Submission to Senate Legal and Constitutional Affairs Committee Inquiry into the Personal Property Securities Bill 2008 [Exposure Draft]

By

Professor Anthony Duggan

1. My credentials

I am a Professor of Law at the University of Toronto and a Professorial Fellow in the Faculty of Law at the University of Melbourne. I moved from Australia to Canada nine years ago. Before that I held a Chair in the Law Faculty at Monash University. Before moving to Canada, I was closely involved with Australian personal property security law reform and also consumer credit law reform. I was Special Consultant to the Ministerial Council on Consumer Affairs on the National Vehicle Security Register Project and in that capacity wrote both a Discussion Paper and a Report.

I was a consultant to the Victorian, Queensland and Australian Law Reform Commissions on their personal property security law reform references, a member of the Viney Committee (Victorian Government, Committee Appointed by the Premier to Report on Aspects of the Chattel Securities Act) (1985) and a member of the Victorian Ministry of Consumer Affairs Working Party on Consumer Credit Law Reform (1986-1987). Relevant Australian publications include Duggan Begg and Lanyon, Regulated Credit: The Credit and Security Aspects (Law Book Co., 1989); Duggan and Lanyon, Consumer Credit Law (Butterworths, 1999); and Wappett, Mayne and Duggan, Review of the Law on Personal Property Securities (Commonwealth of Australia Attorney-General’s Department, 2006).

I am closely familiar with the Canadian Personal Property Security Acts, having taught Secured Transactions at the University of Toronto for the past eight years and served as a member of the Ontario Bar Association Business Law Section’s Personal Property Security Law Committee, also for the past eight years. I am also familiar with the New Zealand Personal Property Securities Act, having taught Secured Transactions in the LLM program at the University of Auckland in 2005. Relevant Canadian and U.S.

2. General comments

The following general comments are a slightly revised version of what I wrote in my submission dated 22 May 2008 to the Attorney-General’s Department on the first draft Bill.

The proposed Australian reforms are superior in a number of respects to Article 9-type laws in other jurisdictions. They envisage the enactment of a single statute, at the national level. This is a considerable advance on the law in the United States and Canada, where the legislation is at the state (provincial) level. The Australian approach avoids the need for parties to familiarize themselves and comply with multiple sets of laws and it eliminates conflict of laws issues at the inter-state level. Also, the Australian reforms envisage a single national register. Again, this is a significant advance on the United States and Canada, where there is a separate register in every state (province). The Australian approach avoids the need for multiple registrations and searches and, in this respect, it should significantly lower the costs of secured lending.

However, a state of the art national register is not enough. It is also critically important to get the legislation right, otherwise secured lenders and debtors will face increased
transactions and litigation costs which may erode the savings from the introduction of a single national register and impact both the cost and availability of credit. Any new legislation will increase transactions and litigation costs if: (1) it is unnecessarily complex requiring parties, their legal advisors and the courts to invest additional resources in working out what the statute means; (2) there are mistakes in the legislation; or (3) the legislation reflects questionable policy choices. Unfortunately, the Exposure Draft is open to criticism at all three of these levels, as was the consultation draft which preceded it.

For the most part, these problems could have been avoided if the Australian Bill had followed the New Zealand lead and adopted one or other of the North American models. The New Zealanders used the Saskatchewan PPSA as their model, but the Ontario PPSA might have served just as well as, for that matter, might Revised Article 9. By contrast, while the Australian Bill takes the Saskatchewan and New Zealand PPSAs as its starting point, it departs significantly from the model in terms of organization, terminology and general style. I discuss some of the differences below.

The New Zealand approach has substantial benefits. The Saskatchewan PPSA is a tried and tested model. It is the product of lengthy and careful deliberations by leading commercial lawyers and it has stood the test of time. The Saskatchewan PPSA, in turn, is based on Article 9 which itself was the product of an exhaustive drafting process involving some of the finest minds in United States commercial law. Close adherence to the North American model makes sense, because it enables the local lawmaker to free-ride on Canadian and United States learning and experience. By contrast, departure from the model creates uncertainty and increases the risk of error. These concerns are exacerbated if the drafting is done under time constraints and without access to the kind of expertise the Canadians and Americans had at their disposal when drafting their laws.

Adherence to the North American model involves substantial cost savings in the drafting process. It also achieves savings in legal costs, because it avoids the need for inquiry into: (1) whether a given provision in the local statute is the same as the corresponding
provision in the established PPSA/Article 9 jurisdictions; (2) if the local provision is differently worded, whether this affects its meaning; and (3) if so, whether or not this consequence was intended, having regard to its commercial implications. In addition, there are cost savings to parties and their legal advisers in terms of access to information. Adherence to the North American model means that parties can turn to North American case law and secondary sources (text books, commentaries, journal articles) for guidance on the meaning of the local statute. It appears that, by and large, New Zealand financial institutions and legal practitioners have managed the transition to the new regime relatively smoothly. One reason for this is surely that they learned quickly to draw on Canadian secondary materials as an aid to understanding the new law. In this connection, it is worth noting in particular Mike Gedye’s teaming with Ron Cuming and Rod Wood to produce a New Zealand version of Cuming and Wood’s very successful Canadian PPSA Handbook series: Michael Gedye, Ronald CC Cuming and Roderick J. Wood, *Personal Property Securities in New Zealand* (Brookers, Wellington, 2002).

The Australian decision not to follow the North American model is explained in para.1.16 of the *Commentary on the Consultation Draft* as follows:

“The differences between the Bill and its international counterparts reflect issues raised by stakeholders, differences in the Australian consumer and commercial environment, advances in information technology, and drafting styles adopted to improve legal certainty and consistency with Australian drafting practices”.

A similar statement appears in the *Revised Commentary*, para. 1.22.

The Commentary does not specify what the relevant issues, differences and advances are, and so it is impossible to test the strength of this assertion. Moreover, while the Bill may improve legal certainty at one level, it increases uncertainty at another level and the statement in the Commentary fails to acknowledge this trade-off. The Bill reflects a strong commitment to drafting precision with a view to ensuring that the legislation provides for every possible contingency. It is in this sense that the claim to improved legal certainty is presumably to be understood. However, a commitment to precision is not cost-free. The inevitable by-product is longer, more complex legislation. The
Australian Bill is at least twice as long as the New Zealand and Canadian PPSAs, it contains numerous definition provisions not found in these other statutes, and it relies on an elaborate system of forward and back referencing which means that the reader is constantly having to look at two or more parts of the legislation at once to get the overall sense of particular provisions. Furthermore, in the absence of cross-references to corresponding provisions in the other jurisdictions, the reader who wants to know the origins of particular provisions in the Australian Bill is forced to do her own research.

In summary, while the greater precision of the Australian Bill may save litigation costs by providing answers to questions that might otherwise have been left to the courts, it increases the costs of comprehension and it is not all clear that the gains exceed the losses. A relevant question to ask in this connection is how much litigation the perceived lack of precision in the Canadian PPSAs has given rise to, particularly in relation to the issues on which the Australian drafters have thought it necessary to elaborate. The answer is, “surprisingly little” and this at least suggests that the benefits of greater drafting precision may not be worth the cost.

The complexity of the Australian Bill is itself a source of uncertainty, but this is compounded by the factors identified above. In particular, the failure to adhere closely to the North American model will substantially reduce the usefulness of Canadian case law and secondary sources as a guide to interpretation and it will make projects like the Gedye, Cuming and Wood collaboration in New Zealand much less feasible. In short, Australia may be forced to develop its own body of case law and literature and, in the meantime, parties and their legal advisers will be left to their own resources in determining what the legislation means. Again, the question that needs to be addressed is whether these costs are worth the benefits that flow from the approach the Australian drafters have taken.

In Parts 3 – 5, below, I will address the complexity of the Draft Bill, using selected examples, and I will also provide some examples of errors and oversights in the Bill and questionable policy choices. It is important to stress that the following discussion is a
selective one. I cannot claim to have undertaken a comprehensive review of the legislation. A comprehensive review would require careful comparison of the Bill with the New Zealand and Canadian PPSAs and, as indicated above, it would involve asking the following questions of each provision: (1) is there a corresponding provision in the other jurisdictions and, if so, is the wording the same? (2) If the wording is different, is the meaning the same? (3) If the meaning is different, was this an intended or unintended consequence and is it justifiable? This kind of analysis would take months and far more resources than are available to me and, I suspect, most stakeholders. The problem is that, without this kind of analysis, it is impossible to be sure that the Australian Bill is an improvement on the other models.

3. The complexity of the Bill

(a) Introduction

To be fair, secured transactions law is a difficult subject and the New Zealand PPSA, the Canadian PPSAs and Revised Article 9 are by no means easy to read. However, while some Canadian commentators are critical of the increased complexity in Revised Article 9, the Australian Bill takes the comprehensibility problem to a whole new level.

The Bill’s comprehensibility is affected by three main factors, (1) prolixity; (2) use of obscure terminology to describe key concepts; and (3) a Byzantine cross-referencing system, none of which are present in the New Zealand or Canadian PPSAs.

(b) Prolixity

The Bill’s prolixity is in part a function of the drafters’ apparent objective to legislate for all possible contingencies so that no stone is left unturned. This approach may reduce uncertainty at one level, by avoiding the need for parties to second-guess what the outcome of a dispute might be in the absence of an express provision governing the issue. However, on another level it increases uncertainty by creating a kind of information
overload problem: it forces parties to wade through masses of text to find the part that is, or may be, relevant to their case. The following is just one illustration of what I mean. It relates to the commingled goods provisions which apply, for example, where a baker uses flour and eggs to bake a cake. If the baker acquires the flour from Supplier A subject to a security interest and the eggs from Supplier B, also subject to a security interest, two questions arise: (1) do A’s and B’s security interests in the flour and eggs, respectively, survive in the finished cake? And (2), if so, what are their respective shares in the finished cake? The Ontario PPSA, s.37 addresses these questions in six lines as follows:

A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass, and, if more than one security interest attaches to the product or mass, the security interests rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

The equivalent Saskatchewan provision is a little longer, coming in at around 40 lines. It reads as follows:

39(1) A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass.

(2) Subject to subsections (4) and (6), where more than one perfected security interest continues in the same product or mass pursuant to subsection (1), and each was a security interest in separate goods, the security interests are entitled to share in the product or mass according to the ratio that the obligation secured by each security interest bears to the sum of the obligations secured by all security interests.

(3) For the purposes of section 35, perfection of a security interest in goods that subsequently become part of a product or mass shall also be treated as perfection of the interest in the product or mass.

(4) For the purposes of subsection (2), the obligation secured by a security interest does not exceed the market value of the goods at the day on which the goods become part of the product or mass.

(5) Any priority that a perfected security interest continuing in the product or
mass pursuant to subsection (1) has over a perfected security interest in the product or mass is limited to the value of the goods at the day on which they became part of the product or mass.

(6) A perfected purchase-money security interest in goods that continues in the product or mass has priority over:

(a) a non-purchase-money security interest in the goods that continues in the product or mass pursuant to subsection (1);

(b) a non-purchase-money security interest in the product or mass, other than as inventory, given by the same debtor; and

(c) a non-purchase-money security interest in the product or mass as inventory given by the same debtor if:

(i) the secured party with the purchase-money security interest gives a notice to the secured party with the non-purchase-money security interest in the product or mass who registered a financing statement containing a description of collateral that includes the product or mass before the identity of the goods is lost in the product or mass;

(ii) the notice mentioned in subclause (i) contains a statement that the person giving the notice has acquired or expects to acquire a purchase-money security interest in goods supplied to the debtor as inventory; and

(iii) the notice mentioned in subclause (i) is given before the identity of the goods is lost in the product or mass.

(7) A notice mentioned in subclause (6)(c)(i) may be given in accordance with section 68 or by registered mail addressed to the person to be notified as it appears in the financing statement mentioned in subclause (6)(c)(i).

(8) This section does not apply to a security interest in an accession to which section 38 applies.

Contrast the Australian version, which spans six sections (ss 138-143), approximately 112 lines of text and 4 ½ pages. I will not tax the committee’s patience by reproducing these provisions. Is this additional amount of detail worth the cost in terms of the clutter and complexity it adds to the legislation? As suggested above, one way of answering this question might be to look at the amount of litigation there has been in Ontario and Saskatchewan on the commingled goods provisions. The answer is “almost none” and this is some indication at least that much of the detail in the Australian provisions may be
unnecessary. The same point could be made about numerous other provisions in the Bill – the commingled goods provision is only one example – but time and space constraints preclude further elaboration.

(c) Obscure terminology

Again, numerous examples could be given but a few selected ones will have to suffice. I made most of these points in my submission to the Attorney-General’s Department on the earlier Consultation Draft. I’m making them again here in the belief that they are important and in the hope that, second time round, they might not fall on deaf ears.

The Bill throughout uses the expression “tangible property” in place of “goods” (the terminology employed in Revised Article 9 and the New Zealand and Canadian PPSAs). This idiosyncrasy may not have substantive implications, but it does affect the comprehensibility of the legislation because the reader must make a mental note to substitute “goods” every time she reads “tangible property”.

Likewise, the Bill uses the expression “grantor” to describe the party who gives the security interest. The objective is to cover the case where the security interest is given by a third party rather than the debtor himself. However, other PPSAs meet this difficulty by defining “debtor” to include a third party grantor where the context requires. This approach has the advantage of avoiding the need to speak of both debtors and grantors in the legislation (a potential source of confusion in itself) and also of not requiring the reader to think twice about what “grantor” means every time she encounters the term. Perhaps more importantly, the expression “grantor” is inappropriate for title retention transactions and it is not hard to envisage inventive counsel making the argument that, notwithstanding the functional definition of “security interest” in s.28, the repeated references in the legislation to “the grantor” signify an intention to limit the scope of the legislation.

A third, and perhaps the most bizarre example, is the Bill’s approach to registration.
The Bill defines “registered” by reference to registration of the collateral, rather than the security interest and it follows through with this approach in other provisions, such as s.64(2), which refers to collateral being “registered” and s.189, which provides for the registration of “personal property as collateral”. By contrast, the New Zealand and Canadian PPSAs refer to registration of the security interest. It is unclear why the Australian drafters took a different approach and the Commentary provides no clues. Registration is one method of perfection. The legislation refers to perfection of the “security interest”. Given that registration is a method of perfection and that the subject-matter of perfection is the security interest, it is conceptually wrong to speak of registration of the collateral instead.1 Perhaps another way of making the same point is to say that what searchers of the register are looking for is not collateral but, rather, security interests. The Bill will replace the company charges provisions in the Corporations Act, the bills of sale legislation, the motor vehicle security legislation and so on. In none of these cases does the legislation refer to registration of the collateral. The Corporations Act refers to registration of charges, the bills of sale legislation refers to registration of bills of sale and the motor vehicle security legislation refers to registration of motor vehicle security interests. Why should the PPSA be different? This idiosyncracy in the Australian Bill may or may not have substantive implications. As with so many of the Bill’s deviations from the other PPSA models, it is impossible to be sure without detailed analysis. In any event, the Australian approach seems to be change for change’s sake and it is a potential source of confusion for readers struggling to come to grips with what is already difficult legislation.

The New Zealand PPSA, the Canadian PPSAs and Revised Article 9 all use the expression “financing statement” to describe the instrument for registering a security interest. The Australian Bill uses the expression “registration” instead. It is unclear why the drafters made this change and neither the original nor the Revised Commentary offers any clues. One problem with the Australian approach is that the Bill uses “registration” in two different senses: first to describe a method of perfection and second,

1 Incidentally, there is an inconsistency between the Bill and the Revised Commentary in this respect. Whereas the Bill refers to registration of the “collateral”, the Revised Commentary adheres to orthodoxy and refers instead to registration of the security interest: see, e.g., Revised Commentary, Chapter 10.
to describe the registration instrument. This is, at best, a potential source of confusion and, at worst, a potential source of unintended consequences.

(d) Cross-referencing

The Bill’s comprehensibility is also affected by a Byzantine system of cross-referencing which forces the reader to skip between different parts of the legislation to find the answer to particular questions. The consequence is to turn what should be a relatively simple legal inquiry into something more in the nature of a treasure hunt. The following are three examples of what I mean.

Assume the reader wants to know what leases the legislation applies to. To answer this question in any of the Canadian provinces, the starting point is the provision saying that the Act applies to any lease of goods for a term of more than one year whether or not it secures payment or performance of an obligation. The only remaining step is to go back to the definition section, which defines “lease for term of more than one year”. By contrast, in the Australian Bill the starting point is s.28 which provides that “security interest” includes the interest of a lessor under a PPS lease. A return to the definitions in s.26 will tell the reader that “PPS lease” has the meaning given by s.31. And so the reader must progress to s.31 for the answer.

Section 50(3) of the Bill provides that a reference to a charge over property is a reference to a security interest that has attached to a circulating asset or personal property that is not a circulating asset. Pause here: if a charge is a security interest whether or not it attaches to a circulating asset, what is the point of drawing the distinction? A clue to the answer lies in s.50(4), but the implication is that the reader must read s.50(4) in order to understand s.50(3). Moving on, to discover what s.50(3) and(4) together mean, the reader must go to the definition of “attachment” in s.26 which refers her on to the definition in s.61. Moreover, the reader must know what “circulating asset” means and to discover this, she must go to s.51(1), which refers to a circulating asset being a “current asset”, the meaning of which is given in s.51(5). Finally, to understand s.50(3) and (4), the reader
One final example: s.142 provides as follows:

(1) This section applies if:

(a) a secured party has a security interest that is taken to have the same priority as one or more other security interests under section 141; and

(b) an amount or proceeds of collateral are received by or on behalf of the secured party (whether or not under section 159 or 166).

(2) Instead of applying the amount or proceeds in accordance with paragraph 177(2)(c), the amount or proceeds must be applied equally towards:

(a) other obligations to the secured party that are secured by the security interest in the collateral as mentioned in that paragraph; and

(b) the obligations secured by each security interest that is taken to have the same priority as the security interest of the secured party.

(3) This section does not otherwise affect the operation of section 177.

*Res ipsa loquitur.*

Taken in isolation, these examples may not seem particularly troublesome. However, it must be kept in mind that the examples are representative of a drafting style that permeates the Bill and the cumulative effect on the comprehensibility of the legislation is significant. The drafters appear to have recognized this point because here and there throughout the Bill a cross-reference will be accompanied by a note summarizing what the cross-referred to section says. However, this technique is not consistently adopted.
4. Errors in the bill

(a) Introduction

Again, a word of caution is necessary under this heading. Even with the benefit of the Revised Commentary, it is impossible to be sure whether what appear to be mistakes in the Bill are in fact mistakes or whether they reflect deliberate policy choices. Consequently, some of the points I make in this part of the submission may more properly belong in Part 5, below – and vice versa. Also, if I had unlimited time to read the bill closely and write a comprehensive submission, Parts 4 and 5 would be much longer than they are. The points I make in both parts are representative only.

(b) Conflict of laws

Sections 80-83 enact conflict of laws rules for the case where collateral was originally located in a foreign jurisdiction but is later moved to Australia. However, this is only one of several kinds of conflicts issue that might arise and the Bill does not address these other cases. Contrast the New Zealand and Canadian PPSAs, which contain a comprehensive set of conflicts rules. The following are some examples of conflicts issues the Australian Bill fails to address:

(1) Assume a debtor ("grantor") and a secured party, both located in Australia, enter into a security agreement relating to collateral located in New Zealand. Which country’s laws govern the validity, perfection and effect of perfection of the security interest? According to the New Zealand and Canadian PPSAs, the answer is New Zealand, because this is the place the collateral is located. The Australian Bill provides no answer and so, presumably, courts will have to apply the relevant common law conflicts rule.

(2) A secured party and a grantor enter into a security agreement in relation to collateral that is located in New Zealand but on the understanding that the debtor will relocate
the collateral to Australia in the short-term. According to New Zealand (and Canadian) law, Australian law governs the validity, perfection and effect of perfection of the security interest from the outset. The Australian Bill has no corresponding provision and so, again, the courts will be forced back to the common law. On this basis, an Australian court may conclude that New Zealand law applies on the basis that it is the *lex situs*. However, if the case is litigated in New Zealand, the New Zealand court, applying the New Zealand PPSA rule, will conclude that New Zealand law applies. In other words, the outcome of the case may be different depending on where it happens to be litigated.

(3) A secured party and a grantor enter into a security agreement with the grantor’s accounts as collateral. The grantor is located in Australia, the secured party is in New Zealand and all the account obligors are in Singapore. The New Zealand (and Canadian) PPSAs apply a debtor location rule to this case and, on this basis, Australian law governs the validity, perfection and effect of perfection of the security interest. However, the Australian Bill is silent on the point. There is also a subsidiary issue relating to determination of the debtor’s location. The main choices are between: (1) the place where the debtor carries on business; (2) the place where the debtor has its chief executive office; and (3) the place of the debtor’s incorporation. The New Zealand and Canadian PPSAs specify the relevant test, but the Australian Bill is silent. This means that Australian courts will be confronted with a two-fold task: (1) to determine the applicable conflicts rule for accounts; and (2) if the court applies a location of debtor (grantor) rule, to determine the test of location.

Uniform conflict of laws rules between jurisdictions are important to avoid the risk of forum shopping created by the prospect of different case outcomes depending on where the litigation takes place. The Canadians have been unable to achieve uniform provincial PPSAs, much less national legislation, but they have at least managed to achieve uniform conflict of laws rules and a high level of harmonization with the conflict of laws rules in Article 9. Australia will avoid conflict of laws problems at the inter-state level, given that its proposed PPSA is a national one, but there is still the potential for conflict of laws
issues to arise at the international level (as the examples above demonstrate). The Revised Commentary acknowledges that the failure to include conflict of laws provisions may create “uncertainty” (para.1.2) and, in Appendix A, it sets out model provisions for consideration. On the basis of the foregoing, there is a strong argument for saying that: (1) the legislation should include conflict of laws provisions; and (2) as far as possible, the provisions should be uniform with New Zealand and the Canadian provinces.

(b) Security interests in investment entitlements

The Canadian provinces are in the process of enacting uniform securities transfer legislation, modeled on Article 8 of the United States Uniform Commercial Code. The new legislation contains detailed rules governing the transfer of both directly and indirectly held securities. The legislation refers to the investor’s interest in indirectly held securities as a “security entitlement” and it goes on to specify that the investor has a proportionate proprietary interest in the intermediary’s holding of the securities in question. It also gives the investor a set of personal rights exercisable against the intermediary for breach of the duties the intermediary owes investors. These rights, in combination, make up the “security entitlement” and they are what the investor gets in return for her investment. Cognate reforms to the PPSAs are aimed at facilitating security interests in investment property. The PPSA definition of “investment property” expressly includes a security entitlement. Other parts of the Act spell out the rules for attachment of a security interest in a security entitlement and other kinds of investment property. They also stipulate what the secured party should do to perfect its security interest in investment property and they enact special priority rules for disputes between the holder of a security interest in investment property and competing claims.

The Australian Bill attempts to replicate this scheme but without an accompanying Securities Transfer Act. The Bill refers to an “investment entitlement” in place of “security entitlement” and it defines “investment entitlement” to mean “the rights of an account holder of an investment entitlement account that result from crediting an interest in a financial product to the account”. So far, so good. The trouble is that, in the absence
of an accompanying Securities Transfer Act or the like, there is no way of knowing what the account holder’s rights are. The Bill makes special concessions for security interests in investment instruments and entitlements, including provision for perfection by control and accompanying priority rules that favour perfection by control over perfection by other means. The aim, presumably, is to facilitate security interests in this type of collateral. However, in relation to investment property, the failure to address the nature of the account holder’s rights is likely to inhibit secured lending because if the account holder’s rights are uncertain, the secured party also cannot be sure just what it is getting by way of collateral.

(c) Fixed and floating charges

Section 50(3) provides that a reference to a charge over property is a reference to a security interest that has attached to a circulating asset or a non-circulating asset, while s.50(4) provides that a reference to a floating charge is a reference to a security interest that has attached to a circulating asset. The New Zealand and Canadian PPSAs do away with the floating charge concept, replacing it with a fixed security interest in circulating assets such as inventory and accounts. The legislation achieves this result by providing that: (1) a secured party may take a security interest in after-acquired property; (2) a security interest attaches when the debtor (grantor) has rights in the collateral; and (3) if the debtor (grantor) disposes of the collateral with the secured party’s authority, the security interest does not continue in the collateral itself but extends to the proceeds.

The PPSA equivalent of a floating charge over inventory and accounts is a fixed security interest in the debtor’s (grantor’s) present and after-acquired inventory and accounts. Assume the debtor (grantor) sells an item of inventory in the ordinary course of business to a retail customer on 90 day terms. Applying the statutory rules summarized above, the security interest does not continue in the inventory, but it extends (attaches) to the account generated by the sale. If the debtor (grantor) collects on the account and uses the collection proceeds to buy new inventory, the security interest does not continue in the collection proceeds, but extends (attaches) to the new inventory. In summary, the secured
party obtains a fixed security interest in each item of inventory as the debtor (grantor) acquires it and each account as it is generated by the sale of inventory in the ordinary course of business. The outcomes exactly replicate floating charge outcomes, but the security interest is a fixed one, not a floating one.

Rules (1), (2) and (3), above are in the Australian Bill: see, respectively, s. 59 (security interests in after-acquired property); s.41 (attachment); and s.68(2) (security interest extends to proceeds following dealing in collateral). It seems to follow that, so far as Australian law is concerned, the floating charge is dead. However, s.50 muddies the waters in two respects: first, it implies the survival of the floating charge after all and secondly, it defines “floating charge” as a security interest that has attached to a circulating asset whereas, *ex hypothesi*, a floating charge does not attach. Section 61(3) provides that a reference in a security agreement to a floating charge does not imply postponement of the time of attachment and s.50(2) provides in part that s.50 does not apply to s.61(3). This appears to confirm the conclusion that the floating charge is dead but, again, if this is true, it is hard to make sense of s.50(4).

According to the *Revised Commentary*, s.50 has two objectives: (1) to make it clear that references in other statutes to a “floating charge” are now to be read as meaning the PPSA fixed security interest equivalent; and (2) to emphasize that the use of floating charge language in a security agreement does not affect the application of the PPSA: see paras 11.57 and 11.58. However, for the reasons suggested above, the provision may prove to be counter-productive. The provision might be improved by deleting all references to a security interest “attached to” an asset and substituting the expression security interest “in” an asset. A better solution might be to shorten and simplify the provision something along the following lines:

“A reference to a floating charge in any statute means a security interest that by virtue of this Act is in substance the same as a floating charge, whether or not the security agreement describes the security interest as a floating charge”.

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This proposal addresses the first of the two objectives the Revised Commentary identifies. As regards the second objective, I doubt whether any special provision is needed. Section 61(3) already makes it clear that the use of floating charge language in a security agreement does not displace the ordinary attachment rules – in other words, the security interest is still a fixed security interest – and it is hard to see what s.50 usefully adds.

(d) Accessions

The New Zealand and Canadian PPSAs define “accession” to mean “goods that are installed in or affixed to other goods”. In Australia, the earlier Consultation Draft also employed this definition. However, in the revised Bill s.34 now defines the term to mean “other tangible property that is installed in, or affixed to, the improved property, but only if the separate identities of the improved property and the other tangible property are lost at the time the other property is installed in, or affixed to, the improved property”. The result, as the Note to s.34 indicates, is that, for example, an aircraft engine is not an accession to a particular aircraft frame. Neither, for that matter, are tyres affixed to a truck, or a car radio following installation or, quite possibly, a car engine. By contrast, all these items are accessions for the purposes of the New Zealand and Canadian PPSAs. The point matters because if an object is an accession, a dispute between the holder of a security interest in the object and a person claiming an interest in the host goods (“improved property”), will be governed by the priority rules relevant to accessions in ss 133-137. What rules apply if the disputed object is not an accession? The answer is not immediately obvious.

Consider the following example. Secured Party A sells tyres to Debtor pursuant to a conditional sale agreement. Debtor fits the tyres to his truck, in which Secured Party B has a security interest perfected by registration. Who has priority in relation to the tyres? Under Canadian and New Zealand law, the answer is straightforward: the tyres are an

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2 There is Canadian case law in point. See, e.g. Credit Suisse Canada v.1133 Yonge Street Holdings Ltd (1998) 41 O.R. (3d) 632 (Ontario C.A.)
3 The Revised Commentary suggests that a roof rack or trailer hitch on a car is an accession: para.8.9. However, it is hard to square this statement with the statement later in the Revised Commentary that property is not an accession unless it is “melded into the identity of the improved property”: para.B.37.
accession and so the accession priority rules apply. The rule relevant to the present case is that a security interest in goods (the truck) that attached before the disputed goods (the tyres) became an accession has priority. Therefore Secured Party A has priority. The justification is to prevent Secured Party B from receiving a windfall in the form of an unbargained for increase in the value of its collateral.

Contrast the analysis the Australian Bill would require. In the first place, the tyres are not accessions, therefore the accession priority rules in ss 133 and following do not apply. Does some other PPSA priority rule apply instead? The answer depends on whether Secured Party B has an interest in the tyres at all and this in turn depends on the wording of the security agreement. If the security agreement simply describes the collateral as “the truck”, Secured Party B may have no claim to the tyres because the PPSA treats the tyres as separate from the truck. Likewise if the security agreement describes the collateral as “the truck together with all accessions” because, according to the PPSA, the tyres are not accessions. However, the position may be different if the security agreement describes the collateral as “the truck, together with all accessions and fittings whether accessions within the meaning of the PPSA or not”. This wording may be sufficient to give Secured Party B an interest in the tyres.

If Secured Party B has no interest in the tyres, then Secured Party A will win the dispute – not because its security interest has priority over B’s security interest - but because B has no security interest in the tyres at all. On the other hand, if B does have a security interest in the tyres, there is a priority dispute and the PPSA pmsi priority rules apply. On this basis, A will have priority provided it perfected its security interest within the required time.

Now assume that the dispute relates not to tyres, but a braking system. Is a braking system an “accession” within the meaning of the Australian definition? Perhaps it is. Then again, perhaps not – the point is arguable. If it is not an accession, the analysis is the same as for the tyres. If it is an accession, then the accession priority rules apply and Secured Party A will have priority even if its security interest is unperfected.
The lessons to be drawn from this analysis are as follows: (1) the proposed Australian definition of “accession” is indeterminate and it is likely to promote litigation; (2) the narrow Australian definition substantially limits the scope of the accession priority rules and, if these rules do not apply, it may not always be easy to resolve the dispute; and (3) the Australian approach leads to the possibility of different outcomes depending on whether the disputed object is, for example, a tyre or a braking system.

The accession priority rules in the Australian Bill are different from the rules in the Canadian and New Zealand PPSAs. This raises the possibility that they may lead to different outcomes. I do not know whether the Australian drafters have contemplated this possibility or, if they have, whether there are plausible policy justifications for the differences.

Section 144(2) of the Australian Bill contemplates removal of accessions by the secured party in order to enforce its security interest. However, this provision appears to overlook the definition of “accession”. Given that an object becomes an accession only if its separate identity is lost upon affixation to the host goods, it seems unlikely that an accession could be removed without doing irreparable damage to the host goods, the accession or both. Note in this connection s.147, which makes the secured party liable for unnecessary damage to the host goods in the course of removing an accession, and s.148, which allows for court applications in connection with the removal of an accession. If the disputed object is not an accession (tyres, for example), ss 144(2), 147 and 148 do not apply and, so far as I have been able to discover, there is nothing in the Bill about the secured party’s right to remove the object or the rights of the host goods owner to claim compensation or apply for a court order.

In summary, the accessions provisions in the Bill appear to have been poorly thought through. I have dealt with the accessions provisions at some length because they are a good illustration of my broader concern relating to the Bill as a whole, namely that the Bill’s numerous and extensive departures from the tried and tested Canadian-New
Zealand model may have unintended consequences that, down the track, could cost lenders, borrowers and other stakeholders dearly.

(e) Secured party’s right to claim both original collateral and proceeds

Assume a secured party has a security interest in the debtor’s truck as commercial property (“equipment” in New Zealand and Canadian PPSA parlance). The debtor (grantor) wrongfully sells the truck to a third party (transferee) for $15,000. The market value of the truck at the date of the sale was $20,000 while the outstanding loan balance owing to the secured party at that time was $40,000. Section 68(2) of the Australian Bill, following the Saskatchewan and New Zealand lead, implies that the secured party may claim both the truck from the transferee and the sale proceeds from the debtor (grantor), but s.68(4) limits its total recovery to the value of the collateral at the date of the sale ($20,000). Without this limitation, the secured party would get a windfall in the form of a $15,000 increase in its collateral from the debtor (grantor’s) dishonesty. Section 68(4) is borrowed from the Saskatchewan/New Zealand model. However, s.68(5) has no counterpart in the other laws. Section 68(5) provides that subsection (4) does not apply if, at the time of the transfer, the transferee knew the transfer was in breach of the security agreement. The implication is that if, for example, the secured party recovers the $15,000 sale proceeds from the debtor (grantor) it is not limited to a $5,000 claim against the transferee but may recover the truck or its full value ($20,000). I have trouble seeing the policy justification for s.68(5). It is unclear why, even if the transferee is dishonest, as s.68(5) envisages, the secured party should get a windfall and why the transferee, even if dishonest, should be made to account for more than the secured party’s actual loss resulting from the transfer.
5. Dubious policy choices

(a) Fixtures

The earlier Consultation Draft included provisions relating to security interests in fixtures. These provisions have been dropped from the Bill’s current version. All the Canadian PPSAs contain provisions governing fixtures, but the New Zealand PPSA does not. The New Zealand PPSA’s failure to provide for fixtures is widely regarded within New Zealand as ill-advised. What it means is that in cases involving a priority dispute between the holder of a security interest in a fixture and the holder of an interest in the land, the court will have to revert to the common law rules. By contrast, in Canada, the rules are codified in the statute, they are clear and accessible and they give effect to the parties’ likely commercial expectations. The rules vary depending on whether: (1) the security interest attaches before or after the goods become a fixture; and (2) the competing party acquired its interest in the land before or after the goods became a fixture.

For example, if the security interest attached before the goods became a fixture and the competing party had already acquired its interest in the land before the goods became a fixture, the security interest has priority. The rationale is that otherwise the competing party would get a windfall at the secured party’s expense because the competing party would not have had the fixture in mind at the time it acquired its interest in the land. Note that in this case, the secured party’s priority does not depend on perfection: attachment is sufficient. On the other hand, if the goods become a fixture before the competing party acquires its interest in the land and the security interest has already attached at that point, the competing party has priority unless the secured party filed a notice of its interest in the Land Registry Office before the competing party’s acquisition. The rationale is that, in the absence of notice, the competing party is likely to assume that its acquisition includes the fixture. Note that in this case, the secured party’s priority depends on registration, not in the PPS register, but in the Land Registry Office. The rationale is to
avoid the need for the prospective land purchaser to search in both the land and PPSA registers.

According to the *Revised Commentary*, the fixtures provisions were removed “at the request of the States and Territories who were concerned about the operation of these provisions upon State and Territory based land laws”: para.B.36. There is no further elaboration of what the concerns might be. As indicated above, in Canada the only direct interaction between the PPSA fixtures provisions and the land laws is the PPSA requirement to file notice of a fixture security interest in the Land Registry Office. I assume that, in Australia, the State and Territory land laws might require amendment to accommodate this procedure, but this is a minor change and it is hard to see it intruding significantly on land law policy and practice. On the other hand, the costs of not including fixtures provisions in the PPSA are likely to be substantial.

(b) PPS leases

In common with the Canadian and New Zealand PPSAs, the Australian Bill applies to a lease for a term of more than one year whether or not the lease secures payment or performance of an obligation. However, the Australian Bill goes further. It also applies to the non-security lease of a motor vehicle, truck or equipment for a term of 90 days or more: see s.31(1)(e).

In Ontario, until recently the PPSA only applied to a lease that was in substance a security agreement, in other words, it applied to finance leases but not equipment leases. This distinction promoted considerable litigation, which was avoided in the other provinces by the bright line rule that every lease for a term of more than one year was subject to the statute and Ontario recently moved to this model. The premise is that a lease for a term of more than one year is more likely than not to be a finance lease and this limits the potential for over-inclusiveness.
This empirical justification does not apply to the Australian initiative of making 90 day to one year vehicle leases subject to the statute. There must be some other justification and, in the absence of any explanation in the Revised Commentary, it is impossible to be sure what it is. Perhaps the justification is that shorter-term leases should be subject to the PPSA registration requirements so that third parties have the means of discovering the lessor’s interest. However, the same concern might be raised about all transactions which involve the separation of ownership from possession (for example, warehouse agreements, shipping contracts and trusts) and it is not immediately obvious why shorter-term leases should be subject to the PPSA registration regime while these other cases are not. The Canadian response to this issue, I think, would be to say that the PPSA is a statute about security interests and that it is not the appropriate vehicle for dealing with publication issues at large.

There is an at least implicit contradiction between s.31(1)(e) of the Bill and s.233(3)(c). Section 233 (1) provides, in effect, that an unperfected security interest is ineffective in the debtor’s bankruptcy or liquidation, and s.233(3)(c) provides an exception for a lease to which s.31(1)(c) applies. The thinking is to prevent lessors who are not aware that the PPSA applies from being taken by surprise: see Revised Commentary, para.11.53. However, there is no corresponding concession attaching to the other priority rules so that, for example, the lessor’s failure to perfect may mean loss of the collateral to a secured party with a competing perfected security interest. I find it hard to see why the lessor needs protection in one context, but not the other. It seems to me that the lessor either deserves protection across the board or not at all. If he deserves protection across the board then, of course, he should not be made subject to the statute in the first place. But if he does not deserve protection at all, then s.233(3)(c) is ill-advised.4

4 The same confusion is reflected in the Revised Commentary which, on the one hand suggests that “requiring the registration of short-term PPS leases … would be onerous” but at the same time defends “subjecting the short term PPS lease to the priority rules”: para.11.53.
(c) Security interest in bankruptcy and liquidation

The Saskatchewan PPSA, s.20(2) provides that:

A security interest in collateral is not effective against:

(a) a trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy; or

(b) a liquidator appointed pursuant to the Winding-Up and Restructuring Act if the security interest is unperfected on the date that the winding-up order is made”.

The corresponding provision in the Australian Bill is s.233, which runs to approximately 112 lines and 3 ½ pages: yet another example of the prolixity of the Australian Bill.

Section 234 applies to non-security leases and consignments. It provides that if the lessor’s or consignor’s interest is affected by s.233, the lessor or consignor is taken to have suffered loss or damage immediately before the bankruptcy or liquidation date and may recover compensation from the grantor (debtor) for the loss of its collateral. The idea, as I understand it, is to give the lessor or consignor a provable claim in the grantor’s (debtor’s) insolvency proceedings.

Making the grantor (debtor) liable for the lessor’s or consignor’s loss seems misconceived. If anyone is to blame for the lessor’s or consignor’s unperfected status, it is the lessor or consignor itself. It is hard to see any reason in principle for holding the grantor (debtor) accountable. A possible response might be that the purpose of the provision is not really to hold the grantor (debtor) accountable, but simply to establish a mechanism for giving the lessor or consignor a claim in the insolvency proceedings. But this seems wrong in principle, too. The purpose of the bankruptcy and insolvency system is to provide a method for liquidating and distributing the debtor’s non-exempt assets among the debtor’s creditors. To qualify for a share in the distribution, a person must have a provable claim which, in turn, presupposes a debt owing by the debtor to the claimant. Allowing a person who is not a creditor to share in the bankruptcy distribution seems contrary to the principles of the bankruptcy laws.
Furthermore, the reasons for this excess of kindness towards lessors and consignors are unclear. The provision may have been drafted to allay concerns about unfair surprise arising from *NDG Pine Ltd (in Receivership) v. Portacom NZ Ltd* [2004]2 NZLR 528 and *Agnew & Waller v. New Zealand Bloodstock* [2005] 2 NZLR 549. However, the concerns these cases have prompted are misconceived. The potential for unfair surprise in the new laws is no more than an aspect of the transition costs parties face in adapting to the new regime. These transition costs are justifiable on the assumption that they will be outweighed by the benefits of the new law in the longer-term. Moreover, the problem will likely prove to be self-correcting. It should take only one or two cases like *Portacom* and *New Zealand Bloodstock* for lessors, suppliers and consignors to get the message that the new law applies to them and that they need to register financing statements. It can safely be predicted that there will not be too many more cases like this in New Zealand and that the courts will be free to turn their attention to more interesting questions. The same goes for Australia. In any event, assuming there is a case for protecting unperfected lessors and consignors in the bankruptcy context, the same considerations surely apply in other contexts where failure to perfect results in loss of the collateral and it is unclear why the Bill extends protection in the one case but denies it in the others.

**ADDENDUM**

The Bill goes to considerable lengths to make it clear that a security interest in a statutory licence does not affect “the capacity of the States and Territories to administer licences and the conditions associated with their issue”: *Revised Commentary*, para.B.13. In this connection, it is worth noting the recent Supreme Court of Canada decision in *Saulnier v. Royal Bank of Canada* [2008] SCC 58, which makes it clear that a security interest does not in any way fetter the licensing authority’s discretion because the security interest gives the secured party no greater rights than the debtor himself enjoys. So, for example, if the debtor holds the licence subject to the licensing authority’s discretion then so, too, does the secured party in the event of enforcement. Likewise, if transfer of the licence is
at the licensing authority’s discretion, the secured party cannot sell the licence without
the licensing authority’s approval.

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