deposit balance to the depositor. If that is the case, then it would never be possible to satisfy the requirement. While it is likely that a court would not reach that conclusion, the uncertainty is undesirable.

Consultation Paper 3 asked stakeholders whether they could explain the thinking behind the provisions and suggested, there is no good explanation for them, that they should be deleted.

9.2.1.6.2 ***Discussion of stakeholder feedback***

All respondents agreed that ss 341(3)(d) and 341A(1)(b) should be deleted.

9.2.1.6.3 ***Recommendation***

Recommendation 360: *That ss 341(3)(d) and 341A(1)(b) be deleted.*

9.2.1.7 **Control of inventory**

9.2.1.7.1 ***The issue***

Another type of personal property that can be a circulating asset is "inventory". Again, s 341 provides a secured party with a mechanism for bringing inventory outside the circulating asset regime, by taking "control" of the inventory. That mechanism is set out in s 341(1).

One of the requirements in s 341(1) is that the secured party and the grantor have agreed in writing that the grantor will "specifically appropriate the inventory to the security interest". As one submission noted, it is quite unclear what this means.[54] The language may be endeavouring to replicate general law rules that help to determine whether a chargee can successfully convert a floating charge over inventory into a fixed charge, but if that is the case then it would be clearer to spell out what is required.

Consultation Paper 3 suggested s 341(1)(a)(i) could perhaps be deleted, on the basis that s 341(1)(a)(ii) is sufficient.

9.2.1.7.2 ***Discussion of stakeholder feedback***

One respondent was concerned that these suggestions would make it unclear just what would constitute "control" of inventory for the purposes of s 341.[55] All other respondents agreed, however, that these changes should be made.

The effect of the changes would be to provide that a secured party has control of inventory for the purposes of the sections if the grantor has agreed that it will not remove the inventory without the secured party's specific and express authority, and it is the grantor's usual practice to comply with that agreement. That, it seems to me, is an appropriate outcome.

54 JLF, S1 page 41.

55 LM, CP3 page 14.

9.2.1.7.3 ***Recommendation***

> **Recommendation 361:** *That s 341(1)(a)(i), and the corresponding reference in s 341(1)(a)(ii) to "specifically appropriated" inventory, be deleted.*

9.2.2 Corporations Act – s 588FL

9.2.2.1 Should s 588FL be repealed?

9.2.2.1.1 ***The issue***

Section 588FL of the Corporations Act provides that a security interest granted by a company can vest in the grantor if an insolvency event occurs in relation to the grantor, even if the security interest was perfected. This can happen if the security interest:

- was only perfected at the critical time by registration;
- had been granted in the previous 6 months; and
- was not perfected within 20 business days of the day on which the security agreement came into force.

Section 588FL is a successor to what had previously been s 266 of the Corporations Act. That section had provided a similar rule in relation to company charges.

A number of submissions argued that s 588FL should be repealed.[56] Even though it is a successor to a previous provision in the Corporations Act, the submissions argued that the need for the provision had been overtaken by s 267 of the Act, and that it is unnecessary doubling-up to retain s 588FL as well. Some also made the point that s 588FL is not reflective of the unifying principle that underpins the Act as a whole, because it applies to only certain types of grantor (that is, only to companies). Other submissions also pointed out that the requirement for registration within 20 business days of the security agreement can produce timing problems if the grantor does not acquire the collateral until some time later (eg if the collateral is aircraft that can only be registered against its serial number), or if the security interest arises under a lease that only becomes a PPS lease after expiry of the one-year period under s 13.[57]

Consultation Paper 3 supported the proposition that s 588FL of the Corporation Act be deleted, and invited stakeholders to comment.

9.2.2.1.2 ***Discussion of stakeholder feedback***

One respondent argued that s 588FL performed a useful function, by incentivising secured parties to register promptly and so to keep the Register up-to-date.[58] All other respondents were of the view, however, that s 588FL should be repealed.

That is my view as well, for a number of reasons. First, there are other compelling reasons under the Act why a secured party will want to perfect its security interest as early as possible – in particular, to set its priority position, to reduce the risk that a buyer or lessee could take the collateral free of the security interest, and to

56 For example: JLF, S1 page 43; AICM, S1 page 24; LCA, S1 page 12; QLS, S1 page 10; CW, S1 page 8; ABA, S2 page 6.

57 For example: JLF, S1 page 43.

58 LM, CP3 page 13.

remove the risk that the security interest could vest in the grantor under s 267. A secured party that does not register promptly is likely to do so only out of inadvertence, so imposing a further deadline under s 588FL will not result in the registration being made any earlier than might otherwise have been the case. Secondly, the deadline under the section does make it very difficult to register effectively for some types of security interests, as described above. Thirdly, the section runs contrary to the Act's unifying principle, because it applies only to companies, not to all grantors.

9.2.2.1.3 ***Recommendation***

Recommendation 362: *That s 588FL of the Corporations Act be repealed.*

9.2.2.2 **If s 588FL is retained**

9.2.2.2.1 ***The issue***

Consultation Paper 3 suggested, if s 588FL is retained, that it should be amended to clarify a number of matters.

- **Deeds of company arrangement**

  For the reasons discussed above in Section 8.7.7 in relation to s 267 of the Act, the references in s 588FL to "deeds of company arrangement" could be removed.

- **Section 588FL(2)(b) – the "registration time"**

  Section 588FL applies if a security interest is only perfected by registration at the "critical time". The section appears to assume that the security interest will only ever have been perfected by registration, as it does not allow for the possibility that a security interest might initially be perfected by some other means, such as possession or control. This is an unnecessary rigidity in the operation of the provision. It could perhaps be addressed as a drafting matter by replacing "registration time" in the lead–in language of s 588FL(2)(b) with "priority time".

- **Deemed security interests**

  Section 267 of the Act does not apply to security interests by way of a transfer of an account or chattel paper, a commercial consignment or some types of PPS lease, if they are not also in-substance security interests. In contrast, s 588FL appears to apply to deemed security interests in the same way as it applies to in-substance security interests. It is not clear as a policy matter why s 588FL should apply to deemed security interests when s 267 does not.

9.2.2.2.2 ***Discussion of stakeholder feedback***

All respondents agreed, that s 588FL should be amended as described above, if it is not repealed. As one submission pointed out, some consequential amendments would then also need to be made to s 588FN of the Corporations Act, if the definition of PPS lease in s 13 of the Act is amended in accordance with the *Personal Property Securities Amendment (Deregulatory Measures) Bill 2014* and my recommendation in Section 4.3.5.2.[59]

59 JLF, S1 page 44.

9.2.2.2.3 ***Recommendation***

> **Recommendation 363:** *If s 588FL of the Corporations Act is retained despite Recommendation 362, that it be amended:*
>
> - *to remove references to "deeds of company arrangement";*
> - *to allow for the possibility that a security interest can be perfected by means other than registration; and*
> - *so that it does not apply to deemed security interests, consistent with s 267.*

9.2.3 Corporations Act – compulsory acquisitions

9.2.3.1 ***The issue***

Chapter 6A of the Corporations Act allows the bidder in a takeover to compulsorily acquire the remaining shares in the target company if, broadly, the bidder holds 90% or more of the shares in the target. The bidder can do this even if the owners of those remaining shares do not want to sell them.

Before commencement of the Act, a bidder could be confident that it could acquire title to those remaining shares free of a security interest over them, as long as the bidder was not aware of the existence of the security interest. This was possible because of the "*bona fide* purchaser for value and without notice" rule, which allowed a purchaser of the legal title to property to acquire the legal title free of any existing equitable interests, as long as the purchaser paid value for the property and was not aware of the existence of the equitable interest.

That protection is unlikely to be available for a purchaser in the context of the Act. That is either because the *bona fide* purchaser rule is excluded by s 254 of the Act, or because the security interest will be characterised as a legal interest under the Act, rather than an equitable one. As one submission pointed out, the bidder in a takeover will also not be able to rely on the taking free rule in s 50 to compulsorily acquire the remaining shares in its target, because that taking free rule only applies to a "consensual" transaction, which this would not be.[60]

A similar issue applies in relation to forcible transfers or cancellations of shares under a scheme of arrangement or in a managed investment scheme.

The Regulations respond to this point by providing that s 32(1)(a) does not apply to a compulsory acquisition of securities under Part 6A.1 or 6A.2 of the Corporations Act, or to equivalent transactions in the context of a scheme of arrangement or a managed investment scheme.[61] The effect of this appears to be that a security interest in securities that are compulsorily acquired, or in securities or interests in a managed investment scheme that are forcibly transferred or cancelled, will not continue in the securities after the acquisition.

The submission suggested nonetheless that the inability of s 50 to cover this gap is undesirable, and that the Act should deem the types of transactions described above to be consensual so that s 50 can apply to them.

60 JLF, S2 page 14.

61 Reg 7.1 of the Regulations.

Consultation Paper 3 suggested that this was not necessary, on the basis that the Regulations are already achieving the desired result. I am also not in favour of deeming a transaction to be consensual when it is not, as that would be a counter-intuitive use of language of the type I have been endeavouring in other places to remove from the Act.

Consultation Paper 3 suggested, if it is felt that the issue deserves a more enshrined solution than just being addressed through a Regulation, that it should be addressed in the Corporations Act itself.

9.2.3.2 ***Discussion of stakeholder feedback***

Respondents had a range of views on this issue, with no clear consensus.

In my view, it would not be appropriate to amend s 50 in the manner proposed, solely to deal with this issue. It could also be argued that the issue should not be left to the Corporations Act, as that would run counter to the principle that the Act should be as comprehensive in its scope as possible. In my view the best way forward, if the current regulation is thought to be inadequate, is to amend the Act to allow Government to enact additional taking free rules by regulation, and for a specific regulation to be made to the effect the acquirer of securities in the situations described above will take the securities free of all security interests.

9.2.3.3 ***Recommendation***

Recommendation 364: *That:*

- *the Act be amended, if necessary, to enable Government to provide for additional taking free rules in the Regulations; and*
- *regulation 7.1 be amended to operate as a taking free rule.*

9.2.4 Insolvency proceedings

9.2.4.1 Verification of claims in an insolvency proceeding

9.2.4.1.1 ***The issue***

One submission drew attention to the difficulty that insolvency practitioners face when endeavouring to assess the validity and quantum of potential secured claims over an insolvent company's assets.[62] The submission referred to two reported cases, relating to the Hastie group of companies and to Renovation Boys Pty Ltd, as illustrations of the challenge.[63] The submission proposed that the difficulty should be addressed by amending the law to allow a practitioner to give notice to claimants on the Register to verify their claims within a set period (the submission suggested 21 days for this purpose). Claims that are not verified within this period would then be treated as unsecured, or as invalid.

The *Hastie Group* case is a good example of the difficulties that insolvency practitioners face. In that case, there were 995 registrations against the companies in the group. The group's records did not allow the insolvency practitioner to

62 ARITA, S2 page 2.

63 *Carson, in the matter of Hastie Group Limited (No. 3)* [2012] FCA 719; *In the matter of Renovation Boys Pty Ltd (admins apptd)* [2014] NSWSC 340.

identify which property was subject to which security interest. The practitioner asked the secured parties on the Register to provide information that identified their particular collateral, but the majority did not respond to the request. This made it very difficult for the practitioner to know how to deal with the property in the group's possession.

It is clear that the insolvency practitioner appointed to the Hastie Group was in a very difficult position. That, no doubt, is the reason why he applied to Court for directions. What is not clear, however, is whether the situation was any worse under the Act than it would have been under the prior law. To the extent that the registrations related to leased goods or to goods purchased on retention of title terms, for example, my understanding is that the practitioner would have faced similar if not greater challenges if the Hastie administration had been conducted under the laws in force before the Act commenced.

That does not mean, of course, that the proposed change is inappropriate. It does question, however, whether it is an appropriate matter for consideration by this review, or whether it is more properly a question of insolvency law reform. While the Terms of Reference require me to consider the interaction between the Act and other laws, I take that to be a reference to considering issues of interaction that have arisen because of the Act, not issues that would arise whether or not the Act had been passed. For that reason, Consultation Paper 3 proposed that the question be referred to the arm of Government responsible for insolvency law reform for its consideration.

9.2.4.1.2 *Discussion of stakeholder feedback*

A small number of respondents were of the view that I should make a recommendation on this matter, rather than refer it for further consideration. As I have explained above, however, I am not in a position to do this.

All other respondents were comfortable with the proposition that the issue be referred on, as I have proposed.

9.2.4.1.3 *Recommendation*

> **Recommendation 365:** *That the arm of Government responsible for insolvency law reform be asked to consider whether the law should be amended to allow an insolvency practitioner to give notice to claimants on the Register to verify their claims within a set period (such as 21 days), on the basis that unverified claims could then be treated as unsecured.*

9.2.4.2 Liquidator's lien

9.2.4.2.1 *The issue*

One submission noted that a liquidator has an equitable lien over a company's assets to secure its remuneration for work undertaken to secure and realise the insolvent company's assets.[64] The submission went on to observe, however, that the boundaries of the availability of this lien are not clear.

64 ARITA, S2 page 4. See, for example, *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171.

The court in the *Renovation Boys* matter held that a secured party (including a supplier of goods on retention of title terms) could not rely on its security interest to rank ahead of an administrator's lien, because it would be unconscientious to do so.[65] The submission proposed, however, that this principle be confirmed by legislation.

I do not have sufficient information before me to be able to determine whether this is necessary or desirable. Similar to the point discussed in the Section 9.2.4.1, though, I am not satisfied in any event that it is properly within the purview of this review to make recommendations on the question.

For this reason, Consultation Paper 3 proposed that the question be referred to the arm of Government responsible for insolvency law reform, for its consideration.

9.2.4.2.2 *Discussion of stakeholder feedback*

Respondents agreed that this issue should be referred on for further consideration.

9.2.4.2.3 *Recommendation*

> **Recommendation 366:** *That the arm of Government responsible for insolvency law reform be asked to consider whether the law should be amended to clarify the extent to which an administrator's equitable lien should rank ahead of security interests.*

9.2.5 The *Shipping Registration Act 1981*

9.2.5.1 *The issue*

Before the Act commenced practical operation on 30 January 2012, a person who took a mortgage over a registered ship was able to register the mortgage on the Shipping Register, under the *Shipping Registration Act 1981* (the *SRA*). The *Personal Property Securities (Consequential Amendments) Act 2009* (the *Consequential Amendments Act*) amended the SRA, with effect from 30 January 2012, so that ship mortgages could no longer be registered on the Shipping Register, but instead needed to be perfected under the Act.[66]

The SRA allows a person claiming an interest in a registered ship to lodge a caveat in relation to the ship.[67] The existence of a caveat does not prevent a proposed dealing in a ship. Rather, the SRA provides in effect that a proposed dealing cannot be registered on the Shipping Register for 14 days after the notice of the proposed dealing is given to the caveator.[68] This allows the caveator an opportunity to take action to prevent the dealing (eg by seeking an injunction) if it wants to.

In addition to amending the SRA so that mortgages could no longer be registered on the Shipping Register, the Consequential Amendments Act also amended the SRA so that the holder of a security interest under the Act was no longer able to lodge a caveat.[69]

65 *In the matter of Renovation Boys Pty Ltd (admins apptd)* [2014] NSWSC 340.

66 *Personal Property Securities (Consequential Amendments) Act 2009*, item 18 of Schedule 3.

67 *Shipping Registration Act 1981*, s 47A.

68 *Shipping Registration Act 1981*, s 47C.

69 *Personal Property Securities (Consequential Amendments) Act 2009*, item 20 of Schedule 3.

One submission raised two issues in relation to these changes.[70] First, it noted that the changes weaken the position of a caveator, as the Registrar of Ships is only obliged to notify them of the proposed dealings on the Shipping Register (and not the Register under the Act). As security interests over ships are now perfected by registration on the Register under the Act and may not be registered on the Shipping Register, the caveator on the Shipping Register no longer receives notice of security interests.

This is clearly a change from the position that applied before commencement of the Act. In my view, however, it would not be practicable to expect the Registrar of Ships to give notices of registrations that are made on the Register under the Act. A caveator now needs to monitor the Register under the Act if it wants to keep track of such interests, in the same way as secured parties generally. If a secured party enforces its security interest and wants to register a dealing (such as a sale of the ship) on the Shipping Register, of course, then the Shipping Registrar would give a notice of the proposed dealing to registered interest holders and caveators at that point.

The submission also queried why the holder of a security interest under the Act cannot even lodge a caveat under the SRA. This, it seems to me, is a fair question. A caveat does not prevent a dealing from being registered, but simply provides the caveator with notice of the dealing, and a window of time within which it can take action outside the SRA to prevent the dealing if it so wishes. I see no reason why the holder of a security interest over a registered ship should not be able to lodge a caveat against the ship under the SRA, in the same way as is available to the holder of any other interest in a registered ship.

For this reason, Consultation Paper 3 proposed that the SRA be amended to allow a secured party to register a caveat on the Shipping Register.

9.2.5.2 ***Discussion of stakeholder feedback***

All respondents agreed with this recommendation.

9.2.5.3 ***Recommendation***

> **Recommendation 367:** *That the Shipping Registration Act 1981 be amended to allow a secured party to lodge a caveat on the Shipping Register.*

9.2.6 The *International Interests in Mobile Equipment (Cape Town Convention) Act 2013*

9.2.6.1 ***The issue***

The *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* received Royal Assent on 28 June 2013. The substance of the legislation (the *Cape Town Act*) will not come into force, however, until Australia accedes to the UNIDROIT *Convention on International Interests in Mobile Equipment* (the *Cape Town Convention*).

70 Ashurst, S2.

The objective of the Cape Town Convention is to regulate and protect security interests in mobile property such as aircraft or rolling stock. It applies to different types of mobile property by means of separate Protocols to the Convention. One such Protocol deals with the application of the Convention to "aircraft objects". Among other things, the Convention and that Protocol establish an "International Registry" for the registration of security interests in aircraft objects, and set out rules to regulate priority competitions between such security interests.

The Cape Town Act states that the Cape Town Convention will prevail over any other Australian law to the extent of any inconsistency. This means that a priority dispute between security interests in aircraft objects will be governed by the Cape Town Convention, to the extent that it provides a rule for the dispute. The Act will continue to apply to security interests over aircraft objects, however, in relation to matters not addressed by the Cape Town Convention. The Act has also been amended to recognise that it is subject to the Cape Town Act, although the amendment has not yet commenced operation.[71]

As I understand it, Government is continuing to work through implementation issues for the Cape Town Act. This includes identifying relevant inconsistencies between the Cape Town Convention and the Act, and determining how they should be addressed.

Consultation Paper 3 invited stakeholders to indicate whether they were aware of any particular issues arising out of the Cape Town Act that need to be considered in the context of the review.

9.2.6.2 ***Discussion of stakeholder feedback***

One respondent observed quite rightly that care will need to be taken to ensure that the registration rules in the Cape Town Convention and the Act do not produce mutually inconsistent results.[72] Apart from that, respondents did not raise any particular issues for consideration by this review.

9.3 Other provisions in the Act

9.3.1 Section 275 – requests to a secured party for more information about its security interest

9.3.1.1 **The rules**

The Register does not necessarily provide a searcher with precise information about exactly what collateral might be subject to a secured party's security interest. Instead, the Register may only alert a searcher to the fact that a secured party may have a security interest over some of the collateral described in a registration. If a searcher wants to confirm whether or not a secured party has security over a particular item of collateral, the searcher needs to employ other mechanisms to do this.

Section 275 contains such a mechanism. It provides that certain "interested persons" may require a secured party to provide them with more information about the secured party's security by:

71 Section 256(d) of the Act, inserted by the *International Interests in Mobile Equipment (Cape Town Convention) (Consequential Amendments) Act 2013*.

72 LM, CP3 page 15.

- providing a copy of the security agreement;
- providing information about the amount secured; or
- responding to questions about the identity of the collateral.

Not every person who searches the Register is entitled to request information from a secured party under s 275. The "interested persons" who can do so are limited by s 275(9) to:

(a) the grantor in relation to the collateral in which the security interest is granted;

(b) a person with another security interest in the collateral mentioned in paragraph (a);

(c) an auditor of a grantor mentioned in paragraph (a), if the grantor is a body corporate;

(d) an execution creditor with an interest in the collateral;

(e) an authorised representative of any of the above.

Even those "interested persons" do not have an unfettered right to require a secured party to respond to a request under the section. Section 275(6) provides, for example, that a secured party does not need to respond if:

(a) subject to subsection (7), the secured party and the debtor have agreed (the ***confidentiality agreement***) in writing that neither the secured party nor the debtor will disclose information of the kind mentioned in subsection (1); or

(b) the response would contravene any of the following:

(i) a law of the Commonwealth, a State or a Territory;

(ii) the general law; or

(c) the response would disclose information that is protected against disclosure by a duty of confidence.

Even if a secured party and debtor have entered into a confidentiality agreement in accordance with s 275(6)(a), though, s 275(7) states that the secured party will still be required to provide the requested information if:

(a) the confidentiality agreement is made after the security agreement that provides for the security interest is made; or

(b) at the time the request is received, the debtor is in default under the security agreement; or

(c) the debtor, in writing, authorises the disclosure of the information; or

(d) the grantor requests the secured party to give the information to the grantor; or

(e) the request is made by an auditor of the grantor, if the grantor is a body corporate.

There are similar provisions to s 275 (other than ss 276(6) and (7)) in most of the Canadian PPSAs,[73] and in the NZ PPSA.[74]

73 For example Sask PPSA, s 18.

74 NZ PPSA, s 177.

9.3.1.2 Should the range of "interested persons" be widened?

9.3.1.2.1 *The issue*

Two submissions suggested that the list of interested persons in s 275(9) was too narrow, and should be widened.[75] One submission suggested that the list should include personal representatives, prospective transferees and financiers.[76] The other submission suggested that the list be expanded to transferees for value, and prospective execution creditors.[77]

As I understand it, the list of interested persons in s 275(9) is deliberately limited to persons who already have an interest in the collateral, or are the grantor's auditors. A person who is considering whether to take an interest in collateral cannot use s 275 themselves. If they want the secured party to provide them with information, they must ask the grantor to make the request to the secured party instead. If a grantor makes a request under s 275, it can then specify the person's address to the secured party as the address to which the information is to be sent,[78] and procure that the secured party sends the information directly to the person in this way. A similar process is available under the Canadian PPSAs[79] and the NZ PPSA.[80]

Turning to the suggested additions to the list, I expect that a "personal representative" would be covered already by s 275(9)(e) as an "authorised representative", and that a prospective transferee or financier would be able to arrange for the grantor to make the request for them.

I believe that a transferee for value is also covered already, albeit for a different reason. If collateral has been transferred subject to a security interest, then the transferee will become the grantor of the security interest for the purposes of the Act.[81] This means that they will be able to make the request under s 275(9)(a).

A prospective execution creditor – a judgment creditor who is contemplating whether to seek execution against the judgment debtor's assets – is in a different position. As the prospective execution creditor does not yet have an interest in the collateral, it cannot make a request itself, and it is unlikely to be able to persuade the grantor to make the request on its behalf. Unless it has the information, however, it is unlikely to be able to determine what assets it can execute against.

A secured creditor would not want to be required to respond to a request for information from any unsecured creditor of its grantor. This is less of an issue, though, if the request may only be made by an unsecured creditor that has obtained a court order for payment of the amount it is owed.

For these reasons, Consultation Paper 4 proposed that the list of interested persons in s 275(9) be expanded to include a judgment creditor that is considering whether to enforce its judgment by seeking execution against property that is described in the secured party's registration, but not to include the other types of parties proposed in the submissions.

75 LCA, S2 page 20; DT, S2 page 12.

76 DT, S2 page 12.

77 LCA, S2 page 20.

78 Under s 275(2).

79 For example Sask PPSA, s 18(1).

80 NZ PPSA, s 177(1).

81 See the discussion in Section 7.2.

9.3.1.2.2 ***Discussion of stakeholder feedback***

One respondent did not agree with this proposal. All other respondents agreed, however, that the list of interested persons in s 275(9) should be expanded in this way.

One respondent queried whether it was sufficiently clear that company receivers or insolvency officials such as administrators or liquidators could make use of the mechanisms in s 275. I expect that they may be covered by either of s 275(9)(a) or (e). I accept, however, that this should be looked into further, and that the section should be clarified along those lines if this proves to be necessary.

9.3.1.2.3 ***Recommendations***

Recommendation 368: *That the list of "interested persons" in s 275(9) be expanded to include a judgment creditor of a grantor that is considering whether to enforce its judgment by seeking execution against property that is described in the secured party's registration.*

Recommendation 369: *That Government investigate further whether it is sufficiently clear that company receivers, and insolvency officials such as administrators or liquidators, that have been appointed to a grantor are able to make use of the information-gathering powers in s 275, and that the section be amended, if necessary, to ensure that this is the case.*

9.3.1.3 **The timeframe for responses**

9.3.1.3.1 ***The issue***

Section 277 says that a secured party must respond to a request for information under s 275 within 10 business days.

One submission argued that this timeframe is too generous, and that it can make it more difficult for a grantor to raise finance from a new financier because of the delay that it can add to the lending decision.[82]

I can understand that an incoming financier might want to be able to receive the information in less than 10 business days. Equally, though, I can see that it might not be easy for an existing secured party to receive and respond to a request for information more quickly than that. I note that the NZ PPSA also allows a secured party 10 working days to provide a response.[83]

For these reasons, Consultation Paper 4 indicated that I was not persuaded at that stage that the response period under s 275 should be shortened.

9.3.1.3.2 ***Discussion of stakeholder feedback***

One response supported a change to 5 business days. All other responses, however, were in favour of the timeframe remaining 10 business days, as it is at present. I agree that there is no clear case for the timeframe to be shortened, and so do not propose to recommend any change.

82 DIFA, S2 att A page 6.

83 NZ PPSA, s 178.

9.3.1.3.3 ***Recommendation***

> **Recommendation 370:** *That the period within which a secured party must respond to a request for information under s 275, as set out in s 277, remain 10 business days.*

9.3.1.4 **Does a secured party need to provide an entire copy of the security agreement?**

9.3.1.4.1 ***The issue***

A security agreement will often contain much more than the grant of the security interest and a description of the collateral. It will commonly contain a range of other commercial matters as well, some of which may be confidential to the secured party. For this reason, a secured party may be reluctant to provide an entire copy of its security agreement in response to a request under s 275, and may want to provide only a redacted version.

One submission observed that some secured parties have responded to this concern by altering their documentation practices so that their security agreements contain only the bare bones required for such an agreement.[84] The commercially-sensitive provisions are then included in a different document. That is indeed one way of dealing with this issue, but it is not a particularly satisfactory one – the Act is intended to facilitate secured finance rather than make it more complicated, and it is not desirable for the Act to force secured parties to adopt more convoluted lending practices than might otherwise need to be the case.

A number of submissions proposed that it be made clear that a secured party is allowed to redact (or black out) sensitive sections of the security agreement before it sends it off.[85]

Consultation Paper 4 expressed the view that this seemed to be a sensible proposal, and that the information that an "interested person" should be able to ascertain from reading the security agreement is:

- the identity of the grantor and the secured party;
- the identity of the collateral that is or could be subject to the security agreement; and
- the manner in which the amount secured is determined,

to the extent that these matters are in fact ascertainable from the security agreement. A secured party should be entitled to redact or black out any information that is not relevant to these matters.

9.3.1.4.2 ***Discussion of stakeholder feedback***

A number of responses did not agree that a secured party should be able to redact its security agreement before sending it out in response to a request under s 275. They argued that there may be other provisions in the security agreement that could be of interest to the person making the inquiry, beyond the list set out in the above discussion. The great majority of respondents were of the view,

84 ABA, S2 page 9.

85 For example: ABA, S2 page 9.

however, that a secured party should be able to redact its security agreement as described above.

This concern is more acute than had been the case under prior law such as the Corporations Act, as the functional concept of a security interest means that it captures interests under commercial agreements that would not have been registrable as security interests under previous law. A copy of a charge needed to be registered with ASIC under the Corporations Act as it applied before commencement of the Act, but it was quite uncommon for a charge document to contain commercially-sensitive provisions. A commercial supply agreement or a joint venture agreement (to take just two examples), in contrast, are likely to contain commercially-sensitive information, and the parties to such an agreement may not want to be obliged to disclose the commercially-sensitive information to outsiders. While the secured party's interests are protected, at least to some extent, if it has also entered into a confidentiality agreement, it is not clear to me as a matter of principle why a secured party should be obliged to disclose more information about the terms of its security agreement than the matters described above. This was also the view of the great majority of respondents.

9.3.1.4.3 ***Recommendation***

> **Recommendation 371:** *That s 275 be amended to provide that a secured party is only required to provide those parts of a security agreement that are relevant to ascertaining the identity of the grantor and the secured party, the identity of the collateral, and the amount or obligation that is secured.*

9.3.1.5 **Confidentiality agreements – s 275(6)(a)**

9.3.1.5.1 ***The issue***

As noted in Section 9.3.1.1 above, s 275(6)(a) provides that a secured party does not need to make a disclosure under s 275 if (subject to some exceptions) the secured party and the debtor have agreed in writing that neither of them will disclose "information of the kind mentioned in [s 275(1)]".

This raises a number of questions. First, it is not clear why the provision is limited to confidentiality agreements between the secured party and the "debtor". As one submission noted, it is equally likely (if not more so) that the secured party will have entered into a confidentiality agreement with the grantor (indeed, it may have included the confidentiality provisions in the security agreement itself), and a confidentiality agreement with the grantor should also be sufficient to engage the exemption.[86]

Secondly, as the same submission pointed out, it is common for a confidentiality clause in a security agreement to oblige the grantor not to disclose information about the transaction, but to leave the secured party free to make disclosures itself if it so wishes. The clause may go on to say that while the secured party can disclose information to third parties, it is not obliged to. It is worth considering whether this type of confidentiality agreement should engage the exemption as well.

86 JLF, S1 page 40.

Thirdly, the same submission noted that even if a confidentiality clause does prohibit the secured party from disclosing information, it will usually contain some carve-outs. For example, such a clause would typically allow the secured party to disclose information if required to do so by law, or to its advisers. It is not clear that the language of s 275(6)(a) can currently accommodate carve-outs of this type.

Consultation Paper 4 provided stakeholders with the opportunity to comment on these matters.

9.3.1.5.2 ***Discussion of stakeholder feedback***

All respondents agreed with each of these observations. Some responses suggested that the drafting of s 275 could then be simplified further, and just say that a secured party is not required to provide information under the section if it has agreed this with the grantor. That may well be the effect, if s 275(7) is amended in line with my recommendation in the Section 9.3.1.6 below.

9.3.1.5.3 ***Recommendation***

Recommendation 372: *That s 275(6)(a) be amended to read along these lines:*

> *"subject to subsection (7), the secured party has agreed with the debtor or the grantor (a **confidentiality agreement**) that the secured party is not obliged to respond to such a request".*

9.3.1.6 **Confidentiality agreements – the qualifications in s 275(7)**

9.3.1.6.1 ***The issue***

As noted in Section 9.3.1.1, s 275(7) says that a secured party cannot rely on the existence of a confidentiality agreement as grounds for not responding to a request for information under s 275(1) if:

(a) the confidentiality agreement is made after the security agreement that provides for the security interest is made; or

(b) at the time the request is received, the debtor is in default under the security agreement; or

(c) the debtor, in writing, authorises the disclosure of the information; or

(d) the grantor requests the secured party to give the information to the grantor; or

(e) the request is made by an auditor of the grantor, if the grantor is a body corporate.

This language raises a number of questions.

First, it is difficult to see why paragraphs (a) and (b) have been included. I am not aware of any reason why paragraph (a) needs to state that a confidentiality agreement will be insufficient for the purposes of s 275(6) merely because it is entered into later than the security agreement. I also cannot see why a confidentiality agreement should become ineffective under paragraph (b) just because the debtor is in default. It might be thought that persons with an interest in collateral would have a legitimate interest in knowing more about the security agreement when the debtor is in default, as that means that the secured party may enforce its security interest

against the collateral. However, their position is unlikely to be potentially worsened until the secured party actually starts enforcing, and once it does that, then the notice requirements in Chapter 4 are engaged instead.[87]

Secondly, paragraphs (c) and (d) appear to proceed on the assumption that the confidentiality agreement will have been entered into for the benefit of the debtor or grantor, so that it should be open to them to waive the confidentiality and require the secured party to provide the information, if they so wish. It is not unlikely, however, that the secured party may have an interest in keeping the terms of the financing confidential, and that it (and not the debtor or grantor) will have required the confidentiality clause. It is difficult to see in such a situation why the debtor or grantor should be able to turn its back on the agreement it has struck with the secured party, and authorise the disclosure anyway.

Thirdly, even if it is thought appropriate to retain paragraphs (c) and (d) as a matter of principle, it is not clear why the wording of the two paragraphs is structured so differently. If they are intended to achieve similar outcomes, then it would remove a source of confusion if they were structured in the same way.

It is also not clear why a debtor should be able to authorise the disclosure of information about the grantor or the collateral under paragraph (c), rather than just information about the amount that the debtor itself owes.

Consultation Paper 4 provided stakeholders with the opportunity to comment on these matters.

9.3.1.6.2 ***Discussion of stakeholder feedback***

Respondents had mixed views on these questions. The majority of respondents agreed, however, that all of paragraphs (a) to (d) in s 275(7) could be deleted. It is likely, also, that auditors (referred to in s 275(9)(e)) would be able to require secured parties to provide information through the grantor. If that is the case, then s 275(7) could be deleted in its entirety.

9.3.1.6.3 ***Recommendation***

Recommendation 373: *That s 275(7) be deleted.*

9.3.1.7 **Disclosure that is prevented by a duty of confidence**

9.3.1.7.1 ***The issue***

Section 275(6)(c) states that a secured party is not required to respond to a request under s 275(1) if the response would disclose information that is protected by a "duty of confidence".

It is likely that s 275(6)(c) is referring to a duty of confidence that arises by operation of law rather than contract, as duties of confidence that arise by contract are addressed by s 275(6)(a) (ie as confidentiality agreements).

One duty of confidence that arises by operation of law is the duty of confidence that bankers owe to their customers in relation to information about their accounts with the bank.[88] The duty of confidence extends to information about securities

87 Note, however, the discussion in Section 8.1.1 about the extent to which those requirements should be mandatory.

88 See *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461.

granted by the customer, so this might mean that a bank would not need to disclose information under s 275 in relation to a grantor that is the bank's customer (as would usually be the case).

A banker's duty of confidence is however subject to a number of qualifications. One such qualification is that disclosure is not prohibited if the disclosure is required by law.[89]

This produces a circular outcome for the purposes of s 275. Section 275 contains a legal requirement to disclose, but that requirement does not apply if it would require a breach of a duty of confidence. A bank has a duty of confidence not to disclose information, but that duty does not apply if a disclosure is required by law.

One submission said that this uncertainty should be clarified.[90] Consultation Paper 4 suggested that the circularity should perhaps be broken by allowing the banker's duty of confidence to prevail.

9.3.1.7.2 ***Discussion of stakeholder feedback***

A number of respondents agreed that the banker's duty of confidence should prevail. The majority of respondents thought, however, that the banker's duty of confidence should be subject to the section. In my view, the important point is that the circularity should be broken, and I am comfortable recommending that this be done by giving priority to disclosure under the section, rather than to the banker's duty of confidence.

9.3.1.7.3 ***Recommendation***

> **Recommendation 374:** *That it be made clear that the banker's duty of confidence cannot be relied on to block a disclosure that would otherwise be required by s 275(1).*

9.3.2 Section 339 – references to fixed and floating charges

9.3.2.1 ***The issue***

Section 339 of the Act provides, broadly, that a reference in a law of the Commonwealth or in a security agreement to a "charge" is deemed (with some exceptions) to be a reference to a security interest over a circulating asset or a non-circulating asset, depending on whether the charge is fixed or floating.

The Commonwealth amended its legislation as part of the introduction of the Act to replace all references to a "charge" with appropriate references to a "security interest".[91] I am advised that all relevant Commonwealth laws have been amended. That suggests that s 339 is no longer needed, at least as it applies to laws of the Commonwealth.

The section also applies to references to charges in security agreements that are entered into after the registration time.[92] It is very difficult to understand, however, exactly what this aspect of the section is trying to accomplish, and why. A security

89 See the previous footnote.

90 ABA, S2 page 9.

91 See the *Personal Property Securities (Consequential Amendments) Act 2009*.

92 Section 318(b) of the Act.

interest that is expressed to be a charge will be a security interest for the purposes of the Act as a result of the definition of a security interest in s 12, and the Act does not need s 339 to achieve this. The operation of the definition of a "circulating asset" in s 340 will also not be affected by the fact that a security interest is described as a charge. The only respect in which the characterisation of a security interest as a charge might have a flow-on effect on the concept of a "circulating asset" is where the charge is a floating charge, as the characterisation of a charge as floating would imply that the secured party had authorised the grantor to transfer the collateral in the ordinary course of its business, making the affected collateral a circulating asset under s 340(1)(b).

This point may cease to be relevant if the concept of a circulating asset is restructured, as I have recommended in Section 9.2.1.1. Even if the concept is retained, though, s 340(1)(b) will be able to do its job whether or not the Act contains s 339. Section 339 appears to have no meaningful role to perform.

Consultation Paper 3 asked whether stakeholders could provide an explanation of the role that s 339 performs in the Act and proposed, if it has no meaningful role, that s 339 be deleted.

9.3.2.2 ***Discussion of stakeholder feedback***

All respondents agreed that s 339 should be deleted.

9.3.2.3 ***Recommendation***

Recommendation 375: *That s 339 be deleted.*

9.3.3 Letters of credit

9.3.3.1 ***The issue***

One of the hallmarks of a good secured transactions law is that it applies a consistent set of rules to all types of collateral. This will not always be possible or desirable, however, as other policy objectives may make it necessary to include additional specific rules for particular types of collateral.

Perhaps with that in mind, the Act contains a number of provisions that are specific to letters of credit. For example, a letter of credit that states that it must be presented on claiming payment is defined to be a type of "negotiable instrument" under the definition of that term in s 10. Sections 21(2) and 28 provide that a right that is evidenced by certain types of letters of credit is a category of collateral over which a secured party may perfect by control. And ss 239(6) and 240 provide some particular choice of law rules in relation to a security interest over such a right.

I have separately made recommendations regarding the extent to which it is appropriate to treat rights under a letter of credit as a species of negotiable instrument,[93] whether it is appropriate for a secured party to be able to perfect over such rights by control,[94] and about the rules in ss 239(6) and 240.[95]

93 See Section 7.6.13.1.

94 See Section 5.3.9.

95 See Section 9.1.9.1.

The combined effect of my other recommendations in relation to letters of credit may be that the Act ends up treating rights under a letter of credit no differently to other payment intangibles. This would be consistent with the way that security interests over letters of credit were treated under the general law. I am conscious, however, that the overseas equivalents to our Act paid particular attention to rights under letters of credit, and I was concerned through the consultation process to ensure that the effectiveness of the Act was not inadvertently compromised by not according them any specific treatment.

For this reason, Consultation Paper 3 asked stakeholders whether they had any suggestions for ways in which the Act should treat security interests over rights under letters of credit in a manner that is different to security interests over other forms of payment intangible.

9.3.3.2 ***Discussion of stakeholder feedback***

Respondents did not propose any specific requirements for letters of credit. Respondents expressed a preference for letters of credit to be treated in the same fashion as other equivalent personal property.

9.3.3.3 ***Recommendation***

Recommendation 376: *That the Act not incorporate any specific provisions for letters of credit, other than any provisions that might remain as a result of Government's decisions in relation to other Recommendations in this report.*

9.3.4 Intellectual property

9.3.4.1 Introduction

The Act contains a number of provisions that deal specifically with "intellectual property" and "intellectual property licences". Those terms are defined in s 10:

> ***intellectual property*** means any of the following rights (including the right to be a party to proceedings in relation to such a right):
>
> (a) the right to do any of the things mentioned in paragraphs 10(1)(a) to (f) of the Designs Act 2003 in relation to a design that is registered under that Act;
>
> (b) the right to exploit or work an invention, or to authorise another person to exploit or work an invention, for which a patent is in effect under the Patents Act 1990;
>
> (c) the rights held by a person who is the registered owner of a trade mark that is registered under the Trade Marks Act 1995;
>
> (d) the right to do, or to license another person to do, an act referred to in section 11 of the Plant Breeder's Rights Act 1994 in relation to propagating material of a plant variety;
>
> (e) the right to do an act referred to in section 17 of the Circuit Layouts Act 1989 in relation to an eligible layout during the protection period of the layout;
>
> (f) the right under the Copyright Act 1968 to do an act comprised in the copyright in a literary, dramatic, musical or artistic work or a published edition of such a work, or in a sound recording, cinematograph film, television broadcast or sound broadcast;

(g) a right under or for the purposes of a law of a foreign country that corresponds to a right mentioned in any of paragraphs (a) to (f).

Intellectual property licence means an authority or licence (within the ordinary meaning of that term) to exercise rights comprising intellectual property.

The main provisions in the Act that deal specifically with intellectual property and intellectual property licences are these:

- s 31(1), which confirms that royalties payable under a licence of intellectual property are "proceeds" for the purposes of the Act;
- s 40(5), which provides that the temporary perfection rule in s 40(1) is not available for collateral that is intellectual property or an intellectual property licence;
- s 105, which describes how the Act applies to intellectual property rights that relate to goods;
- s 106, which describes what happens to a security interest in an intellectual property licence, if the intellectual property is transferred;
- s 128(2)(c), which provides that a secured party that enforces its security interest in intellectual property may "dispose" of the intellectual property by licence; and
- ss 237(2) and 239(3), which provide specific choice of law rules for intellectual property and intellectual property licences.

Importantly, intellectual property is a type of collateral that may or must be described by its serial number in a registration.[96] This means that a security interest over intellectual property is exposed to the "taking free" rule in s 44 of the Act.

A number of these provisions have been discussed in other parts of this report. The following Sections identify some additional issues for consideration.

9.3.4.2 The meaning of "intellectual property"

9.3.4.2.1 *The issues*

Not just registered intellectual property?

The definition of "intellectual property" in s 10 is limited to intellectual property that is the subject of legislative regulation (designs, patents, trade marks, plant breeder's rights, circuit layouts and copyright). It does not extend to other types of property that could be thought of as "intellectual property" in the broader sense, such as unregistered trade marks or, potentially, confidential information or domain names.

Consultation Paper 3 asked whether stakeholders were of the view that it is appropriate to limit the definition of the term as at present, or whether there could be value in defining the term in a more general way.

"Right to be a party to proceedings"?

The definition of "intellectual property" in s 10 includes "the right to be a party to proceedings" in relation to any of the types of intellectual property listed in the definition. It is not immediately apparent why the definition provides for this.

96 See item 2.2 of Schedule 2 to the Regulations.

Consultation Paper 3 also asked whether stakeholders could explain why the definition is extended in this way.

9.3.4.2.2 ***Discussion of stakeholder feedback***

Not just registered intellectual property?

As one respondent observed, this question is unique to the Act, as none of the overseas PPSAs (or Article 9) refers specifically to intellectual property (including, importantly, in their equivalent to s 44).[97]

One respondent suggested that the definition should continue to be limited to registered intellectual property, on the basis the Act uses the term "intellectual property" principally by reference to the fact that it has a serial number.[98] As I have explained a little earlier, however, that is by no means only the case, and there are provisions in the Act where the term should arguably have a broader meaning. Examples could include: the definition of "proceeds" in s 31(1); s 106 (if that section is retained);[99] s 128(2)(c); and ss 237(2) and(3).

Other responses were of the view that the term should have a broader meaning, at least in some contexts.

In my view, some of the references in the Act to "intellectual property" should be broader than they are at present. Indeed, it may be that the only section in the Act that needs to be limited to registered intellectual property is s 44. If that is the case, then the term as used in the Act at large should have a broader meaning, and the more limited meaning for the purposes of s 44 could be established through the Regulations, in the way in which they identify the types of property that "may, or must, be described by serial number in a registration". If there are other provisions in which the term should have a more limited meaning, then the Act could perhaps achieve this by means of a definition of "registered intellectual property".

One response suggested, if the Act is to continue to use the term "intellectual property", that it would be preferable to delete the definition of the term altogether, so that the Act uses the general law meaning instead.[100] That would allow the Act to keep pace with the general law meaning, as it might develop over time. I agree with that suggestion.

"Right to be a party to proceedings"?

Some respondents did not think it was necessary to delete these words, although they did not offer an explanation for them. Other respondents were of the view that they should be removed.

It is difficult to see what these words add to the definition of "intellectual property" (if the definition is retained). Unless there is a cogent explanation for them, then my view is that they should be deleted.

97 AD, CP3 page 23.

98 JLF, CP3 page 22.

99 See Section 9.3.4.4 below.

100 DT, CP3 page 20.

9.3.4.2.3 ***Recommendations***

Recommendation 377: *That the definition of "intellectual property" in s 10 be deleted.*

Recommendation 378: *That careful consideration be given to the manner in which the term "intellectual property" is used in the Act, and if there are provisions in which the breadth of the term should be limited to registered intellectual property, that those provisions be amended accordingly.*

Recommendation 379: *That the definition of "intellectual property" in s 10 be amended, if it is retained, by deleting the text "(including the right to be a party to proceedings in relation to such a right)", unless a good reason can be identified for retaining it.*

9.3.4.3 **Section 105 – intellectual property relating to goods**

9.3.4.3.1 ***The issue***

Section 105(1) says this:

> (1) This Act applies to intellectual property rights (including rights exercisable under an intellectual property licence), in relation to goods, in the same way as it applies to the goods, if:
>
> (a) the exercise by a secured party of rights in relation to the goods arising under a security agreement necessarily involves an exercise of the intellectual property rights; and
>
> (b) the payment or obligation secured by the security interest is (in addition) secured by a security interest that is attached to the intellectual property rights.

Section 105(2) then says, if a registration perfects the security interest over the goods, that a description of the goods in the registration or in the security agreement will be taken to include a description of the intellectual property rights or of a licence that is required to exercise them.

There is no equivalent provision in any of the Canadian PPSAs, or the NZ PPSA.

The effect of s 105 is not clear. The section is likely in any event to have only limited application. This is because the section is only engaged if the exercise by a secured party of rights in relation to the goods "necessarily" involves an exercise of the intellectual property rights, and if the secured party has taken an "additional" security interest over the intellectual property rights.

The Replacement Explanatory Memorandum provides an example of the operation of s 105.[101] It is not clear that the example is an accurate one, as the facts given in the example do not appear to capture the requirement that the obligation secured by the security interest be secured "in addition" by a security interest over the intellectual property rights. That perhaps emphasises the uncertain operation of the section.

101 Replacement Explanatory Memorandum para 3.30.

Consultation Paper 3 invited stakeholders to suggest ways in which the section could be made more meaningful.

Consultation Paper 3 also asked whether the section is desirable at all, as a matter of policy. It appears to assist a secured party (eg by simplifying the process for taking security over the intellectual property rights), but adversely affects a searcher of the Register, as a search against the details of the intellectual property alone would not reveal the existence of the security interest over it.

9.3.4.3.2 ***Discussion of stakeholder feedback***

A small number of respondents did not think that any change to s 105 was necessary. The majority of respondents were of the view, however, that the section should be deleted.

Section 105 has been a source of confusion and uncertainty. It also appears to be inconsistent with the principles that are recommended by the UNCITRAL IP Supplement, as that document recommends, in the case of goods with respect to which intellectual property is used, that a security interest in the goods should not extend to the intellectual property.[102] I agree that s 105 should be deleted.

9.3.4.3.3 ***Recommendation***

Recommendation 380: *That s 105 be deleted.*

9.3.4.4 **Section 106 – licences of intellectual property**

9.3.4.4.1 ***The issue***

Two responses to Consultation Paper 3 suggested that s 106 should be deleted.[103]

9.3.4.4.2 ***Discussion***

Section 106(1) says this:

> (1) If:
>
> (a) a security interest is granted in an intellectual property licence; and
>
> (b) the intellectual property in which the licence is granted is later transferred; and
>
> (c) the licensee of the intellectual property licence continues to hold the licence after the transfer;
>
> the security agreement that provides for the security interest binds every successor in title to the licensor of the intellectual property licence to the same extent as the security agreement was binding on the licensor.

Section 106(2) provides a similar rule for sub-licences.

Section 106 provides in effect that a transferee of intellectual property is bound by a security interest over a licence of the intellectual property, to the same extent that the transferor was bound. The responses pointed out, however, that a security interest granted by a licensee does not ordinarily bind the licensor, so that the section is unlikely to be engaged.

102 UNCITRAL IP Supplement, paras 108 to 112 and recommendation 243.

103 SP, CP3 page 26; JLF, CP3 page 23.

I agree with those responses. Section 106 is only likely to be relevant if a licensor of intellectual property has agreed with the licensee's secured party that it will be bound by the terms of the licensee's security interest. If the parties have gone to the effort of entering into such an agreement, then it would be open to them to provide in that agreement that the licensor must ensure that any future transferee of the licence will be bound by the agreement as well. I do not see why the Act needs to pre-ordain that outcome.

I am mindful, however, that stakeholders generally have not had an opportunity to comment on this proposal. For that reason, I propose to recommend that it be deleted, but that Government afford stakeholders an opportunity to speak against that recommendation before it is implemented, and that Government decide whether to retain or delete the section in light of any such additional feedback.

9.3.4.4.3 ***Recommendation***

> **Recommendation 381:** *That Government ask stakeholders whether s 106 should be retained and, if no good reasons are put forward for retaining s 106, that it be deleted.*

9.4 Layout of the Act, and related matters

9.4.1 Location of mechanical and other supporting provisions

9.4.1.1 ***The issue***

Many of the submissions made the point that the Act is very complex and hard to work with. The very size of the Act makes the task of approaching it a daunting one, and the volume of material in it increases the risk that a reader who is trying to understand how the Act affects a particular transaction might inadvertently miss a provision that is relevant to their analysis.

The Act deals with a complex area of law, and will never be able to be short and simple. The Act is much longer than the Canadian PPSAs and the NZ PPSA, however. The Sask PPSA runs to 92 pages, and the body of the NZ PPSA has 123 pages. The Act, in contrast, has 308 pages. Many of the recommendations in this report will help to simplify and so shorten the Act, but even if those recommendations are adopted, the Act will still be significantly longer than its peers.

Much of the additional content of the Act deals with what might loosely be described as machinery or implementation matters. These are provisions that do not directly affect the application of the Act to businesses or consumers on a day-to-day basis, but help to ensure that the Act works effectively as a matter of Australian law. While important, they do add greatly to the bulk of the Act, and make the Act more difficult to understand and use, particularly as the machinery and implementation provisions are interspersed throughout the body of the Act.

One easy way to make the Act much less unwieldy and much more approachable would be to remove the machinery or implementation provisions from the main body of the Act. They could be moved, for example, into Schedules at the back

of the Act. An even more effective option, though, might be to relocate them into a separate piece of legislation altogether, into what might be called for example a *PPS (Constitutional, Judicial and Other Supporting Provisions) Act*.

Consultation Paper 3 suggested that the provisions that might be able to be relocated in this way could be most, or all, of:

- Part 5.2 (establishment of the Register)
- Part 5.5A (conditions on access to data through the Register)
- Division 2 of Part 5.6 (administrative and judicial processes for amendment demands)
- Parts 5.7 to 5.9 (management of the Register and establishment of the office of the Registrar)
- Part 6 (judicial proceedings)
- Part 7.3 (constitutional matters)
- Part 7.4 (relationship between the Act and other laws)
- Part 8.7 (forms and regulations)
- Parts 9.1 to 9.4 (transitional matters).

This would reduce the length of the Act from its current 308 pages by a little under one third, to around 220 pages. It would then be desirable to include some notes in the Act in appropriate places to direct readers to relevant parts of the supporting legislation, but the resultant Act would still be much shorter and easier to navigate around than the Act in its current form.

This suggestion might seem to be more cosmetic than substantive, and at one level it is. However, part of the current difficulty with the Act is that users are put off by its very bulk. Shortening the Act in this way would make it much less daunting and much more accessible than it is at present, in a way that does not compromise the value of its content to businesses or consumers.

9.4.1.2 ***Discussion of stakeholder feedback***

A number of respondents argued that the Act should not be split in this way, and that it is convenient to have all the current contents of the Act in the one place. The majority of respondents were of the view, however, that it would help to make the Act easier to use if background material could be moved to a separate piece of legislation.

Some responses suggested that further thought might need to be given to just which parts of the Act should be separated out. A number of responses suggested, for example, that the provisions dealing with amendment demands, in Division 2 of Part 5.6, should stay in the Act. I can see good sense in that suggestion, and agree that those provisions could usefully remain in the Act.

Everyday users of the Act are very unlikely to be concerned with the constitutional, judicial and other supporting provisions in the Act. Those provisions are only rarely referred to in my experience, and even then are only referred to by experienced practitioners who should not be too inconvenienced by the fact that they are in a different piece of legislation. In my view, the Act as a whole would be much more accessible for the great majority of users, if it were split up in this way.

9.4.1.3 ***Recommendation***

Recommendation 382: *That the constitutional, judicial and other supporting provisions in the Act be relocated into a separate piece of supporting legislation.*

9.4.2 Other changes relating to presentation

9.4.2.1 Reorganise the contents?

9.4.2.1.1 ***The issue***

Two submissions suggested that the accessibility of the Act could be enhanced if some of its contents were reorganised.[104]

9.4.2.1.2 ***Discussion***

The contents of the November 2008 Exposure Draft of the Bill for the Act was substantially restructured in 2009, in response to a recommendation to that effect by the Senate Standing Committee on Legal and Constitutional Affairs.[105] The contents of the Bill were re-ordered in a way that made them much more accessible than had been the case in the first two public drafts.

Despite that work, there may well be further ways to re-order the material in the Act to make it more user-friendly than it is at present. I agree that it would be valuable to bear this in mind as the Act is being amended in response to the other recommendations in this report.

9.4.2.1.3 ***Recommendation***

Recommendation 383: *That Government consider, as part of redrafting the Act, whether other changes can be made to the location of the Act's provisions that would make the Act easier to work with.*

9.4.2.2 The term "grantor"

9.4.2.2.1 ***The issue***

One submission drew attention to the fact that the Act uses the term "grantor" to describe the person who gives a security interest.[106] This is different to the overseas models, all of which refer to that person as the "debtor". The submission suggested that this was confusing, and recommended that the terminology in the Act be conformed to the overseas models – that is, that references in the Act to "grantor" be changed to "debtor".

The drafters used the term "grantor" in order to draw a distinction between the person who grants a security interest, and the person who owes the obligation that is secured by the security interest. In most cases they will be the same person,

104 AFC, S1 att B page 20; DIFA, S1 att B page 7.

105 Report by the Senate Standing Committee on Legal and Constitutional Affairs into the *Exposure Draft of the Personal Property Securities Bill 2008* (March 2009), para 4.19.

106 DT, S2 page 5.

but that is not necessarily the case, and the roles are conceptually quite distinct. The distinction is in my view a very helpful one, and one that reflects the way in which practitioners in Australia distinguish in their minds between the two roles.

Consultation Paper 3 supported the fact that the Act uses the term "grantor" rather than "debtor" to describe the person who gives the security interest, even though this approach differs from the overseas models, and expressed the view that this should not be changed.

9.4.2.2.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of conforming to the overseas models and referring throughout the Act to a "debtor" instead of a "grantor". The great majority, however, were of the view that the Act should continue to use the term "grantor" to describe a person who grants a security interest, rather than "debtor". That is my view as well.

9.4.2.2.3 ***Recommendation***

> **Recommendation 384:** *That the Act continue to use the term "grantor" rather than "debtor" to refer to the person who grants a security interest.*

9.4.2.3 **The name of the Act**

9.4.2.3.1 ***The issue***

This report has noted that there is still an undesirably low level of awareness of the Act in the small business community, and of the impact that the Act can have on a business's operations and assets.

One submission suggested that the very name of the Act contributes to this lack of awareness.[107] The submission argued that is because some businesses see the words "personal property" in the title of the Act, and then assume that the Act is not relevant to them because it only applies to property that people hold in a personal (ie non-business) capacity.

There is some precedent for using a different title for legislation like the Act. For example, a number of Pacific Island nations have enacted legislation along the lines of the Act in recent years, and at least one of them uses the expression "secured transactions" in its title, rather than "personal property securities".[108]

I can see that the term "personal property securities" might leave a reader with the impression that the Act only applies to non-business assets. I can also see that an expression along the lines of "secured transactions" would respond to the concern identified in the submission. That term would of course overstate the reach of the Act, as the Act does not apply to all secured transactions (for example, it does not apply to secured transactions involving land), but it could be said that it is preferable for the title of the Act to slightly overstate its reach, rather than to understate it.

107 CAFBA, S1 page 2, restated in CAFBA, S2 page 1.

108 See the *Secured Transactions Act 2008* (Solomon Islands).

Consultation Paper 3 made the point that it might have been appropriate, if we were starting afresh, for the Act to be entitled "Secured Transactions Act" rather than "Personal Property Securities Act". As the Act has now been on the statute books for almost 5 years, however, Consultation Paper 3 expressed the view that it would be counter-productive, and potentially the source of even more confusion, if we were to change its name at this stage.

9.4.2.3.2 ***Discussion of stakeholder feedback***

A small number of respondents were in favour of changing the name of the Act. The great majority agreed, however, that the name of the Act should remain as is.

9.4.2.3.3 ***Recommendation***

Recommendation 385: *That the name of the Act not be changed.*

Chapter 10
Next steps

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10.1 Implementing the changes

10.1.1 Inter-dependent nature of the recommendations

I have made many detailed recommendations for amendments to the Act and the Register in this report. Many of those recommendations are inter-dependent, in that the content of many recommendations relies on other recommendations being adopted as well, or is only relevant if another recommendation is not adopted. I have endeavoured to identify these inter-dependencies in some of the recommendations, but the intricacy of the subject matter meant that this was not always possible.

For that reason, I urge Government to adopt my recommendations, as far as possible, as a package. If that is not possible, and there are some recommendations with which Government elects not to proceed, then careful consideration will need to be given to the consequential effects that this could have for other recommendations as well, and the course of action in relation to those other recommendations may need to be adjusted.

10.1.2 A more collaborative drafting process?

Finance is the life blood of our economy. It plays a key role in almost all areas of economic activity. Our economy is complex, and this means that the financier's tools of trade are complex as well.

The drafters of the Act were faced with an almost insurmountable challenge, as they were being asked to rewrite the rules for secured finance without the benefit of having had extensive first-hand experience of how those rules work in commercial practice. The (perhaps inevitable) outcome was that the details of the Act are often not reflective of the way that secured finance functions in Australia. This has made it more difficult for financiers to provide secured finance to businesses and consumers in some contexts, rather than easier, and so has hampered the ability of the Act to achieve its objectives.

I urge Government to approach the task of drafting amendments to the Act differently, this time around. Rather than expecting the Office of Parliamentary Counsel (*OPC*) to draft the legislation alone, I believe the Act will only achieve the best possible outcomes if the drafting process is conducted as a collaborative process that involves all of the OPC, the Attorney-General's Department and the private sector. In particular, Government should seek private-sector input into the drafting before any Bill is released for public consultation, because it is inevitably more difficult to change the language of a Bill once it is in the public domain. And comments made through a public consultation process can often be difficult to reconcile with each other, leading to the risk that important changes may end up not being made.

I acknowledge that a collaborative drafting process along these lines may not be reflective of Government's usual procedures for the preparation of legislation. The Act is an unusual piece of legislation, however, in that it is almost entirely facilitative in nature – that is, the purpose of the Act is not to impose restrictions on business behaviour, but rather to facilitate it. This means that the interests of Government and business are largely aligned, in that both want the Act to succeed in its objectives. OPC has the skills in drafting legislation, and the private sector has the hands-on knowledge of how the finance sector works in practice, and the Act will best be able to achieve its objectives if those skills and that knowledge can

be brought together in the shaping of its language. Private-sector input can also help Government to explain the proposed changes to business in a way that will resonate with its audience.

Even with such an approach to the drafting, it will be important for Government to release a consultation draft of the Bill before it is introduced into Parliament. That will give the broader business community and consumer groups an opportunity to provide Government with feedback on the Bill as well, before the Bill begins its official Parliamentary journey.

Recommendation 386: *That Government engage private-sector input in the drafting of the Bill for the amending legislation, in addition to then releasing the draft Bill for public consultation.*

10.1.3 Dealing with the open issues

There were a number of topics on which I was not in a position to make specific recommendations in this report. They fall into two broad categories:

- Topics on which I did not have sufficient information to form a view, or for which stakeholder feedback indicated that more discussion was appropriate. A good example of this is the treatment by the Act of intermediated securities and other investment assets (Recommendations 64 to 76).
- Topics that relate to matters of particular interest to States and Territories, in particular the exclusion from the Act of statutory licences, water rights and fixtures (Recommendations 31, 40 and 42).

I am hopeful that the first category of topics can be progressed quite quickly, and that an appropriate way forward can be identified without delaying the overall timetable for implementing other recommendations. I am aware, however, that inter-governmental processes may necessitate a longer lead-time for determining a way forward on the second category of topics, and would not want that to delay implementation of other recommendations. I recommend that Government proceed with implementing all other recommendations as soon as possible, and if necessary defer implementation of any changes that might flow from this second category of unresolved topics until a later date.

Recommendation 387: *That Government proceed if necessary with amendments to the Act in two stages, by deferring any amendments on matters relating to statutory licences, water rights and fixtures, if necessary, for enactment at a later date.*

10.1.4 Managing transitional issues

Amending legislation as complex as the Act will itself be a complex task. In particular, great care will need to be taken to ensure that the amendments do not inadvertently upset existing positions. Business will also need to be allowed sufficient time to adjust their processes to reflect the changed rules.

To give just a few examples:

- Where an amendment is made to clarify the meaning of a provision, it should be made clear, where appropriate, that the amendment is not necessarily changing the meaning from the current language.
- If the collateral classes are changed, care will need to be taken in the way that the existing classes are mapped across to the new structure.
- If Government accepts my recommendation that financial institutions should no longer be able to rely on their AML/CTF Act data for grantor details in a registration (Recommendation 107), Government should allow financial institutions an appropriate transitional period to respond to the change. The change should also not upset the validity of existing registrations.

The devil for all this will be in the detail. This is another respect in which it will be critical for Government to work collaboratively with the business community in the drafting of the provisions.

Recommendation 388: *That Government obtain appropriate private-sector input into the crafting of the transitional provisions.*

10.1.5 Managing the lead-up to the commencement date for the amendments

The passage of the amending legislation will be a key step in the reform process, but will by no means signal the end of the reform project.

Many of the amendments that I have recommended will affect the processes that secured parties and others use when they make, amend or search for registrations. Many of the changes will directly impact the functioning of the Register, and will require amendments to be made to the software that drives it.

One of the frustrations that are currently encountered by users of the Register is the fact that the Register's capabilities do not always match the content of the Act itself. This may have been caused by the fact that the software design for the Register was settled before the content of the Act had been finalised. It will be important, in my view, to ensure on this occasion that any re-write of the software for the Register is not completed until after the amending legislation has been finalised, and that the outputs produced by the revised software are tested carefully against the content of the amended Act, to minimise the risk that this could happen again.

Apart from that, it would be valuable for Government to repeat many of the implementation steps that it took in the lead-up to the commencement of the Act in January 2012. Importantly, this should include affording business and other users ample opportunity to test the amended Register in a test environment, and to develop and test amendments to their own systems, before the go-live date. I anticipate that both Government and the private sector will also be able to identify improvements to the processes that were followed in the lead-up to the commencement of the Act, with the benefit of having been through that experience.

It will be important, to ensure business confidence in both the process and its outcomes, that Government develop its implementation plan in close collaboration with the business community. This could perhaps be done, for example, through AFSA's consultative forums.

Recommendation 389: *That Government develop and publish a detailed implementation plan for the period leading up to commencement of the amending legislation, in collaboration with the business community (such as through AFSA's consultative forums).*

10.2 A fresh education campaign

10.2.1 Introduction

As I noted in Section 3.1.1 above, Government went to considerable lengths to inform the business community and the broader public about the Act in the lead-up to its commencement in January 2012. Despite these efforts, it was clear from submissions that awareness of the Act and its implications remained low, especially among small businesses and, I expect, the broader community as well. I anticipate that levels of awareness of the Act are much higher among the small business community now than they were three years ago. As submissions pointed out, though, much can and should still be done to raise awareness levels even further.

The passage of amendments to the Act will provide the Government with a timely and relevant opportunity to launch and conduct a fresh education campaign. As I see it, such a campaign could have two quite distinct strands of activity:

- an awareness campaign, to raise general awareness of the Act and its potential impact among businesses and consumers who are not yet sufficiently aware of it; and
- an education campaign, to improve levels of understanding of the intricacies of the Act among businesses and their advisers.

10.2.2 Awareness–raising

10.2.2.1 Small businesses

Small businesses are affected by the Act in a range of ways: as secured parties, as grantors, and as potential buyers or lessees of property that might be subject to a security interest.

A large number of submissions emphasised the importance of conducting a targeted business information campaign, to improve small business awareness of the Act and of its implications.[1] A number of those submissions included helpful suggestions for how this might be done, such as by targeting small business advisers such as accountants, lawyers and other business advisers.[2] Other Government agencies such as the Small Business Commissioner could also be engaged in the campaign.[3] And, of course, industry organisations will also need to play a central role.

1 For example: ABA, S1 page 2; ASBC, S1.
2 For example: DIFA, S1 att B page 7; LCA, S1 page 2.
3 LCA, S1 page 2.

Recommendation 390: *That Government develop a targeted yet multi-faceted campaign, in the lead-up to the amendments to the Act coming into operation, to increase levels of awareness among small businesses of the Act and its implications.*

10.2.2.2 Consumers

The review has not received much input on the question of the extent to which consumers are aware of the Act. The Consumer Action Law Centre (*CALC*) has informally expressed the view, however, that levels of awareness among consumers are low.

This is perhaps unsurprising. Unlike small businesses, who can be affected by the Act on a regular if not daily basis, consumers are likely to be affected by the Act only when they buy or sell a motor vehicle or boat, and need to search the Register for encumbrances. CALC expressed the view, however, that consumer awareness is low even in these circumstances, and that is undesirable. It may be that levels of awareness among consumers are no lower than they were under the previous REVS regimes, but even if that is correct, steps should still be taken to improve the situation.

Submissions did not include any recommendations on how to respond to this concern, and it is not an area on which I am able to contribute any particular insights. It is nonetheless a concern that Government should address.

Recommendation 391: *That Government develop and implement steps to raise awareness among consumers of the importance of searching the Register before purchasing a motor vehicle or boat, particularly in a private transaction.*

10.2.3 Education

Even businesses that are aware of the Act have found it difficult to understand. That message was clear from many of the submissions, as I noted in Section 3.1.2 of this Report. Many legal advisers face the same challenge, as smaller firms and sole practitioners in particular do not have the time and resources that they would need to invest in order to develop a proper understanding of the Act and its many complexities.

As I observed in the Interim Report, a range of materials, from fact sheets to online tutorials, are currently available on the Register website.[4] These materials are designed to assist users to gain a general understanding of the Act and its purpose, and to guide them through the registration process. Further assistance on the registration process is also available by calling the National Service Centre. Some of this assistance is currently targeted to particular business types and activities.

There is scope for this material to be reviewed and for consideration to be given to the best means of presenting the information to the target audience. For example, this could include greater use of case studies or additional online tutorials. Consideration could also be given to greater use of available communication channels between Government and business (such as the

4 Interim Report, page 38.

Government's Single Business Service) to help raise awareness of the Act and the Register and push information out to those businesses who need it.

It is not the role of the Government, though, to provide legal advice. In circumstances where legal services are too expensive for individual businesses, there is a role for industry organisations to play in developing and providing further education and guidance. A number of organisations do currently provide a range of support services to their members.

There are a number of measures and strategies that could be employed to raise awareness and deliver education to small businesses. Further consultation is needed between Government, affected businesses and their advisers to determine the most appropriate strategy and mechanisms for ensuring that small businesses receive good explanatory information and guidance. The strategy should be multi-facetted, and should target those industries that are in greatest need of assistance (such as retention of title suppliers, the hiring industry and other small businesses).

A number of submissions also made some specific suggestions of ways in which the level of understanding of the Act across the business community might be improved. Veda Advantage suggested, for example, that a minimum level of understanding of the Act and the Register might be mandated as part of initial accreditation or ongoing professional development requirements for both accountants and lawyers.[5] The Australian Institute of Credit Management proposed that Government engage a suitable industry body to deliver education to small businesses.[6] The Combined Small Business Alliance of Western Australia suggested that the Act could perhaps be simplified into a Fact Sheet for small businesses.[7] And the Law Institute of Victoria queried whether there could be scope to establish a private ruling system, to clarify issues of uncertainty.[8]

It is my hope that the amendments that I have recommended in this report will help to make the Act easier for all to understand. I also hope that this report itself will become a useful resource for legal advisers and others who are endeavouring to understand how the Act works in practice. It is clear, though, that much else can and should be done to improve levels of understanding of the effect of the Act across the business community at large. It would be inappropriate for me, however, to attempt to spell out the detail of such an education campaign. That, again, is a proper task for Government, in collaboration with the private sector.

Recommendation 392: *That Government develop and implement a campaign to increase understanding among businesses and their advisers of the detailed effect of the Act, and take other steps that could assist businesses on an ongoing basis to understand how the Act affects them and how best to take advantage of it.*

5 Veda, S2 page 6.

6 AICM, S2 page 32. AICM also suggested that a proportion of registration fees could be dedicated to funding such an education program.

7 CoSBA, S1 page 1.

8 LIV, S2 page 2.

10.3 Should there be a further review?

The introduction of the Act required many businesses to make extensive changes to their systems, documents and operating procedures. It is likely that the amendments that flow from this report will trigger a need for businesses to make another round of changes, although hopefully of nowhere near the same magnitude.

Once the next round of amendments has been implemented, I expect that businesses would prefer that the Act not be amended again for some time, unless some particularly pressing issue were to emerge that needed to be addressed quickly. Financial institutions in particular are facing legislative change on many fronts, and I am confident that they would appreciate a period of stability (as far as the Act is concerned).

That is not to say, of course, that the Act should now be left alone indefinitely. The experience in other jurisdictions, especially in the United States and Canada, has been that there can be developments in market practice or other reasons why it might be appropriate to revisit aspects of the Act from time to time, and Government should remain open to suggestions to that effect from the business community. It would also be desirable for Government, after an appropriate period (for example five years), to invite stakeholders to indicate whether are any aspects of the Act that it might be desirable to amend. I do not think, however, that this needs to be enshrined in the Act, or that the Act otherwise needs to require that it be reviewed again within a specific timeframe.

It is my hope that this report will achieve the objectives that led to the inclusion of s 343 in the Act, and that a further review of the nature contemplated by s 343 is not needed. That would allow s 343 to be repealed.

Recommendation 393: *That Government consult with business and other stakeholders in 5 years' time, to determine whether there is a need for further reform of the Act.*

Recommendation 394: *That s 343 be repealed.*

Annexure A

Glossary of frequently-used terms

Act	Personal Property Securities Act 2009
Act	*Personal Property Securities Act 2009*
AFSA	Australian Financial Security Authority
allpap	The collateral class "all present and after-acquired property" as provided for by para 2.3(1)(c) of Schedule 1 to the Regulations.
allpap except	The collateral class "all present and after-acquired property, except" as provided for by para 2.3(1)(d) of Schedule 1 to the Regulations.
Article 9	Article 9 of the United States *Uniform Commercial Code*
Canadian PPSAs	*Personal Property Security Act*, RSA 2000, c P-7 (Alberta); *Personal Property Security Act*, RSBC 1996, c 359 (British Columbia); *Personal Property Security Act*, CCSM, c P35 (Manitoba); *Personal Property Security Act*, SNB 1993, c P-7.1 (New Brunswick); *Personal Security Property Act*, SNL 1998, c P-7.1 (Newfoundland and Labrador); *Personal Property Security Act*, SNWT 1994, c 8 (Northwest Territories); *Personal Property Security Act*, SNS 1995-1996, c 13 (Nova Scotia); *Personal Property Security Act*, SNWT 1994, c 8 (Nunavut); *Personal Property Security Act*, RSO 1990, c P.10 (Ontario); *Personal Property Security Act*, RSPEI 1988, c P-3.1 (Prince Edward Island); *Personal Property Security Act*, SS 1993, c P-6.2 (Saskatchewan); *Personal Property Security Act*, RSY 2002, c 169 (Yukon)
Cape Town Convention	UNIDROIT *Convention on International Interests in Mobile Equipment* (2001)
Cuming Walsh & Wood	R Cuming, C Walsh & R Wood, *Personal Property Security Law* (2nd ed) (Irwin Law, 2012)
Duggan & Brown	A Duggan & D Brown, *Australian Personal Property Securities Law* (LexisNexis, 2012)
Gedye Cuming & Wood	M Gedye, R Cuming & R Wood*, Personal Property Securities in New Zealand* (Brookers, 2002)
Gilmore	G Gilmore, *Security Interests in Personal Property* (Little, Brown, 1965)
Hague Securities Convention	Hague Conference on Private International Law *Convention for the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary*
Interim Report	*Interim Report on the Review of the Personal Property Securities Act 2009* dated 31 July 2014
National Credit Code	*National Consumer Credit Protection Act 2009*, Schedule 1

Act	Personal Property Securities Act 2009
NZ Law Commission Report	New Zealand Law Commission, *A Personal Property Securities Act for New Zealand*, Report No. 8 (1989)
NZ PPSA	*Personal Property Securities Act 1999* (NZ)
NZ PPS Regs	*Personal Property Securities Regulations 2001* (NZ)
O'Donovan	J O'Donovan, *Personal Property Securities Law in Australia*, (Thomson Reuters, 2009)
Ontario PPSA	*Personal Property Securities Act* R.S.O. 1990, Chapter P.10 (Ontario)
PPS Intergovernmental Agreement	*Personal Property Securities Law Agreement 2008*, dated 2 October 2008
Register	The register established under s 147 of the Act
Registrar	The Registrar of Personal Property Securities appointed under Part 5.9 of the Act.
Regulations	*Personal Property Regulations 2010*
Replacement Explanatory Memorandum	Replacement Explanatory Memorandum, *Personal Property Securities Bill 2009*
Sask Law Commission Report	Law Reform Commission of Saskatchewan, *Proposals for a Personal Property Security Act – Report to the Attorney General* (1977)
Sask PPSA	*The Personal Property Security Act, 1993* (Saskatchewan)
Sask Regs	*The Personal Property Security Regulations* (Saskatchewan)
Serial-numbered property	Collateral that may or must be described by serial number in a registration
Terms of Reference	Terms of reference for the review, as issued by the Attorney-General, Senator the Hon George Brandis on 4 April 2014.
UNCITRAL Guide	*UNCITRAL Legislative Guide on Secured Transactions* (2010)
UNCITRAL IP Supplement	*UNCITRAL Legislative Guide on Secured Transactions – Supplement on Secured Rights in Intellectual Property* (2011)
Understanding the Law of Secured Transactions	M Bridge, R Macdonald, R Simmons and C Walsh, *Formalism, Functionalism, and Understanding the Law of Secured Transactions* (1998-99) 44 McGill LJ 567
UNIDROIT Securities Convention	UNIDROIT *Convention on Substantive Rules for Intermediated Securities* (2009)
Widdup	L Widdup, *Personal Property Securities Act: A Conceptual Approach* (3rd ed) (LexisNexis, 2013)
Ziegel & Denomme	J Ziegel & D Denomme, *The Ontario Personal Property Security Act – Commentary and Analysis* (2nd ed) (Butterworths, 2000)

Annexure B

Criteria used to assess proposed amendments

(Reproduced from the Interim Report)

1. Overall objective

(a) **The objective of the Act is to facilitate the creation and enforcement of security interests in personal property, and to provide rules to regulate their legal effect.**

Commentary

*The rules for the **creation** of security interests should not attempt to prescribe the form that parties must use. Rather, the Act should simply identify the outcome that a transaction needs to achieve, if it is to create a security interest that is effective for the purposes of the Act, and otherwise leave it to the parties to choose how they want to document the arrangement between them.*

*The rules regarding the **legal effect** of a security interest should encompass the effectiveness of the security interest as against third parties such as other secured parties, buyers and lessees.*

*The rules regarding **enforcement** should be facilitative, in that they should not limit the enforcement remedies that the parties may agree to include in their transaction. Rather, the rules should provide a set of enforcement remedies that are available for a secured party to use in transactions where the security agreement itself does not contain enforcement mechanisms, or instead of contractually agreed remedies if the secured party prefers.*

The Act should also deal with appropriate ancillary matters, such as:

- *how to decide when the Act applies; and*
- *matters relating to the operation of the register.*

(b) **The focus of the Act should be on interests that in substance secure obligations. When considering the extent to which the Act should also apply to interests in property that do not secure obligations, the following factors should be taken into account:**

- **whether the interest is of a type that is sufficiently common in or important to our economy that it is appropriate to consider extending the regime to include it; and**
- **whether the overall benefit of including the interest in the Act (or in chosen aspects of the Act) will outweigh any detriment from doing so.**

Commentary

One of the key "mischiefs" that is the target of legislation such as the Act is the so-called "evil of apparent ownership" – the risk that a third party may be misled by the apparent owner of property into believing that the apparent owner can give the third party a better interest in the property than is actually possible. This risk can arise if the third party has no independent means to determine whether another person might already hold a conflicting interest in the property.

The Act aims to reduce this risk, by providing that a secured party puts its security interest at risk if it does not take steps that make it possible for a third party to learn of its existence. Those steps are referred to in the Act as "perfection".

There are many other types of circumstances, beyond the granting of security interests, in which a person can appear to have a greater interest in property than is actually the case. For example, a person may simply be in possession of another person's tangible property, either temporarily or on a long-term basis. A person may hold another person's intangible property as custodian, or as their nominee. It would not be practicable for the Act to deal comprehensively with all circumstances in which apparent ownership of property is divorced from its true ownership. This reality was acknowledged by the Law Reform Commission of Saskatchewan in its report "Proposals for a Saskatchewan Personal Property Security Act" in July 1977, in which it made the following observation:

> *It is totally unrealistic to attempt to bring within the scope of the Act every kind of transaction in which deception results from a separation of interest and appearance of interest. However, it is realistic to include in the registration and perfection system of the Act certain types of transactions which, because of their commercial importance, are likely to continue to produce significant disruption if left out.*

Rather than ignore other types of potentially-misleading transactions completely, however, the practice in jurisdictions that have legislation like the Act has been to include a subset of those other transactions within the legislation. In some jurisdictions (such as Saskatchewan), the selected subset consists of transactions which, as noted in the quotation above, are likely to produce significant disruption if they are left out, because of their commercial importance. In other jurisdictions, the selection has been adopted from predecessor legislation, without necessarily undertaking a full fresh scrutiny of whether the factors that led to that selection in the other jurisdiction were also relevant in the adopting jurisdiction.

When considering proposals to amend s 12(3), we should consider whether the proposed amendments would help to ensure that s 12(3) captures the appropriate types of interests, and only the appropriate types of interests.

2. Balance

The rules should strike an appropriate balance between the interests of secured parties, and the interests of third parties that take or may want to take a competing interest in collateral, such as:

- **other secured parties; or**
- **buyers or lessees.**

Commentary

This is the principle that is likely to inspire the most debate. Different market sectors will understandably want to ensure that their commercial positions remain as robust as possible under the Act. However, it will not always be possible to structure the rules in the Act in a way that provides all parties with the level of protection that they desire. Indeed, in many situations (such as the application of the priority or taking free rules), it may only be possible to protect one person at the expense of another. The rules need to find a balance between the legitimate expectations of the affected stakeholders.

3. Simplicity

Each rule should be expressed as simply as is possible without compromising the ability of the rule to achieve its purpose. It should be clear for each rule what the purpose of the rule is, and how that purpose fits with the overall purposes of the regime. The rules should apply consistently, across all types of personal property and security interest, unless there are good reasons to the contrary (such as a desire to facilitate particular business practices or policy objectives). Taken as a whole, the rules should produce clear and predictable outcomes for business and other stakeholders.

Commentary

It is important to express rules as simply as is possible, so that it is as easy as possible for readers to understand what the rules mean, and how they can work with them.

Commerce, however, is complex. The Act needs to reflect and respond to that reality, and not stifle commercial creativity by imposing "one size fits all" requirements. Because the complexity of commercial life will necessarily require that there be corresponding complexity in the Act, it will be important to monitor the extent of that complexity, and to resist the urge to over-complicate the Act by providing exceptions or sub-rules to deal with particular fact patterns, or by including "avoidance of doubt" clarifications, unless they are truly necessary. As far as possible, potential uncertainties or complexities should be dealt with through careful formulation of the primary rules, rather than by means of exceptions or supplementary qualifications.

This is again a question of finding the right balance. We should resist the urge to over-complicate the Act, but also be mindful of the need, to quote Albert Einstein, to "make everything as simple as possible, but not simpler".

4. Comprehensiveness

The rules should be as all-embracing as possible. They should apply to all types of personal property and all types of security interest, unless there are clear policy reasons for an exception.

Commentary

This is a broader application of the "simplicity" principle. Carve-outs from the Act complicate the Act itself. They can also complicate outcomes for those who want to take an interest in the property, or to enter into a transaction, that is carved out. This is because excluding a type of property or transaction from the Act does not mean that the property or transaction can then operate free of any legal rules at all. Rather, it means that a different set of rules need to be identified and applied, and that could well result in increased complexity and uncertainty for those involved, rather than less.

5. Flexibility

The rules should be as flexible as possible. They should accommodate current market structures and business practices, but also be flexible enough to respond to changes to them. They should allow parties the freedom to structure their agreements as they see fit, unless there are policy reasons to the contrary (such as the need to protect consumers). They should include as few formal requirements as possible.

Commentary

Some care needs to be taken in the pursuit of this principle, as too much flexibility can degenerate into uncertainty. Also, while it is important that the Act not focus entirely on current market practices and conditions, and that it be able to accommodate new developments as well, the primary focus of the Act should be on ensuring that it produces appropriate and meaningful outcomes for Australian businesses and consumers today.

6. Transparency

The rules should aim to provide transparency in relation to the existence of security interests, through mechanisms that enable third parties to determine whether an item of a person's property may be subject to a security interest.

Commentary

This principle targets the "evil of apparent ownership" mentioned earlier. A key objective of the Act should be to provide mechanisms that make it possible for third parties to determine whether a security interest may exist over a particular item of property. This is the role performed by the three main modes of perfection under the Act – registration, possession and control.

A third party will however not always be able to detect whether an item of property is subject to a perfected security interest. For example, the Act provides for circumstances in which a security interest will be deemed to be perfected, either temporarily or permanently, in a manner that will not be apparent to third parties. It is also possible for a security interest to be perfected by control in a manner that is not visible to outsiders. And even registration provides no more than an indication that a security interest might be attached to property. Trade-offs of this kind are inevitable, given the need to balance the practicalities of the perfection process against the information needs of third parties. When assessing the mechanics of the various modes of perfection, however, it is important to remember why perfection is there, and to ask whether it is achieving its purpose.

7. Fit

The rules should be able to function in harmony with the balance of our law.

Commentary

The Act is not a self-contained set of rules that operate in isolation from the balance of our laws. Rather, the Act is just one component of our legal system generally, and needs to be able to function in harmony with it.

The Commonwealth Government has gone to considerably lengths to amend other legislation to adopt the terminology and concepts of the Act. State and Territory Governments have done this to a rather lesser degree.

The Act needs to be able to produce meaningful outcomes when interpreted and applied against the background of our laws generally. Other parts of Australia's commercial law framework, and the expectations that underpin that law, are very different to the laws and expectations that applied in the United States in the 1950s, when Article 9 was introduced. The same can be said (albeit to a lesser extent) in relation to the corresponding legislation in Canada and New Zealand. Terminology or structures that achieve meaningful outcomes in the overseas legislation may not work here. The drafting of the Act needs to take this reality into account.

This is clearly something of an aspirational set of targets. The complexity and innovativeness of the Australian economy, together with the inherent ambiguity of the English language, make any of these principles difficult if not impossible to realise in full. There is a degree of overlap between some of the principles, but others are in tension with each other, in that it may only be possible to pursue one principle in some circumstances if this is done at the expense of another. Where these conflicts do arise, they will need to be resolved by determining where the appropriate balance lies, looking back as needed to the over-arching objectives [of the Act].

Annexure C

Explanation of the unitary model's approach to the concept of "rights in the collateral", and related matters

1. Introduction

Section 5.1.2 of the report noted that two models had been proposed to explain the implications of the requirement in s 19(2)(a) that a security interest will only attach to collateral if the grantor has "rights in the collateral". The report refers to the two models as the "unitary" model and the "possession" model.

This annexure seeks to explain how the unitary model works in practice, by showing the outcomes that it produces in a range of fact patterns.[1]

2. The model explained

(a) **The starting point.** The starting point for the unitary model is *nemo dat quod non habet* – you can only give what you have.[2] If a person has possession of property but not under a transaction that gives rise to a security interest, then they can only give security over that possessory interest in the property (or as some put it, the security interest is bounded by the grantor's own limited interest in the collateral).

Some practitioners have expressed the concern that the phrase "rights in the collateral" might mean that a person who has some rights in an item of property can grant a security interest over all of it – for example, that a part-owner of a racehorse could grant a security interest over the whole racehorse, not just over the part interest. That is not possible under this model, however, because of the *nemo dat* rule, as a part-owner of property can only give security over that part interest, not over the property as a whole.

(b) **In-substance security interests.** If a transaction gives rise to an in-substance security interest in relation to collateral under s 12(1), the unitary model says that the Act treats the grantor as if it had ownership of the collateral, even if that is not the case at general law. Seen this way, *nemo dat* does not prevent the grantor from giving security over the collateral to another secured party, or from selling it (whether subject to the security interest or free of it), because in the eyes of the Act the grantor **is** in substance the owner.

(c) **Deemed security interests.** The same follows under a transaction that gives rise to a deemed security interest under s 12(3). Because the Act characterises the transaction as giving rise to a security interest (albeit a deemed security interest), the unitary model says that the Act treats the grantor as if it were the owner of the collateral, even if that is not the case at general law. This explains why the grantor can grant security over it to another secured party, or sell it (either subject to the deemed security interest, or free of it).

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1 The report recommends that proponents of the "possession" model be provided with an opportunity to prepare a corresponding table for that model as well, so that the outcomes under the two models can be compared.

2 This is also the starting point for the alternative "possession" model.

(d) **Effect of a lease on an existing security interest.** Because the Act treats the grantor of a security interest as if it were the owner of the collateral (whether or not that is the case at general law), if a security interest arises under a transaction under which the secured party has title, the Act treats the transaction as resulting in a transfer of the collateral from the secured party to the grantor (with the secured party then taking the security interest back). If the secured party had itself previously given a security interest over the collateral to another secured party, then that security interest may or may not remain attached to the collateral, depending on whether it is extinguished by s 32 or affected by the taking free rules. If it does remain attached, it will generally prevail over security interests granted by the grantor/transferee, under ss 66 to 68.

3. Other relevant considerations

(a) **Effect of a transfer on the identity of the grantor of an existing security interest.** If collateral that is subject to a security interest is transferred in a way that leaves the security interest attached to the collateral after the transfer, then the Act treats the transferee as becoming the grantor of the security interest. In other words, if the transfer arises under a transaction (such as a lease) that gives rise to a security interest, then the grantor under that security interest becomes the grantor of the prior security interest as well. The transferor-granted security interest will no longer be perfected by any registration that the holder of the security interest may have made against the transferor, as the transferor is no longer the grantor. Rather, the transferor-granted security interest should be temporarily perfected under s 34.

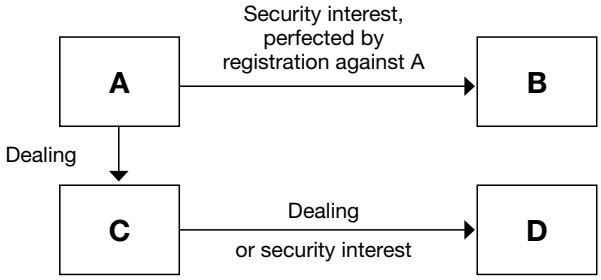
If the transferee then sells the collateral, the buyer will take free of the existing security interest under s 52, unless the secured party has reperfected (eg by registration against the transferee). If the transferee grants another security interest over the collateral, the transferor-granted security interest will generally prevail under ss 66 to 68. And the transferor-granted security interest should survive an insolvency of the transferee despite s 267, as it was perfected (even though only by way of temporary perfection).

(b) **Effect of a transfer if the security interest does not remain attached to the collateral.** If collateral that is subject to a security interest is transferred in such a way that the security interest does not remain attached to the collateral (whether that is because of the operation of s 32 or of a taking free rule), then the security interest will attach instead to the rights that the transferor receives in exchange for the transfer, as proceeds.[3] If the transfer was under a lease (see paragraph 2(d) of this annexure), then the secured party's remaining interest in the original collateral will only be indirect, via the lessor/transferor's interest under the lease (as that will be the proceeds that the lessor/transferor received in exchange for the original collateral, and the secured party will now have direct security over those proceeds instead). The strength of that indirect interest will depend in large part on whether the lessor perfects its interest under the lease as a PMSI, in accordance with s 62.

3 Except in the unlikely event that the secured party has agreed otherwise – see s 32(1)(a), discussed in Section 7.4.3 of the report.

4. Testing the model against representative fact patterns

The attached table shows the results produced by the unitary model in a range of fact patterns. In each of the fact patterns, A owns collateral, and has given a perfected security interest over the collateral to B. A then deals with the collateral in favour of C, and C then deals with the collateral in favour of D. This is what the academic literature calls an A-B-C-D problem. Diagrammatically, it looks like this:



The A-C dealings examined in the attached table are:

(1) a short-term rental (that is not a security interest);

(2) an outright sale for cash;

(3) an outright sale, with security back for the unpaid purchase price;

(4) a sale on retention–of-title terms;

(5) a finance lease or other lease that is an in-substance security interest; and

(6) a lease that is a PPS lease, but is not an in-substance security interest.

Each of dealings (3), (4), (5) and (6) results in C granting a security interest over the collateral to A. As a sub-variable of each of those dealings, the table examines what happens if that security interest is either perfected or unperfected.

As a further sub-variable for each of those fact patterns, the table also examines what happens if the dealing by A to C allows C to take the collateral free of B's security interest, or is subject to B's security interest.

The table then examines the outcomes produced by the model if C either sells the collateral to D, or if C grants D a security interest over it. The table also examines what happens if C becomes insolvent.

How the model works in practice

	Fact pattern			
	A…	**C takes its interest…**	**C then…**	**Outcome**
1	rents the collateral to C under a short-term lease that is not a security interest.	subject to B's security interest.	sells to D.	D only gets C's possessory rights under the lease, subject to B's security interest.[4]
			gives D a perfected security interest.	D vs A: A wins.[5] D vs B: B wins.[6]
			becomes insolvent.	A's interest: survives.[7] B's interest: survives.[8]
		free of B's security interest.	sells to D.	D only gets C's possessory rights under the lease, free of B's security interest.[9]
			gives D a perfected security interest.	D vs A: A wins.[10] D vs B: D wins, in a limited way.[11]
			becomes insolvent.	A's interest: survives.[12] B's interest: survives.[13]

4 C's transaction with A does not give rise to a security interest, so C is not treated by the Act as if it were the owner of the collateral. All that C can sell to D is C's possessory rights under the lease, subject to B's rights under its security interest.

5 C's ability to give a security interest over the collateral to D is bounded by C's own limited interest in the collateral (or put another way, C can only give a security interest to D over its possessory rights to the collateral), so D's rights to the collateral are no greater than C's.

6 B has security over A's ownership interest in the collateral, while D's security interest is bounded by C's own limited interest in the collateral (that is, D only has security over C's possessory rights under the lease).

7 Section 267 is not relevant, because C is not the grantor of a security interest.

8 Section 267 is not relevant, because C is not the grantor of a security interest.

9 C's transaction with A does not give rise to a security interest, so C is not treated by the Act as if it were the owner of the collateral. C can only sell to D its possessory rights under the lease, albeit free of B's rights under its security interest.

10 The analysis is the same as in 2. The fact that C takes its rights under the lease free of B's security interest does not improve D's position as against A.

11 D can enforce its security interest free of interference from B. That security interest, however, is still only over C's possessory rights to the collateral under the rent agreement, not over the collateral as a whole. B continues to have a security interest over the collateral itself.

12 Section 267 is not relevant, because C is not the grantor of a security interest.

13 Section 267 is not relevant, because C is not the grantor of a security interest.

	Fact pattern			
	A…	**C takes its interest…**	**C then…**	**Outcome**
2	sells the collateral to C for cash.	subject to B's security interest.	sells to D.	D takes the collateral, free of B's security interest.[14]
			gives D a perfected security interest.	D vs A: D wins.[15] D vs B: B wins.[16]
			becomes insolvent.	A's interest: not relevant.[17] B's interest: survives.[18]
		free of B's security interest.	sells to D.	D takes the collateral, free of B's security interest.[19]
			gives D a perfected security interest.	D vs A: D wins.[20] D vs B: D wins.[21]
			becomes insolvent.	A's interest: not relevant.[22] B's interest: not relevant.[23]

14 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34. As B's security interest is only temporarily perfected, D takes free of it (s 52).

15 A has sold the collateral to C, so A no longer has any interest in it.

16 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

17 A has sold the collateral to C, so A no longer has any interest in it.

18 B's interest is not affected by s 267, because it is perfected (temporarily, under s 34). Also, while C has become the grantor of B's security interest, C did not grant it (A did).

19 D benefits from the fact that C took the collateral free of B's security interest, under the "shelter" principle. C took free of B's security interest, so D does as well.

20 A has sold the collateral to C, so A no longer has any interest in it.

21 D benefits from the fact that C took the collateral free of B's security interest, under the "shelter" principle. C took free of B's security interest, so D does as well.

22 A has sold the collateral to C, so A no longer has any interest in it.

23 C has taken free of B's security interest.

	Fact pattern			
	A…	**C takes its interest…**	**C then…**	**Outcome**
3(a)	sells the collateral to C on deferred payment terms (but with no retention of title clause), and takes a security interest over the collateral to secure the payment. A perfects its security interest, as a PMSI.	subject to B's security interest.	sells to D.	D takes the collateral subject to A's security interest, but free of B's security interest.[24]
			gives D a perfected security interest.	D vs A: A wins.[25] D vs B: B wins.[26]
			becomes insolvent.	A's interest: survives.[27] B's interest: survives.[28]
		free of B's security interest.	sells to D.	D takes the collateral subject to A's security interest, but free of B's security interest.[29]
			gives D a perfected security interest.	D vs A: A wins.[30] D vs B: D wins.[31]
			becomes insolvent.	A's interest: survives.[32] B's interest: not relevant.[33]

24 D takes the collateral subject to A's security interest, unless a taking free rule applies. However, D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

25 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (s 63).

26 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will no longer be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

27 A's security interest is not affected by s 267, because it is perfected.

28 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

29 D takes the collateral subject to A's security interest, unless a taking free rule applies. D takes the collateral free of B's security interest, however, under the "shelter" principle – C took free of B's security interest, so D does as well.

30 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (under s 63).

31 D benefits from the fact that C took the collateral free of B's security interest, under the "shelter" principle. C took free of B's security interest, so D does as well.

32 A's security interest is not affected by s 267, because it is perfected.

33 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
3(b)	sells the collateral to C on deferred payment terms and takes a security interest over the collateral to secure the payment. A fails to perfect its security interest.	subject to B's security interest.	sells to D.	D takes the collateral free of both A's and B's security interests.[34]
			gives D a perfected security interest.	D vs A: D wins.[35] D vs B: B wins.[36]
			becomes insolvent.	A's interest: vests in C.[37] B's interest: survives.[38]
		free of B's security interest.	sells to D.	D takes the collateral free of both A's and B's security interests.[39]
			gives D a perfected security interest.	D vs A: D wins.[40] D vs B: D wins[41]
			becomes insolvent.	A's interest: vests in C.[42] B's interest: not relevant.[43]

34 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

35 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

36 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

37 Section 267.

38 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

39 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, under the "shelter" principle – C took free of B's security interest, so D does as well.

40 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

41 D benefits from the fact that C took the collateral free of B's security interest, under the "shelter" principle. C took free of B's security interest, so D does as well.

42 Section 267.

43 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
4(a)	sells the collateral to C on retention of title terms. A perfects its security interest.	subject to B's security interest.	sells to D.	Same as for 3(a): D takes the collateral subject to A's security interest, but free of B's security interest.[44]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[45] D vs B: B wins.[46]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[47] B's interest: survives.[48]
		free of B's security interest.	sells to D.	Same as for 3(a): D takes the collateral subject to A's security interest, but free of B's security interest.[49]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[50] D vs B: D wins.[51]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[52] B's interest: not relevant.[53]

44 D takes the collateral subject to A's security interest, unless a taking free rule applies. However, D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

45 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (s 63).

46 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will no longer be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

47 A's security interest is not affected by s 267, because it is perfected.

48 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

49 D takes the collateral subject to A's security interest, unless a taking free rule applies. D takes the collateral free of B's security interest under the "shelter" principle – C took free of B's security interest, so D does as well.

50 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (under s 63).

51 D takes the collateral free of B's security interest under the "shelter" principle. C took free of B's security interest, so D does as well.

52 A's security interest is not affected by s 267, because it is perfected.

53 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
4(b)	sells the collateral to C on retention of title terms. A fails to perfect its security interest.	subject to B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of both A's and B's security interests.[54]
			gives D a perfected security interest.	Same as for 3(b): D vs A: D wins.[55] D vs B: B wins.[56]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[57] B's interest: survives.[58]
		free of B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of both A's and B's security interests.[59]
			gives D a perfected security interest.	Same as for 3(b): D vs A: D wins.[60] D vs B: D wins.[62]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[62] B's interest: not relevant.[63]

54 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

55 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

56 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

57 Section 267.

58 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

59 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest under the "shelter" principle – C took free of B's security interest, so D does as well.

60 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

61 D takes the collateral free of B's security interest under the "shelter" principle. C took free of B's security interest, so D does as well.

62 Section 267.

63 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
5(a)	leases the collateral to C under a lease that is an in-substance security interest. A perfects its security interest.	subject to B's security interest.	sells to D.	Same as for 3(a): D takes the collateral but subject to A's security interest but free of B's security interest.[64]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[65] D vs B: B wins.[66]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[67] B's interest: survives.[68]
		free of B's security interest.	sells to D.	Same as for 3(a): D takes the collateral but subject to A's security interest but free of B's security interest.[69]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[70] D vs B: D wins.[71]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[72] B's interest: not relevant.[73]

64 D takes the collateral subject to A's security interest, unless a taking free rule applies. However, D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

65 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (s 63).

66 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will no longer be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

67 A's security interest is not affected by s 267, because it is perfected.

68 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

69 D takes the collateral subject to A's security interest unless a taking free rule applies. D takes the collateral free of B's security interest under the "shelter" principle – C took free of B's security interest, so D does as well.

70 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (under s 63).

71 D takes the collateral free of B's security interest under the "shelter" principle. C took free of B's security interest, so D does as well.

72 A's security interest is not affected by s 267, because it is perfected.

73 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
5(b)	leases the collateral to C under a lease that is an in-substance security interest. A fails to perfect its security interest.	subject to B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of both A's and B's security interests.[74]
			gives D a perfected security interest.	Same as for 3(b): D vs A: D wins.[75] D vs B: B wins.[76]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[77] B's interest: survives.[78]
		free of B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of both A's and B's security interests.[79]
			gives D a perfected security interest..	Same as for 3(b): D vs A: D wins.[80] D vs B: B wins.[81]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[82] B's interest: not relevant.[83]

74 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

75 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

76 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

77 Section 267.

78 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

79 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, under the "shelter" principle – C took free of B's security interest, so D does as well.

80 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

81 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

82 Section 267.

83 C has taken free of B's security interest.

	Fact pattern			Outcome
	A…	**C takes its interest…**	**C then…**	
6(a)	leases the collateral to C under a PPS lease that is not an in-substance security interest. A perfects its security interest.	subject to B's security interest.	sells to D.	Same as for 3(a): D takes the collateral but subject to A's security interest but free of B's security interest.[84]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[85] D vs B: B wins.[86]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[87] B's interest: survives.[88]
		free of B's security interest.	sells to D.	Same as for 3(a): D takes the collateral, but subject to A's security interest but free of B's security interest.[89]
			gives D a perfected security interest.	Same as for 3(a): D vs A: A wins.[90] D vs B: D wins.[91]
			becomes insolvent.	Same as for 3(a): A's interest: survives.[92] B's interest: not relevant.[93]

84 D takes the collateral subject to A's security interest, unless a taking free rule applies. However, D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

85 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (s 63).

86 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will no longer be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

87 A's security interest is not affected by s 267, because it is perfected.

88 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

89 D takes the collateral subject to A's security interest, unless a taking free rule applies. D takes the collateral free of B's security interest, however, under the "shelter" principle – C took free of B's security interest, so D does as well.

90 A and D both have perfected security interests. A has a PMSI, and will prevail (if it has perfected in time) under s 62, even if D also has a PMSI (under s 63).

91 D takes the collateral free of B's security interest under the "shelter" principle. C took free of B's security interest, so D does as well.

92 A's security interest is not affected by s 267, because it is perfected.

93 C has taken free of B's security interest.

	Fact pattern			
	A…	**C takes its interest…**	**C then…**	**Outcome**
6(b)	leases the collateral to C under a PPS lease that is not an in-substance security interest. A fails to perfect its security interest.	subject to B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of A's and B's security interests.[94]
			gives D a perfected security interest.	Same as for 3(b): D vs A: D wins.[95] D vs B: B wins.[96]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[97] B's interest: survives.[98]
		free of B's security interest.	sells to D.	Same as for 3(b): D takes the collateral free of A's and B's security interests.[99]
			gives D a perfected security interest.	Same as for 3(b): D vs A: D wins.[100] D vs B: D wins.[101]
			becomes insolvent.	Same as for 3(b): A's interest: vests in C.[102] B's interest: not relevant.[103]

94 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, because B's security interest was only temporarily perfected (s 52).

95 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

96 If collateral is transferred subject to a security interest, then the transferee becomes the grantor of the security interest. B's security interest will cease to be perfected by the registration (unless the collateral is serial-numbered property and both A and C hold it as consumer property), because the registration no longer identifies the correct grantor (as the grantor is now C). Instead, B's security interest is temporarily perfected under s 34 (until B becomes aware of the sale and has C's details, at which point temporary perfection ceases and B needs to perfect by registration against C – s 34(1)(c)(ii)). The competition between B's perfected security interest and D's perfected security interest is regulated by ss 66 to 68. As a general rule, B's security interest will prevail.

97 Section 267.

98 B's security interest is not affected by s 267, because it is perfected (even though only temporarily).

99 D takes the collateral free of A's security interest, because A's security interest was unperfected (s 43). D takes the collateral free of B's security interest, under the "shelter" principle – C took free of B's security interest, so D does as well.

100 D has a perfected security interest. A also has a security interest, but A's security interest is unperfected. D's security interest prevails (s 55(3)).

101 D takes the collateral free of B's security interest under the "shelter" principle. C took free of B's security interest, so D does as well.

102 Section 267.

103 C has taken free of B's security interest.

Annexure D

List of contributors

PART A – CONTRIBUTORS TO EACH STAGE OF THE REVIEW[1]

1. First round submissions

Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia
Amglad Enterprises
Australian Bankers' Association
Australian Finance Conference
Australian Institute of Credit Management
Australian Livestock & Property Agents Association
Australian Motor Industry Federation
Australian Pipeline Industry Association
Australian Small Business Commissioner
Avis Australia
Business South Australia
Chalkwest Pty Ltd
Civil Contractors Federation
Combined Small Business Alliance of Western Australia
Commercial Asset Finance Brokers Association of Australia
Craig Wappett
Debtor and Invoice Finance Association
EDX Australia
Electaserv Trading
Elphinstone Engineering
Hire and Rental Industry Association and Elevating Work Platform Association
Kerr's Hire
Law Council of Australia
Manlift Hire
Master Builders Association
National Farmers' Federation
New South Wales Business Chamber
New South Wales Young Lawyers
Office of the New South Wales Small Business Commissioner
Payne Investments
Queensland Law Society
Restaurant & Catering Industry Association
Russell Kennedy Lawyers
Self Storage Association of Australasia
Small Business Development Corporation Western Australia
Thoroughbred Breeders Australia

1 Other than submissions that were made on a confidential basis.

2. Second round submissions

AB Group
Airconditioning and Mechanical Contractors' Association
Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia
Ashurst Australia
Asia Pacific Loan Market Association Limited
Australian Bankers' Association
Australian Finance Conference
Australian Industrial Truck Association
Australian Institute of Credit Management
Australian Racing Board
Australian Restructuring Insolvency and Turnaround Association
BD Global
Big D Industries
Chamber of Commerce and Industry Queensland
City of South Houston Chamber of Commerce
Commercial Asset Finance Brokers Association of Australia
David Turner
Debtor and Invoice Finance Association
DLA Piper Australia
Hal Bolitho
Hall & Willcox Lawyers
International Sanitary Supplies Association
IWS
James Woerner Inc
Law Council of Australia
Law Institute of Victoria
Leading Edge Public Affairs
Lincoln Diaz-Balart
Master Builders Australia
MGZ Investments
Molly Bordonaro
National Association for the Visual Arts
New Americas Foundation
North American Development Group LLC
Office of the Australian Information Commissioner
Progressa
Public Records Office Victoria and State Records office of Western Australia
Reyes Kurson
Shopping Centre Council of Australia
Silk Road International
Slaughter Consulting and Implementation
Synthesis Corp
The Hon Antonio Munoz, State Senator

The Hon Edward Acevedo, State Representative
The Hon Iris Martinez, State Senator
The Hon Jared Moskowitz, State Representative
The Hon Martin Sandoval, State Senator
The Hon Patrick E Murphy, Congressman
The Hon Thaddeus Jones, State Representative
Tourism & Transport Forum
Tuggey Calvoz LLP
Tuscon Hispanic Chamber of Commerce
US Chamber of Commerce
Veda Advantage Limited

3. Responses to Consultation Paper 1

Allens
Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia
Anthony Duggan
Australian Bankers' Association
Australian Finance Conference
Australian Institute of Credit Management
Australian Securitisation Forum
Craig Wappett
David Turner
Debtor and Invoice Finance Association of Australia and New Zealand
DLA Piper
Hall & Willcox Lawyers
Hire & Rental Industry Association and Elevating Working Platform Association
Kerr's Hire
King & Wood Mallesons
Law Council of Australia
Law Society of New South Wales Rural Issues Committee and Property Law Committee
Lionel Meehan
Master Builders Australia
Murray Irrigation
National Irrigators' Council
New South Wales Office of Water
Professors McCracken, Stumbles and Tolhurst, University of Sydney, Faculty of Law
Queensland Law Society
Queensland Titles Registry
Shopping Centre Council of Australia
Steve Pemberton

4. Responses to Consultation Paper 2

Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia
Anthony Duggan
Australian Bankers' Association
Australian Finance Conference, Australian Equipment Lessors Association and Australian Fleet Lessors Association
Australian Institute of Credit Management
Australian Securitisation Forum
Austwine Group
Craig Wappett
David Turner
Debtor and Invoice Finance Association of Australia and New Zealand
DLA Piper
Hire & Rental Industry Association and Elevating Working Platform Association
Law Council of Australia
Linda Widdup
Lionel Meehan
Master Builders Australia
Professor Burrell and Associate Professor Handler
Queensland Law Society
Sheelagh McCracken
Steve Pemberton

5. Responses to Consultation Paper 3

Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia
Anthony Duggan
Australian Bankers' Association
Australian Finance Conference, Australian Equipment Lessors Association and Australian Fleet Lessors Association
Australian Restructuring Insolvency and Turnaround Association
Australian Securitisation Forum
David Turner
Debtor and Invoice Finance Association of Australia and New Zealand
Hire & Rental Industry Association and Elevating Working Platform Association
Law Council of Australia
Lionel Meehan
Master Builders Australia
Queensland Law Society
Steve Pemberton

6. Responses to Consultation Paper 4

Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia

Anthony Duggan

Australian Bankers' Association

Australian Finance Conference & Australian Equipment Lessors Association and Australian Fleet Lessors Association

Australian Institute of Credit Management

Australian Securitisation Forum

Commercial Asset Finance Brokers Association of Australia

Craig Wappett

David Turner

Debtor and Invoice Finance Association of Australia and New Zealand

DLA Piper

Hire & Rental Industry Association and Elevating Working Platform Association

Law Council of Australia

Linda Widdup

Master Builders Australia

Queensland Law Society

Sheelagh McCracken

Steve Pemberton

VEDA

PART B – ABBREVIATIONS USED TO IDENTIFY CONTRIBUTIONS REFERRED TO IN THE FOOTNOTES TO THE REPORT

Abbreviation	Name of contributor
ABA	Australian Bankers' Association
AD	Anthony Duggan
AFC	Australian Finance Conference
AICM	Australian Institute of Credit Management
AITA	Australian Industry Trade Association
ALPA	Australian Livestock & Property Agents Association
AMCA	Airconditioning and Mechanical Contractors' Association
APIA	Australian Pipeline Industry Association
APLMA	Asia Pacific Loan Market Association Limited
ARB	Australian Racing Board
ARITA	Australian Restructuring Insolvency and Turnaround Association
ASBC	Australian Small Business Commissioner
ASF	Australian Securitisation Forum
Avis	Avis Australia
BH	Professor R Burrell and Associate Professor M Handler
BusSA	Business South Australia
CAFBA	Commercial Asset Finance Brokers Association of Australia
CCF	Civil Contractors Federation
Chalkwest	Chalkwest Pty Ltd
CoSBA	Combined Small Business Alliance of Western Australia
CW	Craig Wappett
DIFA	Debtor & Invoice Finance Association
DLA	DLA Piper Australia
DT	David Turner
EDX	EDX Australia
Electaserv	Electaserv Trading
Elphinstone	Elphinstone Engineering
HB	Hal Bolitho
HRIA	Hiring & Rental Industry Association and Elevating Work Platform Association
HW	Hall & Wilcox Lawyers
JLF	Joint law firm submission from Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright Australia

Abbreviation	Name of contributor
Kerr	Kerr's Hire
KWM	King & Wood Mallesons
LCA	Law Council of Australia
LM	Lionel Meehan
LSNSW	Law Society of New South Wales Rural Issues Committee and Property Law Committee
LW	Linda Widdup
Manlift	Manlift Hire
MBA	Master Builders Association
MST	Professors S McCracken, J Stumbles and G Tolhurst
NAVA	National Association for the Visual Arts
NFF	National Farmers Federation
NSWBC	New South Wales Business Chamber
NSWYL	New South Wales Young Lawyers
OSBC	Office of the New South Wales Business Commissioner
Payne	Payne Investments
QLS	Queensland Law Society
RCIA	Restaurant and Catering Industry Association
SCCA	Shopping Centre Council of Australia
SMcC	Professor S McCracken
SP	Steve Pemberton
SSAA	Self Storage Association of Australasia
TBA	Thoroughbred Breeders Australia
Veda	Veda Advantage Limited

The footnotes also use abbreviations to refer to the different stages for contributions to the review. They are:

Abbreviation	Stage
S1	First round of submissions
S2	Second round of submissions
CP1	Responses to Consultation Paper 1
CP2	Responses to Consultation Paper 2
CP3	Responses to Consultation Paper 3
CP4	Responses to Consultation Paper 4

Annexure E

Recommendations

Chapter 4 – The reach of the Act

No.	Section	Recommendation
1.	4.1.4	*That the Act not be repealed, but rather that it be amended to enable it to better achieve its potential.*
2.	4.2.2	*That the definition of "interest" in s 10 of the Act be deleted.*
3.	4.2.3.1	*That s 12(2) be retained.*
4.	4.2.3.2	*That s 12(2)(d) be amended to read:* *"(d) an agreement to sell subject to retention of title;".*
5.	4.2.3.3	*That s 12(2)(g) be retained.*
6.	4.2.3.4	*That section 12(2)(j) be amended to read:* *"(j) a transfer of an account;".*
7.	4.2.3.5	*That s 12(2)(k) be deleted.*
8.	4.2.3.6	*That s 12(2)(l) be deleted.*
9.	4.3.2.1	*That s 12(3)(a), which provides that a transfer of an account can be a security interest whether or not it in substance secures payment or performance of an obligation, be retained.*
10.	4.3.2.2	*That the definition of "account" in s 10 of the Act be amended to clarify:* • *that it is limited to monetary obligations of the types that commercially would be described as being the transferor's "trade receivables" or "book debts"; and* • *that it does not capture corporate loans.*
11.	4.3.2.2	*That Government separately consider, in consultation with the States and Territories, whether the concept of an "account" under the Act should be expanded to include monetary obligations generally.*
12.	4.3.2.4	*That the Act not be amended to provide that s 12(3)(a) does not apply to an outright legal transfer of an account.*
13.	4.3.2.5	*That the Act be amended to confirm that a novation of an account is not a "transfer" for the purposes of s 12(3)(a) of the Act, unless it is clear that a corporate loan obligation is not an "account".*
14.	4.3.2.6	*That the Act not be amended to clarify whether a declaration of trust can be a "transfer" for the purposes of the Act.*
15.	4.3.3	*That the definition of "chattel paper" in section 10, and all references in the Act to chattel paper (including s 71), be deleted.*
16.	4.3.4.1	*That s 12(3)(b) be retained.*
17.	4.3.4.2	*That paragraph (e) of the definition of "commercial consignment" in s 10 of the Act be amended to read:* *(e) a consignee for sale, lease or other disposal if the consignee is or should reasonably be generally known to be selling or leasing goods of others.*

No.	Section	Recommendation
18.	4.3.5.1	*That s 12(3)(c) be retained, so that the Act will continue to apply to some types of longer–term leases, whether or not they operate in substance as security for payment or performance of an obligation.*
19.	4.3.5.2	*That paragraph (1)(e) of the definition of "PPS lease" in s 13 of the Act be deleted.*
20.	4.3.5.3	*That the definition of PPS lease in s 13 be amended to remove all references to "bailments".*
21.	4.3.5.4	*That:* • *s 13(1)(b) of the Act be deleted; and* • *the words "for an indefinite term or" be inserted at the start of s 13(1)(d).*
22.	4.3.5.5	*That references in s 13 of the Act to "one year" not be changed.*
23.	4.3.5.6	*That the Act not be amended to provide that a lease is not a PPS lease if it ends within one year.*
24.	4.3.5.7	*That s 13(2)(a) not be amended to insert "of that kind" after the phrase "regularly engaged in leasing goods".*
25.	4.4.2	*That the Act not be amended to include a definition of "property".*
26.	4.4.3	*That the definition of "personal property" in s 10 be amended by deleting the language "(including a licence)".*
27.	4.4.3	*That the first 4 lines of the definition of "licence" in s 10 be amended to read:* *"**Licence** means either of the following (whether or not the right, entitlement, authority or licence is exclusive), if it is personal property:".*
28.	4.4.4	*That the definition of "land" in s 10 be deleted.*
29.	4.4.5	*That the definition of "crops" in s 10 not be amended to clarify when it may include trees.*
30.	4.4.5	*That Government ask the States and Territories to consider enacting legislation that clarifies the circumstances in which "trees" can be "crops".*
31.	4.4.6	*That Government ask the States and Territories to agree that the Act be amended to delete the provisions that allow statutory rights to be removed from the reach of the Act.*
32.	4.5.2	*That s 8(1) be split into two provisions: one listing interests that are not "security interests" for the purposes of the Act, and the other listing interests that are not "personal property" for the purposes of the Act.*
33.	4.5.3	*That s 8(1)(e) of the Act not be amended.*
34.	4.5.4	*That Government consult further with appropriate experts in real property law to determine whether s 8(1)(f)(ii) of the Act can be recast more simply, and so that it neither overlaps with relevant real property law, nor allows for gaps between the Act and that law.*
35.	4.5.5	*That the language "(including a successive transfer)" be deleted from s 8(1)(f)(iii).*
36.	4.5.6	*That s 8(1)(f)(iv) be deleted.*

No.	Section	Recommendation
37.	4.5.7	*That s 8(1)(f)(v) be limited in its application to transfers of interests in policies of life insurance that are registrable under ss 200 and 201 of the Life Insurance Act 1995.*
38.	4.5.7	*That Government consider further whether transfers by way of security of interests in life insurance policies could also be brought within the Act.*
39.	4.5.8	*That ss 8(1)(f)(vii), 8(1)(f)(viii) and 8(4) be deleted.*
40.	4.5.9	*That Government explore with the States and Territories whether ss 8(1)(i) and 8(5) could be amended so that water rights are only excluded from the Act if they are able to be recorded under a statutory registration scheme that complies with the expectations set out in the 2005 Intergovernmental Agreement on a National Water Initiative.*
41.	4.5.10.1	*That the definition of "fixture" in s 10 be deleted.*
42.	4.5.10.2	*That Government explore with the States and Territories whether a regime can be developed, potentially along the lines of the principles applied in the Canadian PPSAs, that would allow fixtures to be brought within the Act.*
43.	4.5.11	*That ss 8(1)(a) and (b) be deleted, and that s 109 be amended to provide that Chapter 4 does not apply to security interests of the type described in s 8(6).*
44.	4.5.12	*That s 8(1)(jb) be deleted.*
45.	4.5.13	*That the Act not be amended to exclude or otherwise modify the rules for a lease of fit-out or other goods as part of a lease of real property, beyond what is already provided in s 13(2)(c).*
46.	4.5.14	*That the Act not be amended to exclude turnover trusts.*
47.	4.5.15	*That the Act not be amended to clarify whether the making of a deposit under an agreement for the sale of property will give rise to a security interest.*
48.	4.5.16	*That the Act not be amended at this time to clarify whether securities lending arrangements are subject to the Act.*
49.	4.5.16	*That Government consider further, in consultation with industry, whether (and if so, how) securities lending arrangements, and potentially other similar arrangements, should be excluded from the Act.*
50.	4.5.17	*That the Act not be amended to provide that it does not apply to transactions or property below minimum thresholds.*

Chapter 5 – Creating an effective security interest

No.	Section	Recommendation
51.	5.1.2	*That Government:* • *provide stakeholders with an opportunity to present further arguments in support of the competing models that have been proposed to explain the reach of the concept of "rights in the collateral" in s 19(2)(a), including by allowing proponents of the "possession" model to complete a corresponding version of the table that is attached to this report as Annexure C;* • *decide on the basis of the discussion in this report and that further input, which of those two models it prefers; and* • *include an explanation of the preferred model in the Explanatory Memorandum for the legislation that amends the Act to implement other recommendations in this report.*
52.	5.1.2	*That s 19(5) be amended to clarify that it applies to all security interests that arise in circumstances where the secured party has title to the collateral as a matter of general law.*
53.	5.1.3	*That s 19(2)(a) be amended to read:* *"(a) the grantor has rights in the collateral; and".*
54.	5.1.4	*That s 19 not be amended to state that a security interest can only arise under a security agreement.*
55.	5.2.1	*That ss 18(2) and (4) be retained.*
56.	5.2.1	*That s 18(4) be amended to read:* *"(4) A security interest may secure payment or other obligations that are incurred after the security interest is granted."*
57.	5.2.2	*That s 20(2) be recast along these lines:* *"(2) (a) A security agreement covers collateral in accordance with this subsection if the items described in paragraph (b) are evidenced by writing that is:* *(i) signed by the grantor (see subsection (3)); or* *(ii) adopted or accepted by the grantor by an act, or omission, that reasonably appears to be done with the intention of adopting or accepting the writing.* *(b) The items referred to in paragraph (a) are:* *(i) the security interest that is provided for by the security agreement; and* *(ii) a description of the collateral that is sufficient to enable it to be identified."*
58.	5.2.2	*That ss 20(4) and (5) be deleted.*
59.	5.2.3	*That s 20(2) be amended to make it clear that the requirements in the section need only be satisfied with the original grantor of a security interest over collateral, and not with a person who subsequently becomes the grantor as the result of the collateral being transferred to it.*
60.	5.3.2.1	*That the language "(other than possession as a result of seizure or repossession)" in s 21(2)(b) be retained.*

No.	Section	Recommendation
61.	5.3.2.1	*That the language "(other than as a result of seizure or repossession)" be inserted after "the collateral" in s 20(1)(b)(i).*
62.	5.3.2.2	*That s 24(6) be amended to clarify that it only applies to a security interest over a registrable investment instrument.*
63.	5.3.4.1	*That the Act retain the concept of an intermediated security.*
64.	5.3.4.2	*That Government explore, in consultation with experts in the financial investments industry, how the mechanisms for perfecting by control over an intermediated security can be structured to better achieve the publicity objective of perfection, such as by ensuring that a secured party will only be perfected by control if it is able to ensure that the intermediated security cannot be dealt with without its consent.*
65.	5.3.4.3	*That Government explore, in consultation with experts in the financial investments industry, whether and if so how the concept of an intermediated security can be simplified.*
66.	5.3.4.4	*That the Act be amended to make it clear that an intermediary can perfect a security interest by control over intermediated securities held with it.*
67.	5.3.4.5	*That the Act be amended so that shares or other securities listed on the Australian Stock Exchange and held through the CHESS system are investment instruments, rather than intermediated securities.*
68.	5.3.4.6	*That Government explore, in consultation with experts in the financial investments industry, whether the Act should be amended to allow a secured party to perfect by control over cash that is held through an intermediary in the same way as it can perfect by control over other financial assets.*
69.	5.3.5.1	*That Government explore, in consultation with experts in the financial investments industry, whether the definition of "investment instrument" in s 10 could be simplified, for example along the same lines as paragraph (b) of the definition of "financial product" in s 10 of the Act.*
70.	5.3.5.2	*That Government explore, in consultation with experts in the financial investments industry, how the mechanisms for perfecting by control over an investment instrument can be structured to better achieve the publicity objective of perfection, such as by ensuring that a secured party will only have control if it is able to ensure that the investment instrument cannot be dealt with without its consent.*
71.	5.3.6	*That Government explore, in consultation with experts in the financial investments industry, how to make the mechanisms for perfection by control in ss 26 and 27 as consistent as is possible.*
72.	5.3.7.1	*That the term "ADI account" be replaced with a more generic term such as "bank account", and that the definition of the term in s 10 be expanded to include accounts that are held with other financial institutions, for example if they are subject to a corresponding regulatory framework in another country.*
73.	5.3.7.2	*That the Act not be amended to allow a secured party other than the ADI itself to perfect by control over an ADI account.*

No.	Section	Recommendation
74.	5.3.7.3	*That a security interest held by an ADI in an ADI account with it continue to be automatically perfected by control.*
75.	5.3.8	*That Government explore, in consultation with experts in the law of negotiable instruments, whether ss 21(2)(c)(iv) and 29 are meaningful, or should be deleted.*
76.	5.3.9	*That Government explore, in consultation with experts in the law and practice of letters of credit, whether ss 21(2)(c)(v) and 28 are appropriate, or whether they should be deleted.*
77.	5.3.10	*That s 21(2)(c)(vi) be deleted.*
78.	5.3.11	*That the Act not be amended to enable a person with a security interest over a performance bond or bank guarantee to perfect the security interest by control.*
79.	5.3.12.2	*That the references in ss 22(4), 33(2), 34(1), 35(2), 36(2), 38(3), 39(3)(b)(ii) and 40(3)(b)(ii) to "5 business days" be replaced with "10 business days".*
80,	5.3.12.2	*That the references in ss 39(3)(b)(i) and 40(3)(b)(i) to "56 days" be replaced with "60 days".*
81.	5.3.12.3	*That ss 22, 39 and 40 be amended to provide that temporary perfection simply expires at the end of the period provided for in the section.*
82.	5.3.13	*That the Act not be amended to enable a transferee of an account or chattel paper to perfect its security interest by giving notice of the transfer to the obligor, or by taking other steps that would require the obligor to make payments to the transferee (or someone on its behalf).*
83.	5.3.14.1	*That s 56 be amended to reflect the language of s 23(1) of the Sask PPSA, but in a way that still permits a security interest to be continuously perfected by a series of financing statements.*
84.	5.3.14.2	*That the Act not be amended to include a provision of the type found in s 35(7) of the Sask PPSA.*

Chapter 6 – Perfection by registration

No.	Section	Recommendation
85.	6.1.2	*That the layout of the Register, and the order and manner in which it asks questions of a registrant or a searcher, be reviewed in order to make the Register as simple and easy to use as possible, particularly from the perspective of an unsophisticated user.*
86.	6.2.1.1	*That the Act be amended so that:* • *a registration does not need to indicate whether the collateral is consumer property or commercial property;* • *all registrations against individuals, or against serial-numbered property that may not identify the grantor because the grantor is an individual, must have a maximum term of 7 years; and* • *a registration that is made against only serial-numbered property and that identifies the serial number may not identify the grantor, if the grantor is an individual.*

No.	Section	Recommendation
87.	6.2.1.2	*That the definitions of "consumer property" and "commercial property" in s 10 of the Act be deleted.*
88.	6.2.2	*That item 1 of the table in clause 4.1 of Schedule 1 to the Regulations be deleted.*
89.	6.2.3	*That item 2 of the table in clause 4.1 of Schedule 1 to the Regulations be deleted.*
90.	6.2.4	*That item 6 of the table in s 153(1) be deleted.*
91.	6.2.5	*If item 7 of the table in s 153(1) is retained, that it be made clear that a registration that does not tick the PMSI box can nonetheless perfect a PMSI, but on the basis that the PMSI cannot benefit from the super-priority afforded by s 62.*
92.	6.3	*That item 4(c) of the table in s 153(1) and the functionality of the Register be amended to enable a registration to be made against a number of collateral classes at the same time, using a common free text field.*
93.	6.3	*That the collateral classes on the Register be changed to the following 6 classes:* • *serial-numbered property (with appropriate sub-classes for the different types of serial-numbered property);* • *other goods;* • *accounts;* • *other intangible property;* • *all present and after-acquired property;* • *all present and after-acquired property except.*
94.	6.4.2	*That the Act be amended to make it clear that a registration that contains text that describes collateral is only effective to perfect a security interest in the collateral that is so described.*
95.	6.4.3	*That the Act not be amended to oblige a registrant to include details of collateral in the free text field as a condition to making it an effective registration.*
96.	6.4.4	*That the Act not be amended to prohibit the practice of registering a financing statement against the "allpap except" collateral class, and then describing the "except" so that the registration operates in effect to perfect a security interest over "all present and after-acquired property except property that the secured party does not have a security interest over".*
97.	6.4.5	*That the Register functionality not be amended to activate the free text field for a registration against the collateral class "allpap".*
98.	6.5	*That item 4(d) of the table in s 153(1), and clause 2.4 of Schedule 1 to the Regulations, be deleted.*
99.	6.6.1	*That clause 2.2 of Schedule 1 to the Regulations not be amended.*
100.	6.6.2	*That the table in s 153(1) be amended to provide that a registration against serial-numbered property have the same registration period as for any other collateral, for the relevant type of grantor.*

No.	Section	Recommendation
101.	6.6.3	*That Government explore whether the current definition of "motor vehicle" in reg 1.7 of the Regulations could be amended so that a vehicle is a motor vehicle (and is only a motor vehicle) for the purposes of the Act and the Regulations if it has a vehicle identification number.*
102.	6.6.4	*That the Regulations be amended to clarify that a registration made against the collateral class "motor vehicle" before 1 July 2014 will continue to be effective to perfect a security interest taken under a security agreement entered into before 1 July 2014 in a "motor vehicle" within the meaning of that term that applied under the Act before 1 July 2014, despite commencement of the Personal Property Securities (Motor Vehicles) Regulation 2014.*
103.	6.6.5	*That item 2.2(1) of Schedule 1 to the Regulations be amended so that a registration to perfect a security interest over aircraft may include the aircraft's serial number, but is not required to.*
104.	6.6.6	*That Government consider whether clause 2.2(3)(d) of Schedule 1 to the Regulations should be amended to provide that the serial number for a watercraft that does not have an official number is its International Maritime Organisation (IMO) number, if it has one.*
105.	6.6.7	*That items 2.2(1)(a)(ii)(E) and (c)(iii)(E) of Schedule 1 to the Regulations not be deleted.*
106.	6.6.8	*That the Act and the Regulations not be amended to allow a secured party to permanently perfect a security interest over a patent by registering against its patent application number.*
107.	6.7.1	*That item 2 of the table in clause 1.2 of Schedule 1 to the Regulations be deleted.*
108.	6.7.2	*That items 3 to 8 of the table in clause 1.2 of Schedule 1 to the Regulations not be amended.*
109.	6.7.3	*That item 5 of the table in clause 1.3 of Schedule 1 to the Regulations be amended to provide that the identifying details for a body corporate that is not captured by any of items 1 to 4 of the table be its name under the law under which it is incorporated.*
110.	6.7.4.1	*That the Regulations be amended so that a registration to perfect a security interest over trust assets should be made against the relevant details for the trustee, rather than the ABN or other identifying details for the trust.*
111.	6.7.4.2	*That a registration relating to assets of a trust not be required to include the name of the trust.*
112.	6.7.4.3	*If the Regulations continue to require that registrations be made against a trust's ABN, that clause 1.5(1)(b) of Schedule 1 to the Regulations be amended to make it clear that it applies "to any trustee of a trust that is not a body corporate".*
113.	6.7.4.3	*That Government consider whether a registration should be able to be made against a scheme's ARSN if the security interest is granted by the scheme custodian, rather than the responsible entity.*

No.	Section	Recommendation
114.	6.7.5.1	*That the current distinction drawn in clause 1.4 of Schedule 1 to the Regulations, between the assets of a partnership and a partner's net interest in the partnership, be maintained and clarified.*
115.	6.7.5.2	*That the Regulations be amended to provide that a registration to perfect a security interest over assets of a partnership be made against the following grantor details;* • *the partnership's ABN, if it has one;* • *failing that, the partnership's registered name in its place of establishment;* • *if the partnership has no registered name in its place of establishment, the name of the partnership and the name of at least one of the partners; and* • *if the partnership has no name, the names of all partners.*
116.	6.7.6	*That it be made clear that a registration against multiple grantors is only effective to perfect a security interest that is granted by them jointly.*
117.	6.7.7	*That the Register continue to use an exact-match methodology for searches.*
118.	6.7.7	*That the Regulations be amended to provide, in circumstances where a grantor's or secured party's name or other identification details would otherwise need to be entered on the Register in letters that are not accepted by the Register, that the registrant be able instead to use any reasonable transliteration of that name or other identifying details for the purposes of the registration.*
119.	6.8.1	*That paragraph (b) of the definition "secured party" in s 10 be deleted.*
120.	6.8.2	*That item 1(b) of the table in s 153(1) be amended to read:* *"(b) a person, nominated by the secured party before the financing statement is registered, who has authority to act on behalf of the secured party in matters relating to the registration."*
121.	6.8.3	*That the Registrar be asked to explore whether the "Secured Party Group" functionality on the Register could be altered to allow the identity of secured parties in a Secured Party Group to be changed, but that this not be pursued if there are material impediments to doing so.*
122.	6.8.4	*That the expression "GONI" on the Register be replaced with a term that more clearly indicates its purpose, such as: "secured party's internal reference number".*
123.	6.9	*That the Act not be amended to impose a maximum registration period of 7 years for all registrations.*
124.	6.10.1	*That s 153(1) be amended to clarify that data entered on the Register will be a financing statement if the data populates the fields referred to in the table in that section, whether or not the data as so entered is accurate.*
125.	6.10.2	*That ss 164(1)(a) and (b) be amended to read:* *"(a) a defect mentioned in section 165; or* *(b) any other defect in any data relating to the registration, other than a defect of a kind prescribed by the regulations, if the defect is seriously misleading."*

No.	Section	Recommendation
126.	6.10.3.1	*That the Act not be amended to include a definition of "seriously misleading".*
127.	6.10.3.2	*That s 165(c) be deleted.*
128.	6.10.4.2	*That s 151(1) be retained, and that the Act not be amended to require a registrant to obtain a person's consent before registering a financing statement against the person or their property.*
129.	6.10.4.3	*That s 151(1) be amended to provide that a person may register a financing statement if the person believes on reasonable grounds that the person described in the statement as the secured party is or may be, or may become, a secured party in relation to the collateral.*
130.	6.10.4.4	*That s 151(1) be amended to provide that a registrant must include a further description of the collateral in the free text field, using the information that is reasonably available to the registrant at the time the registration is made, but that the section not specify the level of detail that the further description needs to satisfy.*
131.	6.10.4.5	*That ss 151(2) and (3) not be repealed or amended.*
132.	6.10.4.6	*That s 167 be amended so that:* • *it applies (and applies only) to registrations against individuals (or to registrations against serial-numbered property that do not include the grantor's details because the grantor is an individual); and* • *it only requires the secured party to remove a registration from the Register within 5 business days after it becomes aware, or should reasonably have become aware, that it no longer has any security interest over any collateral that is perfected because of the registration.*
133.	6.10.5.2	*That s 178(1) be amended to allow an amendment demand to be made by a person who is identified as the grantor in the registration, or was otherwise the grantor of the security interest to which the registration related.*
134.	6.10.5.3	*That s 178(1) be amended to accommodate the fact that a registration may perfect a security interest that does not secure an obligation because it is deemed to be a security interest by s 12(3).*
135.	6.10.5.4	*That the functionality of the Register allow a registration to be amended by removing a collateral class (if Recommendation 92 is adopted to allow a registration to be made against more than one collateral class), or by replacing a collateral class with a narrower one.*
136.	6.10.5.5	*That s 179(3) be deleted.*
137.	6.10.5.6	*That reg 5.9(g) of the Regulations be deleted, and that the balance of reg 5.9 be simplified.*
138.	6.10.5.7	*That it be made clear that a proceeding "comes before a court" for the purposes of s 179 when a party first files an originating process with the court.*
139.	6.10.5.8	*That the amendment demand process in Part 5.6 of the Act be recast along the lines of the approach taken in New Zealand, under s 165 of the NZ PPSA.*
140.	6.10.5.9	*That the Act not be amended to prohibit a secured party from obliging its grantor not to make amendment demands.*

No.	Section	Recommendation
141.	6.10.6	*That no additional mechanisms need to be included in the Act to facilitate the removal of registrations.*
142.	6.11.1	*That no steps need to be taken at this time to expand the ways in which users can access the Register.*
143.	6.11.2	*That the Act not be amended to require a secured party to file a copy of its security agreement as part of its registration.*
144.	6.11.3	*That the Act not be amended to provide that a registration be required to specify a maximum amount secured.*
145.	6.11.4.1	*That the Act and the Regulations not be amended to provide that a security interest will only be continuously perfected by a series of registrations if those registrations are linked using the "Earlier Registration Number" field on the Register.*
146.	6.11.4.2	*That the Register be amended to allow multiple registration numbers to be entered in the "Earlier Registration Number" field on the Register.*
147.	6.11.5	*That the current structure of the Register as principally a grantor-based registration system be retained, and that the Act not be amended to allow one registration to perfect all security interests over an asset, regardless of the identity of the grantor.*
148.	6.11.6	*That the Act not be amended to provide for separate registers for security interests that arise from different types of transactions.*
149.	6.11.7	*That Government separately consider whether it wishes to facilitate the establishment of a register of construction and heavy industry machines.*
150.	6.11.9	*That AFSA be asked to incorporate suggestions in the submissions that go to the supporting functionalities of the Register into its current planning processes, and to discuss them with AFSA's consultative forums, as appropriate.*
151.	6.11.9	*That Government consider separately whether it wishes to facilitate data analytics being undertaken on data in the Register.*
152.	6.11.10.1	*That s 157(1) be amended to require a secured party to give a notice of a verification statement to the grantor, where the grantor's details are not included in the registration, on the following basis:* *1. If the secured party has already entered into the security agreement, it should give the notice to the grantor under the security agreement.* *2. If the secured party has not yet entered into the security agreement with the grantor, it should give the notice to the person who it anticipates will be the grantor, and then re-issue the notice when the security agreement has been entered into, if the actual grantor is not the same person.*
153.	6.11.10.2	*That the Act be amended to provide Government with the power to make regulations that excuse a secured party from the obligation to give a notice of verification statement to the grantor in relation to events of the type listed in those regulations.*

No.	Section	Recommendation
154.	6.11.10.2	*That the Act not be amended to exempt a secured party from the obligation to give a notice of verification statement just because it is part of a bulk transfer.*
155.	6.11.10.3	*That s 157 not be amended to provide that a secured party need only give a notice of verification statement to a grantor in relation to commercial property if it agrees with the grantor that it will do so.*
156.	6.11.11	*That the Act not be amended to provide that a person should not be taken to have knowledge of the contents of the Register where the general law would hold otherwise.*
157.	6.11.12	*That:* • *s 160 be amended to provide that a financing statement (rather than a description of collateral) starts to be registered when data in the financing statement becomes available for search in the register; and* • *corresponding simplifications be made where possible to other sections of the Act.*
158.	6.11.13	*That the Act not be amended to give courts a power to rectify ineffective registrations.*
159.	6.11.14	*That s 186 be amended to make it clear that it applies only to data that was removed from the Register by the Registrar.*
160.	6.11.15.2	*That residual issues with registrations that were migrated from the ASIC charges register be addressed, if technically feasible, by:* • *matching organisation names for grantors on the Register to ACNs in ASIC's register; and* • *then processing a bulk data change to amend the relevant "deregistered grantor" registrations by replacing the organisation name with the matched ACN.*
161.	6.11.15.3	*That AFSA investigate identified instances of incorrect migrations from State or Territory registers and then develop and implement solutions, where appropriate, in consultation with its relevant consultative forums.*
162.	6.11.15.4	*That the Act be amended to empower the Registrar to amend migrated data on the Register as the Registrar considers necessary to correct errors arising from the migration process.*
163.	6.12.1	*That ss 150(3)(c) and (d) be deleted.*
164.	6.12.2	*That the Act be amended to provide that the Registrar does not need to exercise procedural fairness when giving effect to a court order, and that the Registrar instead be able to seek further directions from the court as to the way in which the Registrar should give effect to the order.*
165.	6.12.3	*That s 195A be amended to confirm that the Registrar's power to conduct investigations extends to investigations that are conducted for purposes that may include pursuing the enforcement of civil penalties.*

No.	Section	Recommendation
166.	6.12.4	*That:* • *the definition of "business day" in s 10 not be amended; and* • *the Registrar be asked to maintain a "business day calendar" on the Registrar's website.*
167.	6.12.5	*That:* • *the Registrar be empowered to issue a notice to a secured party by publication on the Registrar's website, if the Registrar has no other valid notice details for a secured party; and* • *any notice period required by the Act in relation to such a notice be extended by an appropriate additional period.*

Chapter 7 – Dealings in collateral

No.	Section	Recommendation
168.	7.1	*That the Act be amended to ensure that it uses consistent terminology when it refers to dealings in collateral, and if different terms are used to describe particular types of dealings, that it be made clear what the differences in meaning are as between those different terms.*
169.	7.2	*That Government consider further whether the Act should continue to provide that a transfer of collateral subject to a security interest will cause the transferee to become the grantor of that security interest, or whether the Act should be amended to reflect the alternative approach taken under the Canadian PPSAs and the NZ PPSA.*
170.	7.3.1	*That Government expand the further consultation process described in Recommendation 51 to include consideration of the extent to which the competing models described in that Recommendation will affect the position of a lessor of collateral that is subsequently subleased by the lessee to a sublessee.*
171.	7.3.2	*That Government expand the further consultation process described in Recommendation 51 to include consideration of the extent to which the competing models described in that Recommendation will affect a security interest over collateral that is leased by the grantor to a lessee, where the lessee subsequently becomes insolvent in a way that causes the grantor's interest in the leased goods to vest in the lessee under s 267.*
172.	7.3.3	*That the Act not be amended to provide that a registration against one member of a corporate group is sufficient to perfect a security interest that is granted by another member of that group.*
173.	7.4.1.1	*That s 31(3)(a)(i) be amended to make it clear that the grantor referred to in the section is the original grantor of the security interest, not a person who subsequently becomes the grantor as a result of the collateral being transferred to it.*
174.	7.4.1.2	*That the words "an interest" in s 31(3)(a)(i) be replaced with "rights".*
175.	7.4.2	*That s 31(3)(a)(ii) be deleted.*

No.	Section	Recommendation
176.	7.4.3	*That s 32(1) be amended to read along these lines:* *"(1) Subject to this Act:* *(a) if collateral is dealt with, the security interest remains attached to the collateral, unless the secured party expressly or impliedly agreed that a party to the dealing could take the collateral free of the security interest; and* *(b) if collateral gives rise to proceeds (by being dealt with or otherwise), the security interest attaches to the proceeds unless the security agreement provides otherwise."*
177.	7.4.4	*That s 32(2) be retained, and that the start of s 32(2) be amended to read along these lines:* *"(2) If the secured party enforces a security interest against both collateral and proceeds that arise from a transfer of the collateral, the amount secured by the security interest in the collateral and proceeds is limited….".*
178.	7.4.4	*That s 32(3) be deleted.*
179.	7.4.5	*That s 32(5) be amended to read along these lines:* *"(5) The time of registration in relation to original collateral, or the time of perfection of a security interest in original collateral, is also the time of registration or perfection in relation to the proceeds of the original collateral, if the security interest has been continuously perfected ."*
180.	7.4.6.1	*That the Act be amended to provide that a security interest over collateral that is perfected by registration is automatically perfected over any proceeds of that collateral.*
181.	7.4.6.2	*If Recommendation 180 is not adopted, that s 33(1)(b) be amended to make it clear that the security interest is perfected over the proceeds if the proceeds are within the collateral description of any current financing statement made by the secured party against the grantor, not just the same financing statement.*
182.	7.4.6.3	*If Recommendation 180 is not adopted, that s 33(1)(c) be retained.*
183.	7.5.1	*That the Act not be amended to require an intending transferee of collateral to search the Register and advise any relevant secured party of the proposed transfer.*
184.	7.5.2	*That "in the collateral" be inserted after "interest" in line 3 of s 34(1).*
185.	7.6.1	*That the requirement for value in ss 43 to 52 and ss 69 to 72 be as follows:* • *ss 48, 49 and 69 – no value requirement; and* • *the remaining sections – new value.*
186.	7.6.1	*That the Act continue to allow "new value" to be a nominal amount.*
187.	7.6.2	*That the Act be amended to provide that a person has knowledge of something for the purposes of the Act when information comes to their attention under circumstances in which a reasonable person would take cognisance of it.*

<table>
<tr><th>No.</th><th>Section</th><th>Recommendation</th></tr>
<tr><td>188.</td><td>7.6.2</td><td>That the taking free rules in the sections set out in the following table be amended so that the “value” and “knowledge” qualifiers in those sections are as set out in the following table:
<table>
<tr><th>Section</th><th>Circumstance</th><th>Value required</th><th>Knowledge qualifier</th></tr>
<tr><td>43</td><td>Unperfected security interest</td><td>New value</td><td>Knowledge of security interest</td></tr>
<tr><td>44</td><td>Serial-numbered property</td><td>New value</td><td>Knowledge of security interest</td></tr>
<tr><td>45(1)</td><td>Motor vehicle – the “day and a half” rule</td><td>New value</td><td>Knowledge of security interest</td></tr>
<tr><td>45(3)</td><td>Motor vehicle – seller or lessor is a prescribed person</td><td>New value</td><td>Knowledge of breach</td></tr>
<tr><td>46</td><td>Ordinary course of business</td><td>New value</td><td>Knowledge of breach</td></tr>
<tr><td>47</td><td>Low-value personal domestic or household property</td><td>New value</td><td>Knowledge of the security interest</td></tr>
<tr><td>48</td><td>Currency</td><td>None</td><td>Knowledge of breach</td></tr>
<tr><td>49</td><td>Purchaser of investment instrument or intermediated security on stock exchange or similar</td><td>None</td><td>None</td></tr>
<tr><td>50</td><td>Investment instrument with possession or control</td><td>Value New value</td><td>Knowledge of security interest</td></tr>
<tr><td>51</td><td>Intermediated security in consensual transaction</td><td>New value</td><td>Knowledge of security interest</td></tr>
<tr><td>52</td><td>Temporarily perfected security interest</td><td>New Value</td><td>Knowledge of security interest</td></tr>
<tr><td>69</td><td>Creditor receiving payment of a debt</td><td>None</td><td>Knowledge of breach</td></tr>
<tr><td>70</td><td>Negotiable instrument with possession or control</td><td>New value</td><td>Knowledge of breach</td></tr>
<tr><td>71</td><td>Chattel paper in consensual transaction</td><td>New value</td><td>Knowledge of breach</td></tr>
<tr><td>72</td><td>Negotiable document of title</td><td>New value</td><td>Knowledge of breach</td></tr>
</table></td></tr>
<tr><td>189.</td><td>7.6.3</td><td>That the Act not be amended to define the term “buyer”.</td></tr>
<tr><td>190.</td><td>7.6.4.2</td><td>That s 44(2)(a) be deleted.</td></tr>
<tr><td>191.</td><td>7.6.4.3</td><td>That s 44 continue to apply to all types of property that may, or must, be described by serial number in a registration.</td></tr>
<tr><td>192.</td><td>7.6.5</td><td>That s 45(1) be retained, but that it only operate in favour of a buyer or lessee who is an individual.</td></tr>
<tr><td>193.</td><td>7.6.5</td><td>That s 45(2)(c) be deleted.</td></tr>
<tr><td>194.</td><td>7.6.5</td><td>That the content of ss 45(1)(c) and 45(2) be simplified.</td></tr>
<tr><td>195.</td><td>7.6.6</td><td>That s 45(4)(c) be deleted.</td></tr>
<tr><td>196.</td><td>7.6.7.1</td><td>That s 46(2)(a) be deleted.</td></tr>
</table>

No.	Section	Recommendation
197.	7.6.7.2	*That s 46(1) continue to apply only to security interests that are given by the seller or lessor, or that arise under s 32.*
198.	7.6.7.3	*That the Act not to be amended to limit s 46 to goods.*
199.	7.6.8	*That s 47(1) be amended so that the market value only needs to be determined when the agreement to buy or lease is entered into.*
200.	7.6.8	*That s 47(2)(c) be amended to provide that s 47(1) does not apply if, at the time the agreement for sale or lease is entered into, the buyer or lessee believes that the market value of the personal property is more than $10,000 (or any greater amount prescribed by regulation).*
201.	7.6.9	*That Government consider further, in consultation with industry, whether there are good policy reasons for retaining s 50 and, if there are not, that s 50 be deleted.*
202.	7.6.9	*That s 50 be amended, if it is retained, to clarify that it does not operate in favour of another secured party.*
203.	7.6.10	*That Government consider further, in consultation with industry, whether there are good policy reasons for retaining s 51 and, if there are not, that s 51 be deleted.*
204.	7.6.10	*That s 51 be amended, if it is retained, to clarify that it does not operate in favour of another secured party, and to clarify the purpose and meaning of s 51(1)(b).*
205.	7.6.11.1	*That s 52(1) be amended by replacing the references to proceeds, goods or negotiable documents of title with references to "personal property".*
206.	7.6.11.2	*If Government decides (pursuant to Recommendation 169) to allow the Act to continue to provide that a transfer of collateral subject to a security interest makes the transferee the grantor of the security interest, that Government consider whether s 52 should be amended to provide that it does not apply to a security interest that is temporarily perfected under s 34.*
207.	7.6.11.3	*That s 52(2) be amended so that any buyer or lessee can rely on s 52(1) unless they had the requisite knowledge at the time that they entered into the agreement to buy or lease the property.*
208.	7.6.12.1	*That s 69 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*
209.	7.6.12.2	*That the language of s 69 be tailored more closely to Australian market conditions, and that the rules in ss 48 and 69 be more closely aligned.*
210.	7.6.13.1	*That the definition of "negotiable instrument" in s 10 be deleted, to allow the term to have the same meaning as at general law.*
211.	7.6.13.2	*That s 70 be retained.*
212.	7.6.13.3	*That s 70 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*
213.	7.6.15.1	*That s 72 be retained.*
214.	7.6.15.2	*That s 72 be reframed as a taking free rule, and moved to Part 2.5 of the Act.*

No.	Section	Recommendation
215.	7.6.16	*That s 53 be deleted.*
216.	7.6.17.1	*That s 37 be amended to make it clearer that it only applies if the effect of the buyer or lessee taking the goods free of a security interest was that the security interest ceased to be attached to the goods.*
217.	7.6.17.2	*That s 37 not be amended to make it clearer that it applies where a person has taken collateral free of a security interest because of the operation of s 32.*
218.	7.6.17.3	*That ss 37 and 38 be amended to ensure that they apply appropriately for all types of security interests.*
219.	7.6.18.3	*That Government consider, in consultation with the States and Territories, whether or not taking free rules may be contained in laws other than the Act, and that the Act be amended to set out the agreed position.*
220.	7.7.1	*That the Act be amended to confirm that the priority position as between competing security interests is determined at the time when they come into conflict.*
221.	7.7.2	*That the Act be amended to make it clear that priority as between two unperfected security interests that attach to collateral at the same time is to be determined by the order in which the security agreements were entered into.*
222.	7.7.3	*That the language of s 55(5) be simplified, potentially by amending it to read:* *"(5) For the purposes of subsection (4), the **priority time** for a security interest in collateral is, subject to subsection (6), the earlier of the following times to occur in relation to the security interest:* *(a) the registration time for the collateral; and* *(b) the time at which the security interest becomes perfected."*
223.	7.7.4.1	*That Government consider, as part of the further consultations referred to in Recommendations 64 to 76, whether it is appropriate for a security interest that is perfected by control to be entitled to a super–priority, for each of the types of collateral listed in s 21(2)(c).*
224.	7.7.4.2	*That s 57(2) be amended to provide, if more than one security interest is perfected by control over an item of collateral at the same time, that priority is afforded to the security interest that is held by the secured party that took control first.*
225.	7.7.4.3	*That s 57(2A) be deleted.*
226.	7.7.5	*That s 58 be amended to read along these lines:* *"A security interest has the same priority for all amounts and obligations secured by it, whether they are incurred or arise before or after the security interest arises."*
227.	7.7.5	*If Recommendations 56 and 226 are adopted, that the definition of "future advance" in s 10 be deleted.*
228.	7.7.6	*That s 59 be deleted.*
229.	7.7.7	*That the language of s 61 and other relevant sections in the Act be amended to refer to "priority" rather than "subordination" agreements between secured parties.*

No.	Section	Recommendation
230.	7.7.8.1	*That the Act be amended, if necessary, to make it clear that s 14(1) captures all leases or consignments that give rise to a security interest, whether or not they are a PPS lease or a commercial consignment.*
231.	7.7.8.2	*That the Act be amended to provide that a sale and lease-back can give rise to a PMSI if (and to the extent that) the PMSI secured party paid the purchase price for the collateral directly to the supplier.*
232.	7.7.8.3	*That the Act not be amended to provide a security interest with PMSI status to the extent it secures funds provided by a secured party to a grantor or debtor to reimburse it for a deposit previously paid for the collateral.*
233.	7.7.8.4	*That ss 14(2)(c) and (2A) be deleted.*
234.	7.7.8.5	*That the Act be amended to enable PMSIs in inventory to be cross-collateralised, to the extent that the items of inventory are not separately identifiable.*
235.	7.7.8.6	*That references in the Act to a PMSI not be amended to indicate whether they refer to a PMSI as defined in s 14 or to a PMSI that has priority under s 62 (on the basis that the references are simply to a PMSI as defined in s 14), and that clarifying language only be included where the intention is to refer only to a PMSI that has priority under s 62 (such as in s 103).*
236.	7.7.8.7	*That s 14(5) be expanded to make it clear that a security interest that replaces a PMSI can also be a PMSI.*
237.	7.7.8.8	*That ss 62 and 63 continue to assess whether a registration is made in time to achieve PMSI super-priority by reference to the time when the grantor obtains possession, not when the secured party provides its funding.*
238.	7.7.8.9	*That the Act be amended to clarify that references in ss 62 and 63, and elsewhere in the Act, to a grantor obtaining or having possession of personal property, are references to the grantor obtaining or having that possession in its capacity as grantor.*
239.	7.7.8.10	*That ss 62 and 63 be amended to provide a uniform timeframe of 15 business days for a registration that perfects a PMSI for all types of collateral, including collateral that is inventory.*
240.	7.7.8.11	*That s 62 not be amended to require a secured party that wants to claim PMSI priority to give notice of this to existing secured parties, or to provide other information in its registration.*
241.	7.7.8.11	*That s 62(2)(c), and item 7 of the table in s 153(1), be deleted.*
242.	7.7.9.1	*That s 64 be retained.*
243.	7.7.9.2	*That the Act not be amended to provide that a retention of title supplier is not able to trace its security interest into receivables that are acquired by a receivables financier.*
244.	7.7.9.3	*That s 64 be amended to provide that an accounts financier can use the section to take priority over both a PMSI held by an inventory financier in the proceeds of its inventory, and over a non-PMSI security interest held by the same inventory financier in those proceeds.*
245.	7.7.9.4	*That s 64 continue to only apply to PMSIs that are granted by the same person as the person who granted the security interest in the account.*

No.	Section	Recommendation
246.	7.7.9.5	*That s 64(1)(a)(i) be deleted.*
247.	7.7.9.6	*That s 64 be amended to require that the relevant registration be against the collateral class "accounts".*
248.	7.7.9.7	*That s 64(1)(b)(ii) be amended to provide that a "priority interest" in an account will take priority in relation to the account if the priority interest first attaches to the account at least 15 business days after the secured party with the priority interest has given notice to the PMSI secured party in accordance with s 64(2).*
249.	7.7.9.7	*That s 64(1)(b)(i) be amended to reflect the fact that the secured party will not hold the priority interest until it has attached.*
250.	7.7.9.8	*If s 62(2)(c) is retained, that s 64 not be amended to provide that an accounts financier only needs to send notices under the section to secured parties that have indicated in their registration that their security interest is a PMSI.*
251.	7.7.9.9	*That s 64(2)(b) be amended to provide that a s 64 notice need only state that:* • *the accounts financier may be acquiring an interest in accounts that are proceeds of inventory in which the PMSI holder may also have a security interest; and* • *the effect of s 64 is that the accounts financier will have priority over the PMSI in relation to accounts to which its security interest attaches after 15 business days from the day the notice is given.*
252.	7.7.10	*That s 76(3)(a) be amended by replacing "while the goods are in the possession of the person" with "before the repossession time (referred to in paragraph 37(1) or 38(1))".*
253.	7.7.10	*That s 76(3)(b) be amended by replacing "paragraph 37(1)(d) and 38(1)(d)" with "subsection 37(1) or 38(1)".*
254.	7.7.11	*That Government afford agribusiness financiers and farming organisations a further opportunity to comment on whether ss 85 and 86 should be retained or deleted.*
255.	7.7.11	*If s 85 is retained, that it be amended by inserting "(other than a purchase money security interest)" after "other security interest" in line 3.*
256.	7.8.1	*That the Act not be amended to address whether a trustee's lien ranks ahead of or behind a security interest over the assets of the trust.*
257.	7.8.2.1	*That s 74(4)(a) be amended to read:* *"(a) if the collateral is seized as part of the execution process – the time of seizure;".*
258.	7.8.2.2	*That s 74(1) be amended to provide that an execution creditor only has priority over a security interest if the "priority time" for the security interest is after the date specified in the section.*
259.	7.8.2.3	*That s 8(2) and reg 1.4(5)(b) be amended to make it clear that s 74 can only afford an execution creditor priority over another interest if that other interest is a security interest that is subject to the Act.*

No.	Section	Recommendation
260.	7.9.1	*That the definition of "accession" in s 10 be amended to clarify that goods will not be an accession to other goods if their identity has been lost in the other goods in a way that engages the application of Part 3.4 of the Act.*
261.	7.9.2	*That references in Part 3.3 of the Act to a security interest "continuing in" an accession be amended to refer to the security interest "remaining attached to" the accession.*
262.	7.9.3	*That s 90(b) be deleted.*
263.	7.10.1	*That Part 3.4 of the Act be split into two, and that commingled goods be dealt with separately, in accordance with these principles:* *1. A party with an interest in goods that are commingled into a larger bulk shares in that larger bulk in the proportion that its goods represent of all contributions to the bulk.* *2. To the extent that more than one party had an interest in goods that become part of a larger bulk, their rights as against each other continue to be resolved as if the goods were still separate, but on the basis that the aggregate of their claims may not exceed the relevant proportion of the bulk, as described in the previous paragraph.* *3. If a secured party wants to enforce its security interest in a share of the bulk, it must separate the relevant share from the bulk, and then enforce against that separate share.*
264.	7.10.1	*That Government consider further, in consultation with industry and through consideration of the position in Canada and under Article 9, whether the commingling rules should be extended to commingled intangibles.*
265.	7.10.2	*That s 100 be amended by replacing "section 55 (default priority rules)" with "this Act (other than Part 2.5)".*
266.	7.10.3.1	*That s 101 be amended so that it limits the amount recoverable under a security interest, not just its priority.*
267.	7.10.3.1	*That s 101 not be amended to change the point in time at which the value of the input is assessed.*
268.	7.10.3.2	*That ss 102 and 103 be amended to reflect the following principles:* *1. The aggregate amount recoverable under a security interest (or multiple security interests) over an input that becomes part of a product or mass is capped at the value of the input when it became part of the product or mass.* *2. If there was more than one security interest over the input, they rank inter se in the order that would have applied if the input was still separate.* *3. If the amount recovered on enforcement is not enough to pay out all secured parties (taking into account any cap under the previous two items on the amount they can recover), the priority between them is established using the other priority rules.*
269.	7.11.1	*That s 79 be retained, and that it amended so that it applies to the grant of a security interest over collateral, as well as a transfer.*
270.	7.11.2	*That s 80(3) be retained.*

No.	Section	Recommendation
271.	7.11.3	*That s 81 be retained.*
272.	7.11.3	*That s 81(1) be amended:* • *so that it applies to the grant of a security interest over an account, not just a transfer;* • *by deleting "for currency due or to become due" from line 2 of s 81(1)(b); and* • *to make it clear that it only invalidates the restriction to the extent that it applies to an account.*
273.	7.11.3	*That Government consider further whether:* • *the exclusion from s 81 of construction contracts and financial services contracts is appropriate; and* • *s 81 should be amended to make it clear that the transfer may not adversely affect the obligor on the account.*

Chapter 8 – Enforcement of security interests; insolvency of a grantor

No.	Section	Recommendation
274.	8.1.1	*That Chapter 4 be amended to make it clear that the following principles apply:* *1. A secured party may use enforcement remedies in its security agreement or under laws outside the Act (even if they parallel remedies contained in Chapter 4) without needing to comply with any corresponding notice or other requirements in Chapter 4, except to the extent that a provision in Chapter 4 expressly states that it applies to the exercise of remedies outside the Chapter.* *2. If a secured party elects to rely on a remedy provided by Chapter 4, it must comply with the associated notice or other requirements in the Chapter, except to the extent that the secured party and the grantor agree otherwise in accordance with s 115.*
275.	8.1.2	*That the Act be amended by replacing references to "default by the debtor" (or similar) with "default" or "default under the security agreement", and that the term "default" be defined in s 10 along the lines of the corresponding definition in the NZ PPSA.*
276.	8.1.3	*That s 109(1)(b) be deleted.*
277.	8.1.4	*That s 109(2) be deleted.*
278.	8.1.5	*That Government consider, in further consultation with industry, whether s 109(3) should be amended to provide that Chapter 4 (other than ss 110, 111, 113 and 140) does not apply to an intermediated security or an investment instrument that is held on a prescribed financial market within the meaning given to that term by the Corporations Act.*
279.	8.1.6	*That s 109(5) be deleted.*
280.	8.1.7	*That s 111 not be amended.*
281.	8.1.8	*That s 112(3) be deleted.*

No.	Section	Recommendation
282.	8.1.9.1	*That the words "is not used" in line 2 of s 115(1) be replaced with "the grantor does not intend, at the time it enters into the security agreement, to use".*
283.	8.1.9.2	*That s 115(1) be amended by replacing "may contract out of" in s 115(1) with "may agree that a party need not comply with", and that a corresponding amendment also be made to s 115(7).*
284.	8.1.9.3	*That s 115(1)(q) continue to allow parties to contract out of the grantor's right to redeem collateral under s 142.*
285.	8.1.9.4	*That s 115(2) not be amended.*
286.	8.1.10.1	*If s 116 is retained, that it be amended to reflect these principles more clearly:* • *Chapter 4 does not apply to property if the property is in the hands of a receiver, or a receiver and manager, unless the grantor of the security interest is an individual.* • *Section 131 does not apply in relation to property while a person is a controller of the property, unless the grantor of the security interest is an individual.* • *The parties to a security agreement can also agree that any other provision of Part 4.3 will not apply to property that is in the hands of a controller other than a receiver or receiver and manager, unless the grantor of the security interest is an individual.*
287.	8.1.10.2	*That Government consider further whether the nature of company receiverships is such that they need to remain outside Chapter 4, taking into account Government's deliberations on the extent to which provisions in Chapter 4 should be mandatory to all enforcement processes, and that s 116 be retained or deleted in accordance with Government's conclusion.*
288.	8.1.11	*That Government consider whether s 119 could be amended to simply say that Chapter 4 does not apply to an enforcement process that is regulated by the National Credit Code.*
289.	8.2.1	*That the headings to ss 120 and 121 be amended to refer to security interests in "certain payment obligations" (or a similar expression), rather than to security interests in "liquid assets".*
290.	8.2.2	*That the Act be amended so that the garnishee mechanism in ss 120 and 121 can apply to any payment obligation.*
291.	8.2.3	*That s 80(7) be expanded:* • *to apply to a grant of any security interest over an account, not just a transfer;* • *to give the obligor a further 5 business days after receipt of the notice within which it must make the payment; and* • *to apply to payment obligations generally, if Recommendation 290 is adopted.*
292.	8.2.4	*That s 120(3) be deleted, if s 80(7) is amended in accordance with Recommendation 291.*

No.	Section	Recommendation
293.	8.2.4	*That s 120(3) be amended, if s 80(7) is not amended in accordance with Recommendation 291, to read:* *"(3) A person who receives a notice under paragraph (2)(a) must pay, to the secured party, any amount that the person owes to the grantor on the collateral before the later of:* *(a) the end of 5 business days after the day the notice is received; or* *(b) the day the amount becomes due and payable."*
294.	8.2.5	*That s 120(4) be deleted, and that s 120(5) be amended to require that all amounts recovered under s 120 be applied in accordance with s 140.*
295.	8.3.1	*That the Act be amended so that ss 123(2) and (3) apply to all personal property that is not in tangible form.*
296.	8.3.1	*That ss 123(2)(b) and 123(3)(b) be retained.*
297.	8.3.2	*That s 124(2)(b) be deleted.*
298.	8.3.3	*That the Act be amended to provide that a secured party with a security interest in an accession can remove that accession when enforcing its security interest.*
299.	8.3.4	*That s 126(2) continue to provide that a secured party that disposes of collateral on the grantor's premises must not cause the grantor any greater cost or inconvenience than is "necessarily incidental to the disposal".*
300.	8.3.5.1	*That the Act be amended to make it clear that s 127 cannot override an agreement to a different effect as between secured parties.*
301.	8.3.5.2	*That the Act not be amended to include rules that determine, as between a security interest and a non-security interest in relation to the same collateral, which has the superior right to conduct enforcement proceedings.*
302.	8.3.5.3	*That s 17(4) not be amended.*
303.	8.3.5.4	*That ss 127(6) to (11) be retained.*
304.	8.3.5.4	*That the reference in s 127(9) to "20 business days" not be changed.*
305.	8.4.1.1	*That the Act be amended to make it clear that a secured party is able to enforce its security interest against collateral without first having to seize the collateral.*
306.	8.4.1.2	*That the description in ss 128(2), (3) and (4) of a lease or licence as a "disposal" be considered in the context of Recommendation 168, to ensure that the language of the sections does not inadvertently expand the meaning of the term "dispose" as used elsewhere in the Act.*
307.	8.4.1.3	*That s 128(3) be retained.*
308.	8.4.2.1	*That s 129(3)(b) be retained.*
309.	8.4.2.2	*That s 129(2)(b) be deleted.*
310.	8.4.3.1	*That s 130(1) not be amended to require that the secured party also provide the notice contemplated by that section to the debtor.*
311.	8.4.3.2	*That s 144 be expanded to provide that a secured party is only required to give a notice to another secured party if the other secured party is perfected by registration or possession.*

No.	Section	Recommendation
312.	8.4.3.3	*That s 130(2) be amended to say that the notice must set out either the amount to be paid on or before the day specified in s 130(3), or the manner in which the amount is to be calculated.*
313.	8.4.3.4	*That s 130(5)(b) be deleted.*
314.	8.4.3.4	*That s 130(5)(c) be amended to provide that it applies if the secured party believes on reasonable grounds that there will be a material decline in the value of the collateral if it is not disposed of before the end of the period that would have applied under s 130(3) if the notice had been given (rather than "immediately").*
315.	8.4.4.1	*That s 132(1) be amended to clarify that it only applies when the secured party has disposed of all the collateral it is enforcing against.*
316.	8.4.4.2	*That s 132(3)(a) be amended by deleting ", and expected to be received,".*
317.	8.4.5	*That s 133 not be amended.*
318.	8.5.1	*That s 135(1) be amended so that it requires the retaining secured party to give the notice to:* • *the grantor; and* • *any other secured party that is perfected by registration or possession.*
319.	8.5.1	*That s 136 be amended to confirm that it only allows the secured party to retain the grantor's interest in the collateral, free of the interest of the grantor and the security interests listed in s 136(2), and not free of the interests of other third parties.*
320.	8.5.2	*That s 135(3)(d) be amended to say that the notice must set out either the amount to be paid, or the manner in which the amount is to be calculated.*
321.	8.5.3	*That ss 136 and 141 be amended to accommodate the fact that title to the collateral may already be with the secured party, rather than the grantor.*
322.	8.5.4	*That ss 137 and 138 be amended to incorporate provisions that are reflective of ss 61(2) and (6) of the Sask PPSA.*
323.	8.6.1	*That:* • *s 140(1) be amended to read:* *"This section applies if any personal property (a **recovery**) is received by or on behalf of a secured party as a result of enforcing a security interest in collateral (whether or not under section 120 or 128)."; and* • *each subsequent reference in s 140 to an "amount, personal property or proceeds" (or similar) be replaced with "recoveries".*
324.	8.6.2	*That s 142 be amended so that it only permits the grantor or another secured party to redeem collateral if:* • *the secured party is enforcing its security interest; and* • *the secured party has not yet disposed or committed to dispose of the collateral (whether under s 128 or otherwise), or retained that collateral under s 134.*
325.	8.6.3	*That s 143 be retained.*

No.	Section	Recommendation
326.	8.6.3	*That s 143 be amended:* • *so that the reinstatement right may only be exercised by the grantor, not by any "person"; and* • *by replacing "disposes" in line 1 of s 143(1) with "commits to dispose".*
327.	8.6.5	*That the Act be amended to make it clear that a secured party is entitled to pursue its debtor for any shortfall between what it is owed, and what it recovers by enforcing against the collateral, unless the secured party has agreed otherwise.*
328.	8.7.2	*That ss 267 and 267A be retained.*
329.	8.7.3	*That ss 267 to 269 continue to use the expression "vests in the grantor".*
330.	8.7.4	*That s 268(1)(a)(ii) be amended to read:* *"(ii) a PPS lease;".*
331	8.7.5	*That s 267 not be amended to provide that a security interest over collateral does not vest in the grantor under the section if there is any registration on the register that describes that particular collateral.*
332.	8.7.6	*That sub-paragraphs (ii) and (iv) be deleted from s 268(2)(c).*
333.	8.7.7	*That s 267(1)(a)(iii) be deleted.*
334.	8.7.8	*That ss 267(3)(b) and 267A(2)(b) be expanded to include the bankruptcy-related events referred to in ss 267(1)(a)(iv) and (v).*
335.	8.7.9	*That s 268(1)(aa) be deleted.*

Chapter 9 – Interaction with other laws; other matters relating to the content of the act

No.	Section	Recommendation
336.	9.1.1	*That Government consider further whether s 6 is needed, and that it be either deleted, or simplified so that it facilitates the application of the Act, rather than have the potential to impede it.*
337.	9.1.2.1	*That the Act make it clear that a reference in Part 7.2 to "attachment" or "perfection" under laws of another jurisdiction is a reference to the functional equivalent of those concepts under those other laws.*
338.	9.1.2.2	*That the terminology used in Part 7.2, and in ss 39 and 40, be aligned with the terminology used elsewhere in the Act.*
339.	9.1.2.3	*That Part 7.2 be amended to clarify that references to "the effect of perfection or non-perfection" of a security interest include the effect of all the priority and taking free rules in the Act, including rules that do not turn on whether a security interest is perfected.*
340.	9.1.3	*That the Act adopt a choice of law rule for the enforcement of security interests that reflects Recommendation 218 of the UNCITRAL Legislative Guide on Secured Transactions.*

No.	Section	Recommendation
341.	9.1.4	*That Part 7.2 be amended to provide that questions relating to the validity, perfection and effect of perfection or non-perfection of a security interest over an intermediated security be determined by the law (other than the law relating to conflict of laws) of the jurisdiction in which the intermediary maintains the securities account.*
342.	9.1.5.1	*That s 235(5) not be amended.*
343.	9.1.5.2	*That s 235(2) be deleted.*
344.	9.1.6.1	*That s 237 be deleted.*
345.	9.1.6.2	*If s 237 is retained, that s 237(2) be amended so that s 237(1) only applies to tangible personal property.*
346.	9.1.7.1	*That s 238(2) not be amended.*
347.	9.1.7.2	*That s 238(2A) be deleted.*
348.	9.1.7.3	*That the words "(including the law relating to conflict of laws)" in s 238(3) be replaced with "(other than the law relating to conflict of laws)".*
349.	9.1.7.3	*That s 238(3)(c) be retained*
350.	9.1.8	*That s 239(5) be deleted.*
351.	9.1.9.1	*That ss 239(6) and 240(2) be deleted.*
352.	9.1.9.2	*That ss 240(3) and (5) be amended to provide that the choice of law rules for a security interest in a negotiable instrument, or any other tangible instrument that is regarded by the law as embodying the payment obligation that it represents, should be governed by the law of the place where the instrument is located, consistent with the primary governing law rules for goods.*
353.	9.1.9.3	*If Government decides pursuant to Recommendation 75 to delete ss 21(2)(c)(iv) and 29, that s 240(7) be deleted as well.*
354.	9.1.10	*That s 241 be amended to reflect Recommendation 215 of the UNCITRAL Legislative Guide on Secured Transactions.*
355.	9.1.11	*That s 40(5) be deleted.*
356.	9.2.1.1	*That ss 340 to 341A be amended so that collateral is only a "circulating asset" of a grantor if it is inventory (in the ordinary meaning) of the grantor (other than inventory that is subject to a PMSI), or its proceeds.*
357.	9.2.1.2	*That ss 340 to 341A, in whatever form they may ultimately take, be removed from the Act and relocated to the Corporations Act.*
358.	9.2.1.4	*If ss 340 to 341A are not amended in accordance with Recommendation 356, and the Register continues (despite Recommendation 89) to allow a person registering a financing statement to indicate whether or not the secured party may have control, that s 340(2) be amended to make it clear that an ADI that is perfected by control over an ADI account does not need to register a financing statement and indicate that it has control, in order to cause that ADI account not to be a circulating asset for the purposes of s 340.*

No.	Section	Recommendation
359.	9.2.1.5	*If ss 340 to 341A are not amended in accordance with Recommendation 356, that s 341(3)(b) be amended so that a secured party will have control of an account if it satisfies the other requirements of the section, unless it is shown that the grantor's usual practice is not to deposit the proceeds into the ADI account and that it has the express or implied consent of the secured party to not do so.*
360.	9.2.1.6	*That ss 341(3)(d) and 341A(1)(b) be deleted.*
361.	9.2.1.7	*That s 341(1)(a)(i), and the corresponding reference in s 341(1)(a)(ii) to "specifically appropriated" inventory, be deleted.*
362.	9.2.2.1	*That s 588FL of the Corporations Act be repealed.*
363.	9.2.2.2	*If s 588FL of the Corporations Act is retained despite Recommendation 362, that it be amended:* • *to remove references to "deeds of company arrangement";* • *to allow for the possibility that a security interest can be perfected by means other than registration; and* • *so that it does not apply to deemed security interests, consistent with s 267.*
364.	9.2.3	*That:* • *the Act be amended, if necessary, to enable Government to provide for additional taking free rules in the Regulations; and* • *regulation 7.1 be amended to operate as a taking free rule.*
365.	9.2.4.1	*That the arm of Government responsible for insolvency law reform be asked to consider whether the law should be amended to allow an insolvency practitioner to give notice to claimants on the Register to verify their claims within a set period (such as 21 days), on the basis that unverified claims could then be treated as unsecured.*
366.	9.2.4.2	*That the arm of Government responsible for insolvency law reform be asked to consider whether the law should be amended to clarify the extent to which an administrator's equitable lien should rank ahead of security interests.*
367.	9.2.5	*That the Shipping Registration Act 1981 be amended to allow a secured party to lodge a caveat on the Shipping Register.*
368.	9.3.1.2	*That the list of "interested persons" in s 275(9) be expanded to include a judgment creditor of a grantor that is considering whether to enforce its judgment by seeking execution against property that is described in the secured party's registration.*
369.	9.3.1.2	*That Government investigate further whether it is sufficiently clear that company receivers, and insolvency officials such as administrators or liquidators, that have been appointed to a grantor are able to make use of the information-gathering powers in s 275, and that the section be amended, if necessary, to ensure that this is the case.*
370.	9.3.1.3	*That the period within which a secured party must respond to a request for information under s 275, as set out in s 277, remain 10 business days.*

No.	Section	Recommendation
371.	9.3.1.4	*That s 275 be amended to provide that a secured party is only required to provide those parts of a security agreement that are relevant to ascertaining the identity of the grantor and the secured party, the identity of the collateral, and the amount or obligation that is secured.*
372.	9.3.1.5	*That s 275(6)(a) be amended to read along these lines:* *"subject to subsection (7), the secured party has agreed with the debtor or the grantor (a **confidentiality agreement**) that the secured party is not obliged to respond to such a request".*
373.	9.3.1.6	*That s 275(7) be deleted.*
374.	9.3.1.7	*That it be made clear that the banker's duty of confidence cannot be relied on to block a disclosure that would otherwise be required by s 275(1).*
375.	9.3.2	*That s 339 be deleted.*
376.	9.3.3	*That the Act not incorporate any specific provisions for letters of credit, other than any provisions that might remain as a result of Government's decisions in relation to other Recommendations in this report.*
377.	9.3.4.2	*That the definition of "intellectual property" in s 10 be deleted.*
378.	9.3.4.2	*That careful consideration be given to the manner in which the term "intellectual property" is used in the Act, and if there are provisions in which the breadth of the term should be limited to registered intellectual property, that those provisions be amended accordingly.*
379.	9.3.4.2	*That the definition of "intellectual property" in s 10 be amended, if it is retained, by deleting the text "(including the right to be a party to proceedings in relation to such a right)", unless a good reason can be identified for retaining it.*
380.	9.3.4.3	*That s 105 be deleted.*
381.	9.3.4.4	*That Government ask stakeholders whether s 106 should be retained and, if no good reasons are put forward for retaining s 106, that it be deleted.*
382.	9.4.1	*That the constitutional, judicial and other supporting provisions in the Act be relocated into a separate piece of supporting legislation.*
383.	9.4.2.1	*That Government consider, as part of redrafting the Act, whether other changes can be made to the location of the Act's provisions that would make the Act easier to work with.*
384.	9.4.2.2	*That the Act continue to use the term "grantor" rather than "debtor" to refer to the person who grants a security interest.*
385.	9.4.2.3	*That the name of the Act not be changed.*

Chapter 10 – Next steps

No.	Section	Recommendation
386.	10.1.2	*That Government engage private-sector input in the drafting of the Bill for the amending legislation, in addition to then releasing the draft Bill for public consultation.*
387.	10.1.3	*That Government proceed if necessary with amendments to the Act in two stages, by deferring any amendments on matters relating to statutory licences, water rights and fixtures, if necessary, for enactment at a later date.*
388.	10.1.4	*That Government obtain appropriate private-sector input into the crafting of the transitional provisions.*
389.	10.1.5	*That Government develop and publish a detailed implementation plan for the period leading up to commencement of the amending legislation, in collaboration with the business community (such as through AFSA's consultative forums).*
390.	10.2.2.1	*That Government develop a targeted yet multi-faceted campaign, in the lead-up to the amendments to the Act coming into operation, to increase levels of awareness among small businesses of the Act and its implications.*
391.	10.2.2.2	*That Government develop and implement steps to raise awareness among consumers of the importance of searching the Register before purchasing a motor vehicle or boat, particularly in a private transaction.*
392.	10.2.3	*That Government develop and implement a campaign to increase understanding among businesses and their advisers of the detailed effect of the Act, and take other steps that could assist businesses on an ongoing basis to understand how the Act affects them and how best to take advantage of it.*
393.	10.3	*That Government consult with business and other stakeholders in 5 years' time, to determine whether there is a need for further reform of the Act.*
394.	10.3	*That s 343 be repealed.*