PERSONAL PROPERTIES SECURITIES BILL 2009

SUBMISSIONS ON BEHALF OF THE VICTORIAN BAR 17 AUGUST 2009

Background to Submissions

1. On 24 April 2009, the Victorian Bar provided written submissions on the exposure draft of 10 November 2008 ("the Exposure Draft") of the Personal Property Securities Bill. These submissions update those submissions by reference to the different numbering used in the Personal Properties Securities Bill 2009 and the changes which have been made since the Exposure Draft.

2. The proposed reform is far reaching and every effort should be made to ensure it works. For comparison, it is at least as significant as the reforms made by the Trade Practices Act 1974, the new Consumer Credit Laws and the financial services reform provisions of the Corporations Act 2001. Its impact on Australian law will be profound.

3. The following submissions have been prepared by Peter Fox, ("the Author").

Bill - General Observations

4. The Bill is a vast improvement over the Exposure Draft. However, it still requires a lot of work and some significant concepts have been added, which require careful consideration. For example, Part 8.2 of the Bill, which is new, provides for the expropriation of any unperfected security interests upon the bankruptcy of an individual, or the winding up or administration of a company, by vesting the unperfected security interests in the liquidator or trustee in bankruptcy. These provisions depart from the New Zealand example and incorporate outcomes which are contrary to the views of leading commentators.[1] There is no pressing need to hurry the process of reform. The existing laws work well enough to allow further time to finetune the Bill, and to obtain the advice and assistance of experts to work with the drafters.

[1] See below in relation to Part 8.2.

5. The Author shares Professor Duggan's concern that the reforms be considered fully and in a timeframe which allows proper consideration. We repeat the views in the submission on the Exposure Draft and repeat the views set out in the submission on the Exposure Draft in recommending that extraordinary caution should be exercised in relation to the proposed reform:

   - Once a PPSA model comes into force the whole of Australia's credit industry for the finance of goods and other personal property will be governed by such legislation;
   - The legislation will determine most of the fundamental rights as between the financier and the debtor in respect of many millions of financing and purchase arrangements;
   - It will overlay centuries of meticulous judicial reasoning which identified a myriad of security interests in goods and other personal property;
   - The reform will be experimented largely on Australia's four major banks which will bear the initial cost of :
     a. drafting agreements that adequately protect their security interest and are compatible with all applicable statutes;
     b. educating sales personnel regarding the changes;
     c. implementing systems that are compatible with the national register;
   - By reason of most disputes relating to priorities and interpretation of the legislation generally starting off as simple debt collection or *Corporations Act* matters, litigation will occur mainly in, and occupy the scarce resources of, the courts of the various States;
   - The cost of interpreting the legislation will be borne by the banks on the one hand and those debtors who have the misfortune to be caught in a dispute in the years immediately following its implementation – this has the consequence of privatising the cost of effective drafting;
   - The register has the potential to be a readily accessible inventory of an individual's primary assets thereby possibly bringing into play some significant privacy issues.

Conclusion

6. The Author concludes that despite the vast improvements made in the Bill, further detailed work is still necessary, and the time should be taken to get the end-product right - in the detail, for that is what is required.

Specific Matters Regarding the 2009 Bill

Definitions

Security Interest and securitisation

7. The definition of security interest is particularly broad. Subsections 12(2) (j) and 12(3) (a) relate to assignments and sales and when taken with use the words "in substance" in subsection 12(1) and the economic equivalence overlay, will undoubtedly extend to securitisation transactions, some of which involve an outright sale of accounts and chattel paper. The securitisation market in Australia is different to that of the US. Whether the Australian financial market needs to adopt these provisions should be carefully analysed by comparison with the current US position. The policy behind the Article 9 inclusion of sales is the view that the distinction between a security transfer and a sale is blurred, that is, it is difficult to ascertain whether the transaction is intended as security or not.

8. The policy choice is between having no means of notifying assignments by true sale of interests in securitisation assets and having them included in the registration system because the alternative is, or continues to be, unworkable.

9. The first choice which posits the international focus of securitisation is not a sound policy choice to include transactions that are truly sales lest it create unnecessary confusion and mislead persons making inquiry of the Register. It is not that long ago that Victoria repealed Part IX of the *Instruments Act* which required the registration of assignments of book debts (accounts) by way of security or absolutely.

10. The latter choice is similar to the Victorian treatment of book debts under the *Companies Act* 1961. Transactions under Part IX of the *Instruments Act* were registrable as charges under the *Companies Act* 1961 in Victoria whether they were in the nature of charge or outright sale. There was otherwise no way of notifying a future dealer or debtors except by notice and in the course of inquiry. Including true sales in the PPS model with provision for deemed registration may be beneficial when compared with the fragile nature of factored book debts at law.

"In substance" approach to determining the nature of an interest in personal property

11. The definition of "security interest" in section 12 provides that it means "an interest or right in relation to personal property provided for by a transaction that *in substance* secures payment of performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property)".

12. This is a functional approach and corresponds with the approach to determine whether an interest in property is a "security" by the High Court in, for example, *Handevel Pty Ltd v Comptroller of Stamps (Vic)*[2], and accepted in *General Motors Acceptance Corporation Australia v Southbank Traders Pty Ltd*[3]. As such the definition is not objectionable, but the use of the words "in substance" may prove to be problematic. Those words do not exist in Article 9. These words do appear in the Canadian statutes, notably Saskatchewan - section 3(1) and Ontario - section 2. There it is stated the statute "applies to every transaction without regard to its form and without regard . . . that in substance. . . ". The words themselves to do not appear in the definition of a security interest. The New Zealand drafting style is different hence the inclusion in the definition of security interest. It would seem that the use of the words "in substance" is to differentiate between true security interests and those that are in an economic sense security interests such as title retention devices, including leases.

13. The traditional Anglo-Australian approach has been to determine the character of a transaction by reference to its legal nature, not its economic effect[4]. In other words, courts have generally respected the legal form intended by the parties as evidenced by the language they actually used in the contractual agreement. The case of *Beaconswood Securities Pty Ltd v ANZ* [5] is an important recent example. A proceeds clause of the type considered by the High Court in *Associated Alloys Pty Ltd v ACN* [6] to not to be a charge, could be considered a security interest under the substance over form approach.

14. The Author's view is that trust arrangements of the type identified in the *Associated Alloys Case* should be excluded from the interests caught by the Act. It is inconsistent with the notion of the debtor or grantor being empowered to

---

[2] (1985) 157 CLR 177 at 196
[3] (2007) 227 CLR 305 at [20]
[4] It is noted, however, that the High Court in *General Motors v Southbank Traders* (2007) 227 CLR 305 took a broad approach to the interpretation of "secured payment of a debt" so as to pick up a retention of ownership clause.
[5] [2008] FCA 594

grant a security interest by reason of being the beneficial owner of property. The Author considers that a trust arising out of retention of title clauses is stretching "in substance" too far. As a matter of policy the Act should confine its operation to transactions where the debtor has beneficial ownership or has an opportunity under the security agreement to acquire it. Attachment

Control of Controllable Property

15. The Author is concerned regarding the notion of "control", which is introduced in 2.3, as a method of perfection.

16. Notice filing is a key principle of Article 9. The 2001 revision has introduced a third method of perfection by control. This change was made in the context of legislation dealing with primarily investment securities transfers. Canada has the *Securities Transfer Act* to inform parties with some certainty when securities are transferred and their rights in respect of them. Despite this, we understand that the Canadian provinces have resisted moving to control as a third form of perfection because of the conflict with the principle method of perfection by notice filing. This publication principle is a central tenant of Article 9.

17. New Zealand has not added control as a method of perfection but its legislation predates the Article 9 2001 revision. The Author believes that Australia should consider very carefully whether it should adopt control as a third method of perfection.

18. Notwithstanding that a set off is excluded as a security interest under section 6 of the Bill, where a bank has a general security interest such as a debenture charge, combined with its right of set off, the ADI of the grantor customer will fall within the terms of section 25 of the Bill to perfect a security interest in respect of the ADI. This is the result of providing that a secured party has control of an ADI account if the secured party is able to direct disposition of the funds from the account without further consent by the grantor. If control is to be maintained as a method of perfection the right to set-off or combine accounts as a form of control should be specifically excluded from the Bill.

19. Section 340 contains the term "grantor" (and not debtor) that is used throughout the Bill. It is widely defined in section 26 to mean, amongst other things, *any* person who has *an* interest (or right) in personal property to which a security

interest is *attached*. The definition seems to include persons who are not party to the security interest.

Floating charge; Negative restrictions

20. The creation of a security interest by way of a floating charge is recognised in clause 12(a) and given efficacy by clause 19(4) (attachment)..

21. This is consistent with the notion that a security interest in personal property arises where property is used to secure payment or the performance of an obligation regardless of the legal form of the obligation[7].

22. The Bill, however, does not protect the present priority under the Corporations Act 2001 of a floating charge holder who relies on a registered negative restriction on future dealing with floating charge property to maintain priority over a subsequent security taker. There is no provision for registering the restriction or a précis of the restriction. There is no provision for registering the complete security agreement which contains the restriction.

Part 2.5 Taking personal property free of security interests

23. Section 46 allows a buyer or lessee (but not the holder of a security interest) to take personal property free of a security interest in the "ordinary course of business".

24. Four issues remain.

25. First, the section introduces the concept that a dealing in the ordinary course of business gives good title, not only in the case of a floating charge security, but also where the charge is a fixed and specific charge or, even a legal mortgage. This is a marked departure from the current Australian practice for taking security over the personal property of companies, where certain classes of asset are charged by way of fixed charge on the basis that the grantor ought not be able to dispose of the fixed charge property (with provision for a legal mortgage). The problem might be overcome if the exceptions in section 46(2) were expanded to exclude personal property which was not acquired by the seller or lessor for the purposes of resale. This is consistent with the limitation that the personal property concerned must be of the kind sold or leased by the seller or lessor.

26. Second, it is not clear what is comprehended by the idea of "ordinary course of the seller's or lessor's business of selling or leasing personal property of that

[7] PPS Bill 20008 Commentary, May 2008 para.11.96

kind" in section 46. The "ordinary course of business" is an idea of wide import. It may extend to a transaction of an exceptional nature[8] and might extend to a transfer of the entire undertaking of a company, "If for example, the company were proposing to sell the business with a view to starting another business, or of carrying on the same business in another place", but not if , "The company was hard up for money, and instead of a mortgage of the assets to the defendant this arrangement is made with him, the effect of which is to transfer to him … the whole undertaking".[9] The expression "the ordinary course of the buyer's or lessee's ordinary business of selling or leasing personal property of that kind", if still uncertain, would be less intrusive.

27. Third, section 46 applies to personal property other than goods. It should be confined to the sale of goods. What other personal property is section 46 meant to deal with which is dealt with in the ordinary course of business and which is not dealt with by other provisions in Part 2.5?

28. Fourth, the exception in section 46(2) (b) where the buyer or seller has actual knowledge will be of limited use if the security agreement (or a restriction in it) cannot be registered.

29. Section 47: The personal property ought to be a kind usually used for personal, domestic or household purposes.

30. Section 49: There should be an exception that the rule does not apply if the buyer has actual knowledge that the purchase is in breach of a security agreement. "Ordinary course of trading" can include large and exceptional transactions. Section 49 would postpone the interest of a legal mortgagee of shares and that of a person having some other fixed security interest notwithstanding that the interest was noted on the register or in the CHESS system.

31. Sections 50 and 51: The inclusion of a "mortgage, pledge, lien" in the definition of "purchaser" in section 50(3), and the use of the wide term "transferee" in section 51 means that these sections regulate priorities between competing security interests (otherwise dealt with in Part 2.6). Although provision is made in Part 8.4 for obtaining information about security interests which are wide enough

---

[8] Reynolds Bros (Motors) Pty Ltd v Esanda Ltd (1983) 8 ACLR 422 (dealer in agricultural equipment, faced with liquidity problems, sold several used tractors to a finance company in reduction of its debt. Held that this was within the ordinary course of business under a floating charge.

[9] Hubbuck v Helms 56 LT 232 per Stirling J, cited in Palmer, Ninth Edn, Part III on Debentures (1903), Stevens) 67-69.

to identify any negative restriction on dealing in a security agreement, there is no provision for registering a copy of the security agreement or a précis of a negative restriction. This undermines the utility of the constructive knowledge (constructive notice) exception in sections 50 and 51(which might include transactions conducted at great speed with limited opportunity for actual inquiry), and thereby weakens the protection currently afforded by the Corporations Act 2001 in relation to registered charges given by companies. Inclusion of provision for registering the security agreement or a precise of any restrictions on dealing would enhance the operation of the proposed legislation.

32. Section 53: The words of limitation, "in relation to the property", will prevent a security holder who is ousted under sections 50 and 51 from being subrogated to the whole of the property secured in favour of the competing successful security holder. The successful security holder may have executed against the personal property and satisfied its claims out of that fund. In those circumstances the ousted security holder should be entitled to be subrogated (on a subordinate basis) to the rights of the successful security holder against other property securing the monies owing to the successful security holder.

Part 2.4 Priority Between Security Interests

33. These rules are generally appropriate. However, the rules do not incorporate the protection given by a negative restriction on future dealing which can be registered with a charge on the register of charges under the Corporations Act 2001. There ought to be provision for registering such a restriction and, where it is registered, a subsequent security holder (but not a lessee or buyer) should rank after the security holder who has registered the restriction. The provisions for obtaining information in Part 8.4 will alleviate this concern to some extent, however registration is simple (it is done now) and provides a sound basis in law for saying that a security holder who fails to search the register and note the restriction is fixed with constructive knowledge (constructive notice) of the restriction.

34. This is now especially important because the rules for determining priority have abandoned the distinction between legal and equitable interests, so a legal owner may be displaced if not given priority under the Bill.

35. Section 58, which gives priority in respect of all future advances, is a very small section but may have very large consequences. In practice, the present law does not give priority for further advances unless there is an obligation to make the

further advance (and very rarely is there such an unqualified obligation). Section 58 reverses this position and may prove wholly unsatisfactory in declining economic conditions where borrowers need to obtain further finance. Section 58 would prevent a subsequent lender from obtaining priority with respect to present property even though the present lender is unwilling itself to make further advances. The prospect of such further advances and the priority afforded by section 58 may be sufficient to discourage new lenders. Section 58 advantages existing lenders. It is acknowledged that except in the case of a purchase money security interest, a later lender must deal with the prior holder of a security interest before funding. The proposed position is not necessarily a good policy choice for Australia. It may produce anticompetitive effects in a market dominated by four main banks. It does not have the advantage of prior ranking of new money lent into a bankruptcy against the unsecured assets available in the bankruptcy.

36. The Author refers to and adopts the submissions of Mr David Turner concerning purchase money security interests.

37.

38. Section 74: The rule should make it clear that the execution creditor's priority is contingent on the execution creditor having seized the collateral and the rule should be limited to goods.

Commingling

39. Part 3.4 deals with "Commingling" or commingled property, that is where goods have become part of a product or mass and have lost their original identity in the product or mass - for example, where ingredients are used to make processed food, such as flour and yeast to make bread.

40. Competing priority of security interests in commingled goods is dealt with in section 102. The cost of the good should be the basis for a pro rata outcome rather than the sums secured. The sums secured by the security interests may be totally disproportionate to the cost or value of the goods, e.g., where the security interest secures a large amount owing (the goods being but part of the security taken by the secured party).

Enforcement and Remedies

41. The contracting out provisions in section 115 and following should be subject to an overriding standard of not being "manifestly unreasonable". This is the approach in Article 9-603(a). This more appropriately balances party autonomy and freedom of contract with minimum standards of commercial fairness.

Contractual Restrictions on Transfer of Accounts and Chattel Paper

42. Section 81 follows Article 9-406. It should, however, also include the language with respect to notice to the account debtor contained in that section.

Loss of registration for failure to pay maintenance fees

43. Section 168: It is Draconian, to provide that registration can end on non-payment of a maintenance fee. It would be better to make the fee accrue as a charge on the secured property.

Effect of failure to Perfect Security Interest – New Part 8.2

44. Section 267 provides that with some exceptions, on the bankruptcy of an individual, or on the winding up or administration of a company, any unperfected security interests vest in the individual or company concerned.

45. This is a more far reaching consequence than the Corporations Act 2001 provides, where failure to register a registrable charge may be void as against a liquidator.

46. It expropriates the property of the secured party in favour of the unsecured creditors. It incorporates notions of reputed ownership. It is unnecessary and it should be omitted.

47. In New Zealand an unperfected security interest is valid. As Professor Wood and others have observed, there is no sound policy justification for compulsory registration for a security interest to be effective or effective against parties other than the grantor and secured party[10].

Specific Drafting Issues

---

[10] See Wappett, "Personal Property Securities" in Australian Financial Law (Mallesons, 5th ed), p 500.

48. Section 19: Without attachment a security interest cannot be perfected. It is not clear how section 19(2) (attachment) operates on after-acquired future property. Before the property is acquired by the grantor or before it comes into existence, does the grantor have rights in the collateral, or the power to transfer rights in the collateral to the secured party, and is the agreement to confer the security interest an act by which the security interest arises, these being elements necessary to satisfy section 19(2). Section 19 should be expanded to say that where the grantor has agreed to a security interest in after-acquired or future property, the time when the agreement is made is the time when the grantor has power to transfer rights in the collateral and is the act by which the security interest arises.

49. Section 123 provides for notice to the grantor. The legislation should provide that a notice under section 123 satisfies the requirement to give notice under the Consumer Credit Codes and under Property and Conveyancing statutes of the States and Territories and vice versa.

50. Section 136 is effectively a foreclosure, however without the safeguards which should apply. In relation to subsection 136(2), what if the debt owed to the secured party is less than the value of the collateral? In a surplus do the secured parties with a lower priority still lose their security interest? Does the grantor lose the right to the surplus? The retaining party could have quite a windfall which is contrary to some very basic principles of fairness and equity. How is notice given? What if a security holder does not receive a notice (for example, lost in mail) – do they lose their security? Section 143 allows the reinstatement of a security agreement by paying up arrears, but only once and not after retention of the collateral.

51. The right of reinstatement in section 142 should be limited to the debtor. Also it should be limited to security agreements entered into after the commencement of the legislation. It is to be noted that there is a right to reinstate a *Credit Code* contract (section 94) as well as restriction on sale in the case of the goods mortgage (section 83). The provisions in the Bill should be made consistent with those rights.

52. The rights, in effect, of foreclosure and the extinguishment of the interests of other secured parties should be reviewed and provision made for properly dealing with the surplus value of collateral which is retained. There is also a

question left open as to whether the debtor remains liable to pay the secured monies after retention of the collateral.

PETER FOX

17 August 2009