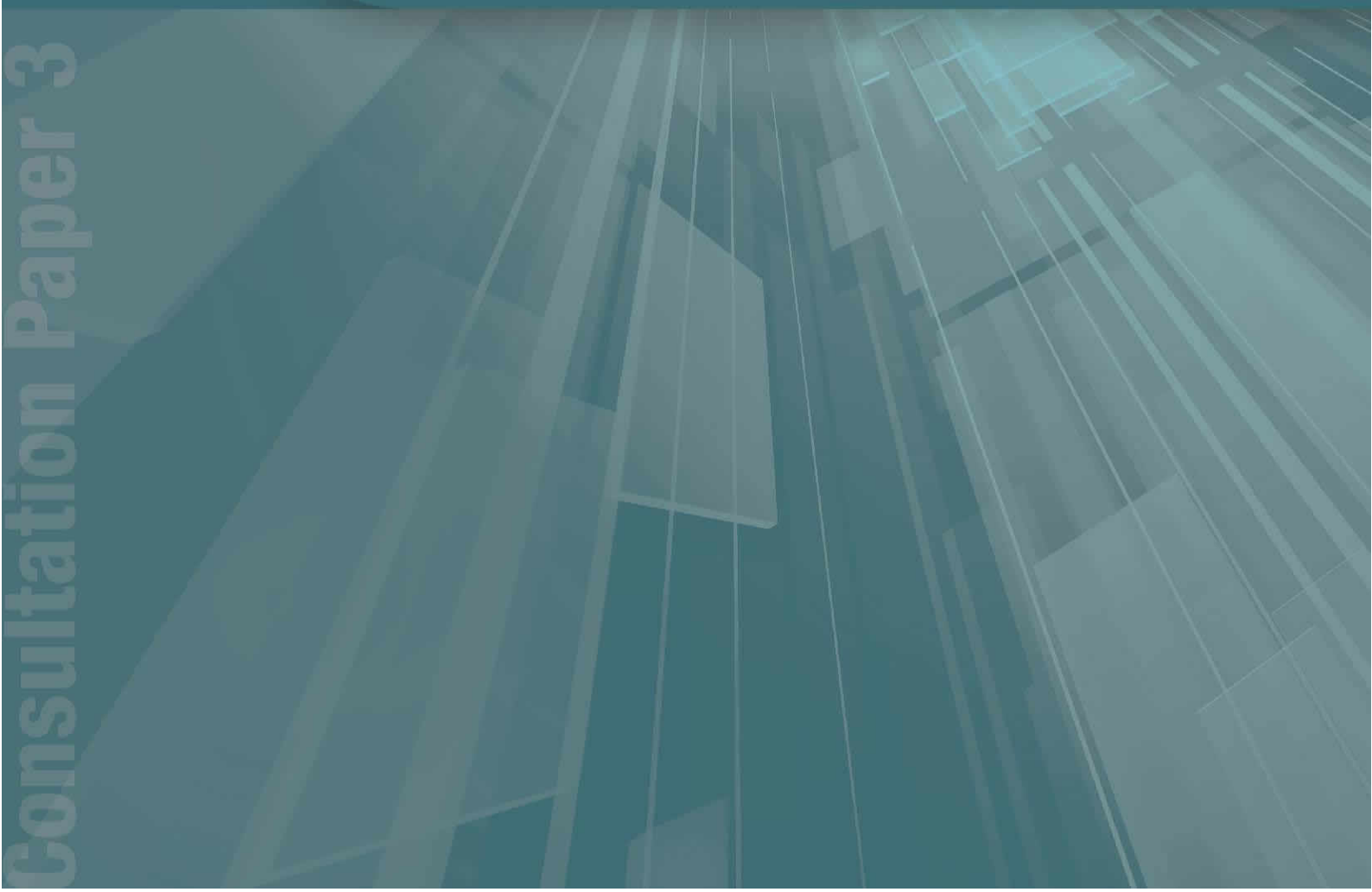
Review of the Personal Property Securities Act 2009

CONSULTATION PAPER 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



Consultation Paper 3

INDEX

SECTION **PAGE**

REVIEW OF THE PERSONAL PROPERTY SECURITIES ACT 2009

CONSULTATION PAPER NO. 3

1. INTRODUCTION

1.1 What this paper is about

This is the third of a series of consultation papers that are being released in connection with the review of the operation of the *Personal Property Securities Act 2009* (the **Act**) that is being conducted in accordance with s 343 of the Act. The consultation papers were foreshadowed in the *Interim Report on the Review of the Personal Property Securities Act 2009* dated 31 July 2014, available online at www.ag.gov.au/ppsareview.

This consultation paper considers issues regarding:

- the enforcement of security interests;
- the vesting of security interests on a grantor's insolvency;
- the interaction between the Act and other legislation;
- the governing law rules;
- other provisions in the Act; and
- the general layout of the Act, and related matters.

1.2 Supporting materials

This paper uses abbreviated terms for concepts or documents that are referred to frequently. A glossary of these terms can be found in Annexure A.

The Interim Report set out a number of principles to guide the process of assessing the merits of proposed amendments to the Act. For convenience, a copy of those principles is set out in Annexure B.

2. ENFORCEMENT OF SECURITY INTERESTS

2.1 What this Section covers

This Section 2 looks at the rules in Chapter 4 of the Act, regarding the enforcement of security interests. Section 2.2 discusses the exclusions from the Chapter, and whether the Chapter should be mandatory where it does apply – that is, whether or not parties should be free to negotiate their own enforcement remedies in substitution for the remedies in the Chapter. Sections 2.3 to 2.7 then consider the individual remedies in Chapter 4 in more detail.

2.2 Application of Chapter 4

2.2.1 Should Chapter 4 be mandatory, where it applies?

The Canadian PPSAs[1] and the NZ PPSA[2] also contain a standard set of enforcement mechanisms for security interests. Those rules 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.

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 argue 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. While support for that proposition can be found in the language of Chapter 4, however, it is not clear that this is the case, or just what the boundaries of the principle are.

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 position is not as clear as it might appear to be on a first read of s 110, 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.

---

[1] Eg Sask PPSA, Part V.

[2] NZ PPSA, Part 9.

Some 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 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.

The same argument can be made by reference to s 115. This 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 first needs to be determined what the policy outcome should be. The main options appear to be these.

(a) **Mandatory application of the Chapter, where it applies**

Under this approach, the Chapter would be mandatory where it applies. 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 option, 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.[3]

(c) **Mandatory application of the Chapter, where it applies, to security interests that are granted by particular types of grantor, such as individuals**

Another option would be to 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.)

---

[3] See Section 2.2.8 below.

As noted earlier in this Section, the Canadian PPSAs and the NZ PPSA take the first of these approaches. The approach can be 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.

In the Australian context, however, there may not be a strong consensus of support for option (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. A full adoption of the *laissez faire* approach of option (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 option (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.

I would be interested to receive comments on these issues.

> **Proposed recommendation 3.1**: *None at this stage, pending further consideration.*

2.2.2 The meaning of "default"

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. As an example, the Sask PPSA[4] also provides that a secured party can exercise the enforcement remedies set out in the legislation if "the debtor is in default". The NZ PPSA[5] does the same. 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.[6]

In my view, 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.

---

4 Sask PPSA, s 56(2)(a).

5 NZ PPSA, s 109(1)(a).

6 Sask PPSA, s 2(1)(n); NZ PPSA s 16.

Proposed recommendation 3.2: *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.*

2.2.3 Section 109(1)(b) – incidental security interests

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 nothing that can be recovered by an enforcement process. Section 109(1)(b) extends the exclusion however, in the case of a transfer of an 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[7] and the NZ PPSAs[8] 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).

It is not clear why s 109(1)(b) was included in the Act. I would be interested to hear of explanations for it.

Proposed recommendation 3.3: *None at this stage, pending further consideration.*

2.2.4 Section 109(2) – property located outside Australia

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.[9] It 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).

---

7 Eg Sask PPSA, s 55(2)(a).

8 NZ PPSA, s 105(b).

9 Replacement Explanatory Memorandum, para 4.4.

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 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. There could also be circumstances where 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.[10]

I am inclined for these reasons to recommend that s 109(2) be deleted. I would however be interested to hear if there are contrary views.

Proposed recommendation 3.4: *That s 109(2) be deleted.*

2.2.5 Section 109(3) – investment instruments and intermediated securities

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.

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]"[11]. 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.

I would be interested to hear the views of others on this.

Proposed recommendation 3.5: *None at this stage, pending further consideration.*

2.2.6 Section 109(5) – personal, domestic or household collateral

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

---

[10] 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.

[11] Replacement Explanatory Memorandum, para 4.5.

with, if the secured party has complied with a corresponding provision in the National Credit Code.[12]

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. It is worth asking, 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. I would however be interested to hear the views of others on this.

Proposed recommendation 3.6: *None at this stage, pending further consideration.*

2.2.7 Section 111 – exercise of rights under Chapter 4

Section 111 provides as follows:

> (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.

The Canadian PPSAs[13] and the NZ PPSA[14] 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". The Canadian PPSAs also extend this even further, to "any other law".

One submission suggested that s 111 should be amended to follow the overseas approach 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.

This provision was the subject of 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, but was brought back to its current narrower form as a result of representations from industry. For that reason, I suspect that industry will continue to be comfortable with the current setting, and will not want to expand the reach of the section along the lines proposed in the submission. I would however be interested to hear whether there is support for doing this.

Proposed recommendation 3.7: *None at this stage, pending further consideration.*

---

12 See reg 4.1 of the Regulations.

13 Eg Sask PPSA, ss 65(3) and (4).

14 NZ PPSA, s 25.

2.2.8 **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 the Chapter.

The relevance of s 115 will need to be revisited as part of the consideration of the issue raised in Section 2.2.1 above. If the section is retained, it would be valuable to clarify some aspects of the section.

- **When should the "use" be determined, and how?**

  The section 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. It would be helpful to clarify this, for example by replacing "is not used" in line 2 with "the grantor does not intend, at the time it entered into the security agreement, to use".

  > **Proposed recommendation 3.8**: *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 entered into the security agreement, to use".*

- **The expression "contract out"**

  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.

  This could be easily clarified, for example by replacing "may contract out of" in s 115(1) with "may agree that a party need not comply with". In my view, an amendment along these lines would help to clarify the operation of the section.

  A corresponding amendment could also be made in s 115(7).

  > **Proposed recommendation 3.9**: *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).*

- **Section 115(1)(q) – the right of redemption**

  One submission argued that parties should not be allowed to contract out of the grantor's right to redeem collateral under s 115(1)(q). 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. I would be interested to hear whether others share this view.

  > **Proposed recommendation 3.10**: *None at this stage, pending further consideration.*

2.2.9 **Section 116 – property in the hands of a controller**

2.2.9.1 **The meaning of the section**

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 on at least one occasion during the public consultation process for the Bill that ultimately became the Act. The intention behind the section appears however to be 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.

- 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.

It would aid in the interpretation of the Act if this could be spelt out more clearly and succinctly than at present.

> **Proposed recommendation 3.11**: *That s 116 be amended to set out the above principles more clearly and succinctly.*

2.2.9.2 **Are the exclusions appropriate?**

The Replacement Explanatory Memorandum states that s 116 is designed to avoid overlap with provisions in the Corporations Act that regulate company receivers.[15] In this respect the Act follows the NZ PPSA.[16] In contrast, the Canadian PPSAs make it clear that their enforcement provisions do apply to receivers.[17]

This exclusion of corporate receivers from Chapter 4 was inserted in the Act in response to submissions from industry. It is likely that industry will continue to be of the view that the current policy setting is appropriate. One submission suggested however that the exclusion is not desirable. I would be interested to hear whether that view is more widely held.

> **Proposed recommendation 3.12:** *None at this stage, pending further consideration.*

2.2.10 **Section 112(3) - licences**

Section 112(1) has the effect that a secured party can generally only deal with collateral under Chapter 4 to the same extent as the grantor would be entitled to. Section 112(3) then states the following:

---

[15] Replacement Explanatory Memorandum, para 4.18.

[16] NZ PPSA, s 106.

[17] Eg Sask PPSA, s 55(1).

(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.

Section 112(3) does not appear to add anything to the general principle in s 112(1). It could be deleted, in my view, without adverse impact.

Consultation Paper No. 1[18] suggested that Government should explore with the states and territories whether currently-excluded statutory licences could be brought within the Act. It might ultimately assist states and territories to agree to this, if they can clearly see that they would still retain control over who holds licences under their legislation. If that is the case, then it might be helpful to retain s 112(3), to put this point beyond doubt (although I believe that the position would be clear anyway). Subject to that proviso, it is my view that s 112(3) is not necessary, and that it would help to simplify the Act if the section were deleted.

Proposed recommendation 3.13: *That s 112(3) be deleted.*

2.3 Sections 120 and 121 – enforcement against liquid assets

2.3.1 Terminology

The headings to ss 120 and 121 refer to the enforcement of security interests in "liquid assets".

In market parlance, a "liquid asset" is typically 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.

In my view, 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).

Proposed recommendation 3.14: *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".*

2.3.2 Collateral to which the sections apply

Sections 120 and 121 provide a secured party with a mechanism for recovering amounts owed to it by a grantor or debtor, by directly collecting amounts that are owed to the grantor by third parties. This is a statutory equivalent of a garnishee order.

The Canadian PPSAs[19] and the NZ PPSA[20] 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 however why the provisions need to be limited in this way. Most of the Canadian PPSAs, in contrast, allow a secured party to collect payment under a broader range of obligations. I would be interested to hear whether it might be

---

[18] Consultation Paper No. 1, Section 5.6.

[19] Eg Sask PPSA, s 57(2).

[20] NZ PPSA, s 108.

thought appropriate to expand ss 120 and 121 to apply to some other types of payment obligations as well, or indeed 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. Again, I would be interested to hear whether this was thought to be appropriate.

> **Proposed recommendation 3.15**: *None at this stage, pending further consideration.*

2.3.3 Should the availability of the remedy be tightened?

One submission made the point that s 120 presented practical difficulties for an obligor that receives a notice under the section. 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 five 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.

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.

This issue is not addressed by the Canadian PPSAs or the NZ PPSA.

I can see that the provision has the capacity to adversely affect obligors in an inappropriate way. I would be interested to hear suggestions as to how the section could be improved – whether that is by extending the period of five business days to a longer period, or by restructuring the section more generally.

> **Proposed recommendation 3.16**: *None at this stage, pending further consideration.*

2.3.4 Effect of the five business day period in s 120(3)

Section 120(3) provides:

> (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 give the obligor an extra five business days to make all of its payments. The submission queried whether this is appropriate.

I anticipate that the objective of the five business day period was to give the obligor an opportunity to assess the claim of the secured party, as discussed in the previous Section. If that is thought to be important, then some grace period may be unavoidable. The way the section is currently structured, though, the five business days are added in for each payment, no matter how far in the future the payment is due. It seems to me that this is not necessary. There is a case to be made that the five business days (or whatever period of time the section ultimately applies – see the

previous Section) 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.

Proposed recommendation 3.17: *That s 120(3) be amended to read as set out above.*

2.3.5 Sections 120(4) and (5) – the application of amounts collected

Sections 120(4) and (5) read as follows:

> (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 suggested that all amounts recovered under s 120 should be applied in accordance with s 140. I believe that this suggestion has considerable merit.

If a secured party recovers an amount under s 120 and gets to keep it, it should be obliged to apply the amount against what it is owed, in exactly the same way as would be the case if it had seized the collateral and disposed of it under Part 4.3. Part 4.3 provides for this through the application of the mechanisms in s 140 (see s 140(5)). If all recoveries under s 120 are to be applied in accordance with s 140, then s 120(4) could be deleted.

Proposed recommendation 3.18: *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.*

2.4 Sections 123 to 127 – seizing collateral

2.4.1 Sections 123(2) and (3) – seizing intangible property

A secured party cannot commence enforcing a security interest over intangible property by seizing it in the conventional sense, because the property is intangible.

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 another method if this has been agreed.

These provisions raise two issues.

- **They are limited 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. This gap is covered to some extent by s 124 (discussed further below), but s 124 does not close the gap completely.

  It will clarify the operation of Chapter 4 if this gap can be closed. This could be done by amending the rules in s 123(2) and (3) so that they apply to all personal property other than goods, rather than just to "intangible property".

- **Licences**

  Section 123(2) requires, if the intangible property in question is a licence, that the secured party give the notice to the grantor, and 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.[21] 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.

  I would be interested whether others are able to explain why licences have been singled out in this way.

  > **Proposed recommendation 3.19**: *None at this stage, pending further consideration.*

2.4.2 Section 124 – security interests that are perfected by possession or control

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.

---

[21] Eg Sask PPSA, s 57(3).

Similar to ss 123(2) and (3) (see Section 2.4.1), 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 2.4.1, it must be asked why this is appropriate. It is also 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. It could be argued for these reasons that s 124(2)(b) could be deleted.

> **Proposed recommendation 3.20**: *None at this stage, pending further consideration.*

2.4.3 Accessions

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. The submissions suggested that this should be rectified.

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. I agree however that it would be helpful to clarify the position.

> **Proposed recommendation 3.21**: *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.*

2.4.4 Section 126 – disposal of collateral from the grantor's premises

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 from the grantor's premises. However, the secured party must not cause the grantor any greater cost or inconvenience "than is necessarily incidental to the disposal".

One submission queried why this formulation is used in the section. 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) be replaced with "reasonably required".

The corresponding provisions in the Canadian PPSAs[22] and the NZ PPSA[23] also use the term "necessary". This is presumably the source of the word as used in s 126(2).

I can see some benefit in making this change. I will be interested to hear the views of others on this.

> **Proposed recommendation 3.22**: *None at this stage, pending further consideration.*

2.4.5 Section 127 – seizure by higher-priority parties

2.4.5.1 Priority agreements

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

---

[22] Eg Sask PPSA, ss 57(2)(b) and (c).

[23] NZ PPSA, s 111(2).

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 provides 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.

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. 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 could 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. I would be interested to hear whether others agree that a clarification of this point would be worthwhile.

> **Proposed recommendation 3.23**: *None at this stage, pending further consideration.*

2.4.5.2 **Competitions with non-security interests**

The same 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". 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. It 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 suitably comprehensive set of rules. I am inclined for this reason not to recommend that the Act be amended to deal with this. I would however be interested to hear whether there is more support for the view that the Act should address this question.

> **Proposed recommendation 3.24**: *None at this stage, pending further consideration.*

2.4.5.3 **Section 127(4) – the hand-over period**

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 five business days. One submission queried why the Act gives the enforcing secured party five business days to do this. The submission contrasted this with the position of the grantor, who would need to comply immediately.

This question is not addressed in the Canadian PPSAs or the NZ PPSA.

It might be thought appropriate to provide the enforcing secured party with a period of time within which it can comply with the senior secured party's notice. I would however be interested to hear the views of others on this.

Proposed recommendation 3.25: *None at this stage, pending further consideration.*

2.4.5.4 **Section 127(6) - recovery of costs**

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. 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.

This question is not addressed in the Canadian PPSAs or the NZ PPSA.

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 that a lower-ranking secured party is in fact entitled to recover its enforcement costs ahead of a more senior secured party's secured amount, particularly if the recoveries need to be applied to pay out the senior secured creditor first. This means that it is not so clear that s 127(6) does in fact produce a result that is at odds with the general law. Whether or not that is the case, though, I would be interested to the views of others on these points.

Proposed recommendation 3.26: *None at this stage, pending further consideration.*

2.5 **Sections 128 to 133 – disposing of collateral after default**

2.5.1 **Section 128 – disposing of collateral**

2.5.1.1 **Section 128(1) – need for seizure?**

One submission queried whether it should be necessary for a secured party to have seized collateral, before it can dispose of it. 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.[24]

I would be interested to hear what others think of this proposal.

Proposed recommendation 3.27: *None at this stage, pending further consideration.*

---

[24] See Cuming Walsh & Wood, page 631.

2.5.1.2 **Section 128(2) – method of disposal**

Section 128(2) provides 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. Depending on the meaning that the Act should attach to the word "dispose" (as to which, see Consultation Paper No. 2[25]), the same question could also be asked in relation to the use of the word "lease".

This may be a drafting convenience for which there is no easy alternative. I would however be interested to hear what others think.

Proposed recommendation 3.28: *None at this, pending further consideration.*

2.5.1.3 **Section 128(3) – timing of disposal**

Section 128(3) provides as follows:

> (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 role it is intended to play. That is fair question, and I would be keen to hear if others are able to provide an explanation for it. If there is no good explanation for the provision, then I would propose that it removed.

Proposed recommendation 3.29: *None at this stage, pending further consideration.*

2.5.2 **Section 129 – disposal by purchase**

2.5.2.1 **Restrictions on the right**

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.

It could be argued that s 129(3)(b) is unnecessary and overly burdensome, and that a grantor is adequately protected 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; and
- the secured party's duty under s 111 to act honestly and in a commercially reasonably manner.

It could also be argued against this, however, that s 129(3)(b) is needed in at least some circumstances, became s 116(2) has the effect that s 131 does not apply if a

---

[25] Consultation Paper No. 2, Section 5.1.

controller is appointed (although the impact of that is reduced to the extent that the controller has corresponding duties under the Corporations Act).

I would be interested to hear whether s 129(3)(b) is thought to be useful, or whether it could be deleted.

> **Proposed recommendation 3.30**: *None at this stage, pending further consideration.*

2.5.2.2 **Notice of objection**

Before purchasing the collateral itself, a secured party must notify the grantor and each higher-ranking secured party of its intention to do so. This is provided for by s 130(1). A secured party cannot purchase collateral if any of those persons objects to its doing so, despite the additional protections that are provided by s 129(3), as just discussed. It must be asked whether this additional objection procedure is necessary. It is not required under the Canadian PPSAs.[26] I would be interested to hear what others think of this.

> **Proposed recommendation 3.31:** *None at this stage, pending further consideration.*

2.5.3 **Section 130 – notice of disposal**

2.5.3.1 **Section 130(1) - notice to the debtor**

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. 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 seems to me to be a sensible proposal. It would also be consistent with the position under the Canadian PPSAs[27] and, for the same reasons, under the NZ PPSA.

> **Proposed recommendation 3.32**: *That s 130(1) be amended to require the secured party to also provide the notice contemplated by that section to the debtor.*

2.5.3.2 **Sections 130(1) and 144 – notice to higher-ranking secured parties**

Section 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.

---

[26] Eg Sask PPSA, s 56(13). The NZ PPSA does not give a secured party an express right to purchase the collateral.

[27] See Cuming Walsh & Wood, page 646.

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. It may be appropriate to expand the list of circumstances in 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. I would be interested to hear the views of others on this.

Proposed recommendation 3.33: *None at this stage, pending further consideration.*

2.5.3.3 **Section 130(2) - the contents of the notice**

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); …

It seems 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, if the interest rate fluctuates or if the collateral secures an overdraft facility). It is not clear how the section can accommodate this. I would be interested to receive suggestions for how this might be addressed.

Proposed recommendation 3.34: *None at this stage, pending further consideration.*

2.5.3.4 **Section 130(5) - exclusions**

Section 130(5) describes circumstances in which a secured party does not need to give a notice under s 130(1). Under section 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[28] and the NZ PPSA[29]. It must be asked, however, what s 130(5)(b) adds to s 130(5)(c). It may be that s 130(5)(b) could be deleted without material impact.

It is also not clear why s 130(5)(c) refers to "immediately". That could be seen to be too abrupt. 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 believes on reasonable grounds that the collateral will materially decline in value before the end of the period for which it would otherwise need to wait after giving the notices. 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.

---

[28] Eg Sask PPSA, ss 59(16)(a) and (b).

[29] NZ PPSA, ss 114(2)(a) and (b).

Proposed recommendation 3.35: *That s 130(5)(b) be deleted, and that s 130(5)(c) be amended to reflect the above discussion.*

2.5.4 Section 132 – statements of account

2.5.4.1 Section 132(1) – timing of the statements

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 burdensome for the secured party, if the collateral is disposed of in increments over time. The submission suggested that the obligation in s 132(1) should only apply when all the collateral has been disposed of.

This proposal has merit. Indeed, this may be the intention behind s 132(1) in any event.

The grantor and other secured parties should not be unduly inconvenienced by a change along these lines, because s 132(4) separately allows them to require the secured party to provide them with a statement of account every six months, if the collateral has not been (fully) disposed of. I would however be interested to hear what others think of this proposal.

Proposed recommendation 3.36: *None at this stage, pending further consideration.*

2.5.4.2 Section 132(3) – content of the statements

One submission also 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 amounts that are likely to be received in the future under a lease or licence. 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.

I would be interested to hear what others think of this proposal.

Proposed recommendation 3.37: *None at this stage, pending further consideration.*

2.6 Sections 134 to 138 – retaining collateral

2.6.1 Section 135(1) – notice requirements

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, in this way. It might be simpler if s 135(1) just required the retaining secured party to give the notice to each secured party with a registration that describes the collateral. This would be reflective of the approach in the NZ PPSA.[30] I would be interested to hear whether others agree that this would be a worthwhile change.

Proposed recommendation 3.38: *None at this stage, pending further consideration.*

2.6.2 Section 135(3)(b) – statement of amount secured

Section 135(2) provides that the notice 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. For the reasons explained in Section 2.5.3.3 above in relation to s 130(2)(1), however, this may not be practicable.

Proposed recommendation 3.39: *None at this stage, pending further consideration.*

2.6.3 Sections 136 and 141

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. It would remove a potential source of confusion if the sections were amended to clarify this.

Proposed recommendation 3.40: *That ss 136 and 141 be amended to accommodate the fact that title to the collateral may be with the secured party, rather than the grantor.*

2.6.4 Sections 137 and 138 – notice of objection

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. The section also provides the secured party with no mechanism for challenging an objection.

The submission contrasted this position 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. I agree that there is merit in this proposal.

---

[30] NZ PPSA, s 120(2).

Proposed recommendation 3.41: *That ss 137 and 138 be amended to reflect s 61 of the Sask PPSA.*

2.7 Sections 140 to 144 – rules applying after enforcement

2.7.1 Section 140 – application of recoveries

2.7.1.1 Terminology

Section 140(1) states as follows:

> (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 refer to an "amount, personal property or proceeds", or uses a similar word string.

These word strings are quite cumbersome. 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". This would make s 140 much easier to read.

Proposed recommendation 3.42: *That s 140 be amended as described above.*

2.7.1.2 Section 140(2) – interplay with s 133

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 provides that any recoveries are applied first to pay out senior-ranking secured parties, as 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. It is however 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[31], and not require a junior-ranking secured party to use its recoveries to pay out the senior-ranking secured parties first. That however could have other consequential effects (for example, in relation to amounts collected under s 120), and would need to be thought through

---

[31] Eg Sask PPSA, s 59(1).

carefully. A third option might be to just accept the potential incongruity between ss 133 and 140, and to leave the provisions in their current form. I would be interested to hear the views of others on this.

> **Proposed recommendation 3.43**: *None at this stage, pending further consideration.*

2.7.2 Section 142 – right to redeem collateral

Section 142 provides that a grantor or other secured party can redeem a secured party's security interest at any time before it disposes of collateral under s 128, by paying out the secured party.

This section could be clarified in a number of ways.

- **The cut-off time**

  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[32] and, as I understand it, under our general law.

- **What if 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).

  It seems to me that the right to redeem collateral should terminate in these circumstances as well. Again, that would be consistent with the position at general law.

- **Only 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.

  I anticipate that the section is only intended to apply to a security interest that is being enforced. It would be helpful, however, if this were clarified.

> **Proposed recommendation 3.44**: *That s 142 be amended as described above.*

2.7.3 Section 143 – reinstatement of security agreement

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.

---

[32] Eg Sask PPSA, s 62(1).

The Canadian PPSAs[33] and the NZ PPSA[34] contain similar 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 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. Even allowing for this though, it must be asked whether the provision is appropriate, both as a matter of principle and also because 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.

It is also not clear why the reinstatement right should be available to "a person". If the section is retained, the right should be limited to the grantor or the debtor. That would be consistent with the Canadian and New Zealand provisions. Similarly, for the reasons discussed in Section 2.7.2 above, the word "disposes" in line one of s 143(1) should be replaced with "commits to dispose".

My preference however would be to delete the section. I would be interested to hear the views of others on this.

Proposed recommendation 3.45: *That s 143 be deleted.*

2.7.4 Section 144 – when notices are not required

See Section 2.5.3.2 above.

2.7.5 Deficiency claims

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. The submission suggested that this be clarified.

This would reflect the approach taken in the Canadian PPSAs[35].

It might be thought that this was a sufficiently self-evident proposition 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 a security interest under a sale of goods subject to retention of title, as the seller/secured party's right to receive the purchase price could terminate if it repossesses the goods. I would be interested to hear what others think of this.

Proposed recommendation 3.46: *None at this stage, pending further consideration.*

---

[33] Eg Sask PPSA, ss 62(1)(b) and 62(2).

[34] NZ PPSA, ss 133 and 134.

[35] Eg Sask, PPSA, s 60(5).

3. VESTING OF SECURITY INTERESTS ON A GRANTOR'S INSOLVENCY

3.1 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 an obligation.

Section 268(2) provides that ss 267 and 267A do not apply to certain subordination arrangements.

3.2 The policy behind the provisions

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[36] and in bills of sale legislation[37].

The Canadian PPSAs[38] also contain a provision that is similar in intent to s 267. In New Zealand, however, the decision was taken not to include a similar 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".[39] The arguments for and against the approach are based in part on history, and in part on principle. The main arguments in favour of the approach appear to be these:[40]

- The common law has traditionally disliked non-possessory or "secret" liens.

---

[36] 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.

[37] Eg *Bills of Sale Act 1898* (NSW), s 4(2).

[38] Eg Sask PPSA, s 20(2).

[39] 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.

[40] See Gedye Cuming & Wood, pages 8 to 10; R Goode, *Principles of Corporate Insolvency Law* (4th Ed) (Sweet & Maxwell, 2011), para 13.124.

- 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.

In response, the counter-arguments are as follows:

- While the common law 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 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.

- 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. 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.[41]

---

[41] See Duggan & Brown, para 5.48.

This is an intriguing explanation for s 267. If that is the reason, however, it might be thought that it is 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 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 in-substance security interest.

I will return to the question of PPS leases shortly. For the purposes of this discussion, though, I will assume that the overall policy behind the sections is thought to be appropriate, unless I hear otherwise.

> **Proposed recommendation 3.47**: *None at this stage, pending further consideration.*

3.3 Terminology – "vests in the grantor"

Section 267 says that an unperfected security interest "vests in the grantor" on insolvency. In contrast, the Canadian PPSAs (and previous s 266 of the Corporations Act) talk of the security interest being "void" or "ineffective" 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".

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. 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.

I am not convinced at this stage that the proposed change is necessary or desirable. I would however be interested to hear the views of others on this.

> **Proposed recommendation 3.48**: *None at this stage, pending further consideration.*

3.4 Application to leases

3.4.1 PPS leases

It was argued in a number of submissions, particularly submissions from the hiring industry, that s 267 should not apply to a PPS lease if it is not also an in-substance security interest under s 12(1) of the Act. 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 Consultation Paper No. 1.[42] If the proposed recommendations in that paper are adopted, then that would significantly ameliorate this particular concern. It is noteworthy, however, that the Act excludes both a transfer of an account or chattel paper and a commercial consignment from the application of s 267 (again, as long as they are not also in-substance security interests), but that the Act only excludes a subset of 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".[43] However, the Act excludes all transfers of an account or chattel paper and commercial consignments that are only deemed security interests from s 267, not just a subset of them, and it is not clear why PPS leases should not enjoy the same protection.

I am inclined to recommend that s 268(1)(a) be amended so that the exclusion applies for all PPS leases that do not secure the payment or performance of an obligation. I would however be interested to hear the views of others on this.

Proposed recommendation3.49: *That s 268(1)(a)(ii) be amended to read:*

"(ii) *a PPS lease;".*

3.4.2 Serial-numbered property

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. 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 protective measure. The submission also suggested that it might 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.

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.

---

[42] Consultation Paper No. 1, Section 4.4.

[43] Replacement Explanatory Memorandum, para 8.9.

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 my view at this stage is that it should be limited to serial-numbered goods. The proper breadth of that concept will be considered in more detail in a later consultation paper. 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.

It also concerns me somewhat 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.

I would be interested to hear the views of others on all this.

> **Proposed recommendation 3.50**: *None at this stage, pending further consideration.*

3.5 Turnover trusts

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. In particular, s 268(2)(c)(iv) has the effect that the exclusion will only 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 s 268(2) should 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.

I am inclined to recommend that s 268(2)(c) be amended to reflect these comments.

> **Proposed recommendation 3.51**: *That s 268(2)(c) be amended by deleting sub-paragraphs (ii) and (iv).*

3.6 Deeds of company arrangement

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. 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. I agree that this would make the operation of s 267 and its related provisions less confusing.

> **Proposed recommendation 3.52**: *That s 267(1)(a)(iii) be deleted, and that any necessary consequential amendments be made to the related provisions.*

3.7 Innocent purchasers

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, and in my view should be corrected.

> **Proposed recommendation 3.53**: *That ss 267(3) and 267(A2) be expanded to include to the bankruptcy-related events referred to in ss 267(1)(a)(iv) and (v).*

3.8 Foreign security interests

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. 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), and I agree on that basis that it would clarify and streamline the Act to make this change. I would be interested to hear if there are views to the contrary.

> **Proposed recommendation 3.54**: *That s 268(1)(aa) be deleted.*

4. INTERACTION BETWEEN THE ACT AND OTHER LEGISLATION

4.1 The Corporations Act

4.1.1 Section 588FL of the Corporations Act

4.1.2 Should s 588FL be repealed?

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 six 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. Even though it is a successor to a previous provision in the Corporations Act, the submissions argued that the provision has been overtaken by s 267 of the Act (discussed above), and that it is unnecessary doubling-up to retain s 588FL as well. Some submissions 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.

I am inclined to agree with this proposition. I would be interested to hear if there are contrary views.

> **Proposed recommendation 3.55**: *That s 588FL of the Corporations Act be repealed.*

4.1.3 If s 588FL is retained

If s 588FL is retained, it would be helpful if it could be amended to clarify a number of matters.

- **Deeds of company arrangement**

  For the reasons discussed above in Section 3.6 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 also 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 section. The concern 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. If s 588FL is retained, it would be worth considering this question further.

  Proposed recommendation 3.56: *None at this stage, pending resolution of the previous proposed recommendation.*

4.1.4 Sections 340 to 341A of the Act – circulating assets

4.1.4.1 The concept

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 six 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. Rather than abolish the provisions in the Corporations Act that relied on the concept of a floating charge, however, the Act has instead created the concept of a "circulating asset", and the Corporations Act in turn has been amended to use that term in a new definition, of 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.

The submissions pointed out that the concepts of "circulating asset" and "circulating security interest" draw distinctions between assets that are based on whether the

---

[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*.

[46] Section 51C of the Corporations Act.

grantor or the secured party has title to them, 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 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.

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. I do agree however that ss 340 to 341A are difficult to work with, and would benefit from being simplified, as long as they can continue to satisfy the policy that they are intended to support.

I would be interested to hear the views of others on this.

> **Proposed recommendation 3.57**: *None at this stage, pending further consideration.*

4.1.4.2 **The location of the provisions**

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 referred to in the previous Section. 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.

I am also not aware that ss 340 to 341A are relevant to anything other than the Corporations Act. If that is correct, then there appears to be no good reason why ss 340 to 341A should be in the Act, rather than the Corporations Act. I agree that it makes sense to relocate them to there.

> **Proposed recommendation 3.58**: *That ss 340 to 341A, in whatever form they may ultimately take, be removed from the Act and relocated to the Corporations Act.*

4.1.4.3 **Detailed comments on the provisions**

A number of submissions also made comments on specific aspects of ss 340 to 341A. Those comments may cease to be relevant, if the provisions are restructured along the lines discussed earlier. For completeness, and in case the provisions are not restructured, however, those more detailed comments are discussed below.

- **ADI accounts – registration to indicate control**

  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, 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 come outside the concept of 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 security over an ADI account with it, it 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 that the requirement for the ADI to take this additional step should be removed.

  I agree 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 – a suggestion that was made by a number of submissions. That possibility will be discussed in a later consultation paper. If the "control" box is retained, however, I agree that it should not be necessary for an ADI to make a registration purely for the purposes of indicating that it has control.

  > **Proposed recommendation 3.59**: *If the Register continues 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.*

- 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.

The 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 the deposit the proceeds into the ADI account, and that it has the express or implied consent of the secured party to this.

I would be interested to hear the views of others on this proposal.

- Sections 341(3)(d) and 341A(1)(b) state that a secured party will only have "control" of an ADI account[47] 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).

This appears to be intended to be an anti-avoidance measure. I am not aware however of any particular mischief that the provision is designed to address. The meaning of the provision 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.

More generally, though, I am not satisfied at this stage that this provision has a meaningful role to play. I would be interested to hear whether others are able to provide a better explanation for it. If not, then I am of the view that it should be deleted.

> **Proposed recommendation 3.60**: *That ss 341(3)(d) and 341A(1)(b) be deleted.*

- 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". It is quite unclear what this means. The language may be endeavouring to replicate general law rules that assist to determine whether a

---

[47] Unless the secured party is the ADI itself.

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.

I am tempted simply to recommend that s 341(1)(a)(i) be deleted, on the basis that s 341(1)(a)(ii) is sufficient. I would however be interested to hear what others think.

> **Proposed recommendation 3.61**: *That s 341(1)(a)(i), and the corresponding reference in s 341(1)(a)(ii) to "specifically appropriated" inventory, be deleted.*

4.1.5 Compulsory acquisitions

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[48], 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.

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.[49] 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.

I am not convinced at this stage that this is necessary, as it would appear 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 an example of a

---

[48] See Consultation Paper No. 2, Section 5.4.14.

[49] Reg 7.1 of the Regulations.

counter-intuitive use of language of the type I have been endeavouring in other places to remove from the Act.

If it is felt that the issue deserves a more enshrined solution than just being addressed through a Regulation, then I believe that the issue should be addressed in the Corporations Act itself. I would however be interested to hear what others think of this.

> **Proposed recommendation 3.62**: *None at this stage, pending further consideration.*

4.1.6 Verification of claims in an insolvency proceeding

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. 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.[50] The submission proposed that the difficulty 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 identify which property was subject to which security interest. The practitioner requested 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 in Hastie was in a very difficult position. That, no doubt, is the reason why he applied to Court for directions. What is not clear to me at this stage, 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 for this review do clearly contemplate that the review can 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, I propose to refer the question to the arm of Government responsible for insolvency law reform for its consideration, rather than express a view on it myself.

> ***Proposed recommendation 3.63***: *That this question be referred to the arm of Government responsible for insolvency law reform for its consideration.*

---

[50] *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.

4.1.7 **Liquidator's remuneration**

The same 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.[51] The submission went on to observe, however, that the boundaries of the availability of this lien are not clear.

The court in the Renovation Boys matter (referred to in the previous Section) did hold 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. 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 issue discussed in the previous Section, though, I am not satisfied in any event that it is properly within the purview of this review to make recommendations on such a question. Again, I propose to refer it to the arm of Government responsible for insolvency law reform for consideration.

> **Proposed recommendation 3.64**: *That the arm of Government responsible for insolvency law reform be asked to consider the issue discussed above.*

4.2 **The Shipping Registration Act 1981**

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.[52]

The SRA allows a person claiming an interest in a registered ship to lodge a caveat in relation to the ship.[53] 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.[54] 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.[55]

One submission raised two issues in relation to these changes. 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.

---

51 *Re Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171.

52 *Personal Property Securities (Consequential Amendments) Act 2009,* item 18 of Schedule 3.

53 *Shipping Registration Act 1981,* s 47A.

54 *Shipping Registration Act 1981,* s 47C.

55 *Personal Property Securities (Consequential Amendments) Act 2009,* item 20 of Schedule 3.

This is clearly a change from the position that applied before commencement of the Act. It would not be practicable however 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 is the case for secured parties.

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.

> **Proposed recommendation 3.65**: *That the Shipping Registration Act 1981 be amended to allow a secured party to lodge a caveat on the Shipping Register.*

4.3 The International Interests in Mobile Equipment (Cape Town Convention) Act 2013

The *International Interests in Mobile Equipment (Cape Town Convention) Act 2013* received Royal Assent on 28 June 2013. The substance of the legislation (referred to here for convenience as the **Cape Town Act**) will not come into force, however, until Australia accedes to the *Convention on International Interests in Mobile Equipment* (known as the **Cape Town Convention**).

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.

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.

I am not aware of any particular issues arising out of the Cape Town Act that need to be considered in the context of this review. If others are aware of issues that should be considered, however, I would invite them to communicate this to the review.

> **Proposed recommendation 3.66**: *None at this stage, pending further consideration.*

4.4 Other state and territory legislation

Section 254(1) of the Act provides as follows:

> (1) This Act is not intended to exclude or limit the operation of any of the following laws (a concurrent law), to the extent that the law is capable of operating concurrently with this Act:
>
> (a) a law of the Commonwealth (other than this Act);
>
> (b) a law of a State or Territory;
>
> (c) the general law.

Consultation Paper No. 2 discussed two areas where there is the potential for conflict between the operation of the Act, and other laws:

- the fact that a grantor may be able to sell the collateral to a third party, even though it may not own the collateral[56]; and

- whether the "taking free" rules in Part 2.5 are an exhaustive code, or whether "taking free" rules under other legal principles such as the "mercantile agent" or "buyer in possession" rules in state and territory legislation can still apply[57].

I would be interested to hear whether it is thought desirable to eliminate the uncertainty in the interplay between the Act and these other legal rules, either by way of clarification in the Act or by making appropriate amendments to the relevant state and territory legislation.

> **Proposed recommendation 3.67**: *None at this stage, pending further consultation.*

---

[56] Consultation Paper No. 2, Section 5.4.1.4.

[57] Consultation Paper No. 2, Section 5.4.14.

5. GOVERNING LAW RULES

5.1 Section 6 – the gateway to the Act

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[58] and the NZ PPSA[59] 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, also, do not include an equivalent of s 6.

One submission pointed out a number of inconsistencies between the operation of s 6 and of Part 7.2. 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.[60] In my view it is worth considering whether s 6 is in fact even necessary, or whether the Act should simply rely on the rules in Part 7.2 to determine whether the Act applies. I would be interested to hear the views of others on this.

> **Proposed recommendation 3.68**: *None at this stage, pending further consideration.*

---

58 Eg Sask PPSA, ss 5 to 8.1.

59 NZ PPSA, ss 26 to 33.

60 See for example Duggan & Brown, para 14.6.

5.2 Terminology

5.2.1 Equivalent concepts in other jurisdictions

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 "perfection") rely on other definitions, concepts and processes (such as registration on the Register) that are not going to 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[61]. 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.[62] However, most of the Canadian PPSAs have also been amended to spell this out. For example, s 8(2) of the Sask PPSA provides that:

> (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.

I would be interested to hear whether it is thought that it would be helpful to include a corresponding provision in the Act, in relation to either or both of "attachment" and "perfection".

> **Proposed recommendation 3.69**: *None at this stage, pending further consideration.*

5.2.2 Consistency with other parts of the Act

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".

---

[61] Cuming Walsh & Wood, page 190.

[62] Cuming Walsh & Wood, page 192.

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, but this is not entirely clear.

A similar variability in terminology can be found in the Canadian PPSAs[63] and the NZ PPSA[64]. 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. I would be interested to hear whether it is thought desirable to align the language used in Part 7.2 (and ss 39 and 40) with the language used in the Act more generally.

> **Proposed recommendation 3.70**: *None at this stage, pending further consideration.*

5.2.3 Meaning of "effect of perfection or non-perfection" – priority rules

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 this language encompasses the effect of the priority and taking free rules, even though not all those rules are determined by whether or not a security interest is perfected. It may be that Australian courts are likely to take the same approach.[65] I would be interested to hear however whether it might be thought desirable to clarify this.

> **Proposed recommendation 3.71**: *None at this stage, pending further consideration.*

5.3 Rules for enforcing a security interest

The rules in Part 7.2 relate to the validity, perfection and effects 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. This Consultation Paper has already asked some questions about the appropriateness and scope of that section. The Act is otherwise silent on how to choose what law governs the enforcement of a security interest. This appears to mean that Chapter 4 will apply to an enforcement (subject to s 109(2)), if the Act is engaged pursuant to s 6.

The Canadian PPSAs do provide a rule for this. As an example, s 8(1) of the Sask PPSA provides as follows:

> 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

---

63 Eg Sask PPSA, ss 5 to 8.1.

64 NZ PPSA, ss 28 to 33.

65 See Duggan & Brown, para 14.12.

(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.[66]

I would be interested to hear whether it is thought desirable to provide a governing law rule in the Act for the enforcement of security interests and, if so, what that rule should be.

Proposed recommendation 3.72: *None at this stage, pending further consideration.*

5.4 Intermediated securities

One submission pointed out that Part 7.2 does not provide a rule to determine what laws should be applied to resolving issues relating to a security interest over intermediated securities. It was said that the decision was taken in the drafting of the Act to not deal with intermediated securities in Part 7.2, because Australia had not yet decided whether to accede to the Hague Securities Convention, and that it was thought to be premature to include choice of law rules for intermediated securities in the Act until that decision had been taken.

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 law of the location of the intermediary.[67]

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. I am inclined to support this proposal, but would be interested to hear the views of others on this.

Proposed recommendation 3.73: *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 of the intermediary, or of the jurisdiction in which the intermediary maintains the securities account.*

---

66 UNCITRAL Guide, Recommendation 218.

67 Eg Sask PPSA, s 7.1.

5.5 Section 235 – the meaning of "located"

5.5.1 Section 235(5) – individual grantors

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. This has the effect, if an individual grantor relocates from overseas to Australia after it has granted a security interest over collateral, that 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 steps to protect its security 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 subsequently does this without the secured party's knowledge.

The secured party's position may be improved somewhat if the recommendations I have proposed in relation to s 40 are adopted.[68] Apart from that, though, I suspect that this is a consequence of the operation of the Act that secured parties will need to be prepared for. I would however be interested to hear the views of others on this.

> **Proposed recommendation 3.74**: *None at this stage, pending further consideration.*

5.5.2 Sections 235(1) and (2)(a) – certificated investment instruments, chattel paper and negotiable instruments

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. 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. This would be inconsistent with the Corporations Act, which provides that a share is taken to be located in the place of the share register.[69] 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. I would however be interested to hear the views of others on this.

> **Proposed recommendation 3.75**: *None at this stage, pending further consideration.*

---

[68] See Consultation Paper No. 2, Section 4.4.2.

[69] Corporations Act, s 1070A(4).

5.6 Section 237 – express choice of Australian law

Section 237(1) provides the parties to a security agreement with an ability in some situations 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.[70] The Canadian PPSAs do not. The UNCITRAL Guide does not either – indeed, it suggests that such a provision is not appropriate:[71]

> … 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.

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.[72] 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".[73] This objective should extend beyond the immediate parties to the security agreement, to include other relevant stakeholders as well.[74] 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.

I would be interested to hear the views of others on this.

If it is thought desirable to retain s 237, it would be helpful to consider whether the exclusions in s 237(2) are appropriately framed, or whether (for example) they should exclude all non-tangible property from the section. Again, I would be interested to hear the views of others on this.

> **Proposed recommendation 3.76**: *None at this stage, pending further consideration.*

---

70 NZ PPSA, s 26(1)(c).

71 UNCITRAL Guide, Chapter X, para 13.

72 Duggan & Brown, para 14.14.

73 Replacement Explanatory Memorandum, para 7.1.

74 UNCITRAL Guide, Chapter X, para 6.

5.7 Section 238 – goods

5.7.1 Section 238(2) – goods intended for another jurisdiction

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.[75]

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 then located in that jurisdiction, then questions relating to validity and perfection are all to be determined by the laws of that other jurisdiction.

The purpose behind 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 however that the section is very open-ended, in that it does not require that the goods be shipped within any particular timeframe. 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.[76]

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 here, as an interim measure. I would however be interest to hear the views of others on this.

> **Proposed recommendation 3.77**: *None at this stage, pending further consideration.*

5.7.2 Section 238(2A)

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.

I would be interested to hear of explanations for s 238(2A). If it is not possible to explain its role, then my preference would be to delete it.

> **Proposed recommendation 3.78**: *That s 238(2A) be deleted.*

5.7.3 Section 238(3) – moveable goods

Section 238(3) provides another exception for goods, in this case goods that are "of a kind that is normally used in more than one jurisdiction", if the goods 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 the goods are governed by the law of the jurisdiction in which the grantor is located, if the grantor is located there when the security interest attaches.

---

[75] Sections 238(1) and (1A).

[76] Eg Sask PPSA, s 6(1).

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[77] and the NZ PPSA[78] as well.

One submission suggested that the reasons for including *renvoi* in s 238(3) are historical in nature, and no longer relevant.[79] 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.[80]

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. I would be interested to hear an explanation for this. If there is no good reason for the limitation, then I would suggest that the limitation be removed.

> **Proposed recommendation 3.79**: *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)", and that s 238(3)(c) be deleted.*

5.8 Section 239(5) – ADI accounts

The general choice of law rule for a security interest over an ADI account is that the security interest is governed[81] by the law that governs the ADI account. That rule is in s 239(4). However, s 239(5) provides 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. The submission suggested for this reason that s 239(5) be removed.

I am inclined to agree with this suggestion. I would be interested to hear the views of others on this.

> **Proposed recommendation 3.80**: *That s 239(5) be deleted.*

---

77 Eg Sask PPSA, s 7(2).

78 NZ PPSA, s 30.

79 For an explanation of the reasons, see Duggan & Brown, para 14.28.

80 UNICTRAL Guide, Recommendation 221.

81 See Section 5.2.2 regarding the use of the word "governed".

5.9 Section 240 – financial property

5.9.1 Section 240(2)

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) is as follows:

> (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.[82] It would simplify the Act if s 240(2) and accompanying references to it were removed.

Consultation Paper No. 2 has separately queried whether it is appropriate to define a letter of credit as being a type of negotiable instrument.[83] Even if the definition of negotiable instrument is amended so that it does not capture letters of credit, it may still be appropriate to delete s 240(2), particularly if s 240(3) is deleted (see the next Section 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.

> **Proposed recommendation 3.81**: *None at this stage, pending further consideration.*

5.9.2 Section 240(3)

Section 240(3) contains an exception to the rule in s 240(1). It provides that the validity of the 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.

One submission made a number of observations regarding s 240(3). 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.[84] It is worth asking what the purpose is behind s 240(3), and whether it is really needed. I would be interested to hear the views of others on this.

---

[82] Some provisions in the Act refer to a letter of credit for payment, while others refer to a letter of credit for payment or performance of an obligation. It is not clear that there is meant to be a difference.

[83] See Consultation Paper No. 2, Section 5.4.9.

[84] See also Duggan & Brown, para 14.43.

Proposed recommendation 3.82: *None at this stage, pending further consideration.*

5.9.3 Section 240(7)

Section 240(7) provides a special rule for a security interest in "a negotiable instrument that is not evidenced by a certificate". Consultation Paper No. 2[85] has queried whether that concept should be retained in the Act, as it does not reflect the understanding of the concept of a negotiable instrument under Australian law. The outcome of that consideration may be that s 240(7) can be deleted.

5.10 Section 241 – proceeds

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. 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. 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 however determined 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 third parties who take a competing interest in the proceeds confidence as to the rules that will determine the priority position of the interest that they take.

I would be interested to hear the views of others on the relative attractiveness of these options.

Proposed recommendation 3.83: *None at this stage, pending further consideration.*

5.11 Section 40(5)

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. I would be interested to hear of an explanation

---

[85] Consultation Paper No. 2, Section 4.3.6.

for this. If there is no compelling explanation for the exclusion, then my preference would be to keep the rules as consistent as possible, and delete s 40(5).

Proposed recommendation 3.84: *None at this stage, pending further consideration.*

6. OTHER PROVISIONS IN THE ACT

6.1 Section 339

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".[86] 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.[87] It is very difficult to understand, however, exactly what the section is trying to do, and why. A security 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 foreshadowed in Section 4.1.2 above. 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. Seen in this way, section 339 appears to have no meaningful role to play.

I would be interested to hear if others are able to provide an explanation of the role that s 339 plays in the Act. If it has no meaningful role, then it would simplify the Act, and remove a source of confusion and uncertainty, if it were deleted.

Proposed recommendation 3.85: *That s 339 be deleted.*

6.2 Letters of credit

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, however, and other policy objectives may make it necessary to include additional specific rules for particular types of collateral.

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 a category of "negotiable instrument" under the definition of that term in s 10. Sections 21(2) and 28 provide that a right evidenced by certain types of letter of credit is a category of collateral over which a secured party may perfect by control. And

---

86 See the *Personal Property Securities (Consequential Amendments) Act 2009*.

87 Section 318(b) of the Act.

ss 239(6) and 240 provide some particular choice of law rules in relation to a security interest over such a right.

Consultation Paper No. 2 discussed the extent to which it is appropriate to treat rights under a letter of credit as a species of negotiable instrument[88], and whether it is appropriate for a secured party to be able to perfect over such rights by control.[89] Section 5.5 below will consider the rules in ss 239(6) and 240.

The combined effect of the proposed 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 would like to ensure that the effectiveness of the Act is not inadvertently compromised by not according them any specific treatment.

I would be interested to hear if there are 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 collateral.

> **Proposed recommendation 3.86**: *None at this stage, pending further consideration.*

6.3 Intellectual property

6.3.1 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.

---

88 Consultation Paper No. 2, Section 5.4.9.

89 Consultation Paper No. 2, Section 4.3.7.

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 also, intellectual property is a type of collateral that may or must be described by its serial number in a registration.[90] This means that it is exposed to the "taking free" rule in s 44 of the Act.

A number of these provisions have been considered in other parts of the consultation papers. The following Sections identify some additional issues for consideration.

6.3.2 The meaning of "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. I would be interested to hear whether it is thought to be 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.

The definition also extends to "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 to me why the definition provides for this, and I would be interested to hear any explanations for why it is appropriate to extend the definition in this way.

> **Proposed recommendation 3.87**: *None at this stage, pending further consideration.*

6.3.3 Section 105 – intellectual property relating to goods

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:

---

[90] See item 2.2 of Schedule 2 to the Regulations.

(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 provides, 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 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 particularly 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.[91] 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.

I would be interested to receive suggestions of ways in which the section could be made more meaningful.

It should also be considered 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. I would be interested to hear the views of others on this as well.

Proposed recommendation 3.88: *None at this stage, pending further consideration*.

---

[91] Replacement Explanatory Memorandum para 3.30.

7. LAYOUT OF THE ACT, AND RELATED MATTERS

7.1 Location of mechanical and other supporting provisions

The point was made in many of the submissions 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 however much longer than any of the Canadian PPSAs and the NZ PPSA – the Sask PPSA, for example, runs to 92 pages, and the body of the NZ PPSA to 123 pages. The Act, in contrast, has 308 pages. Many of the proposed recommendations in this and the other consultation papers 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 are important 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 provisions are interspersed through the body of the Act.

One easy way to make the Act much less unwieldy and much more approachable would be to remove these background 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, would 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*. 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).

At a rough count, 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 the Act is at present, in a way that did not compromise the value of its content to businesses or consumers.

> **Proposed recommendation 3.89**: *That the constitutional, judicial and other supporting provisions in the Act be relocated into a separate piece of supporting legislation.*

7.2 Other changes relating to presentation

7.2.1 The use of the term "grantor"

One submission drew attention to the fact that the Act uses the term "grantor" to describe the person who gives a security interest. 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 the 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, but that is not necessarily the case, and the roles are conceptually quite distinct. There are a handful of places in the Act where the distinction has not quite been drawn correctly (they have been mentioned in other parts of the consultation papers), but the distinction is in my view a very helpful one, and one that reflects the way in which practitioners in Australia draw a distinction in their minds between the two roles.

I am in favour of 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 am not inclined to recommend that this be changed. I would however be interested to hear whether the proposal to do so has wider support.

7.2.2 The name of the Act

The Interim Report highlighted the fact that there is still only a low level of awareness of the Act in the small business community, and an even lower level of awareness 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. The submission argued that is because 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".[92]

I can see that the term "personal property securities" might leave a reader with the impression that the Act applies only 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

---

[92] See the *Secured Transactions Act 2008* (Solomon Islands).

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.

If we were starting afresh, I might be inclined to recommend that the Act be entitled "Secured Transactions Act" rather than "Personal Property Securities Act". As the Act has now been on the statute books for almost five years, however, my sense is that it would be counter-productive, and potentially the source of even more confusion, if we were to change its name at this stage. I would however be interested to hear whether others have a different view on this.

ANNEXURE A

GLOSSARY

Act	*Personal Property Securities Act 2009*
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)
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 *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 January 2014
National Credit Code	*National Consumer Credit Protection Act 2009*, Schedule 1
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)
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
Regulations	*Personal Property Regulations 2010*
Replacement Explanatory Memorandum	Replacement Explanatory Memorandum, *Personal Property Securities Bill 2009.*
Sask PPSA	*The Personal Property Security Act, 1993* (Saskatchewan)
Sask Law Reform Commission	Law Reform Commission of Saskatchewan, *Proposals for a Personal Property Security Act - Report to the Attorney General* (1977)
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*
Widdup	L Widdup, *Personal Property Securities Act: A Conceptual Approach* (3rd ed) (LexisNexis, 2013)

ANNEXURE B

PRINCIPLES TO GUIDE THE ASSESSMENT OF PROPOSED AMENDMENTS

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 referred to in Part 6 of this report.