

PPSA Review Secretariat
Commercial and Administrative Law Branch
Attorney-General's Department
3-5 National Circuit
BARTON ACT 2600

Email: ppsareview@ag.gov.au



Dear Sir or Madam,

Statutory Review of the *Personal Property Securities Act 2009 (Cth)*

1. Background to submission

- 1.1 This submission for the statutory review of the *Personal Property Securities Act 2009 (Cth)* ("**Act**") is made on behalf of Business Law Section of the Law Council of Australia ("**BLS**"). This submission is in addition to the earlier submission lodged by the BLS which focused on the impact of the Act on small business.
- 1.2 This submission has been assembled with the assistance of three of the specialist committees of the BLS - the Financial Services Committee, the Insolvency & Reconstruction Committee and the Small Business Committee. These committees are made up of senior legal practitioners working in their respective areas and also highly respected academics who have detailed and relevant experience in dealing with issues arising out of the Act across Australia and many of the practitioners in these committees deal with small businesses on a regular basis.
- 1.3 In these submissions, where a section is referred to this is a reference to a section in the Act, unless the contrary intention appears.

2. Acknowledgments

- 2.1 In compiling these further submissions in the time available, the BLS wishes to expressly acknowledge the following:
 - (a) The work carried out by Craig Wappett of Johnson Winter & Slattery who provided observations and submissions in respect of earlier submissions made by other parties as part of the statutory review of the Act – Mr Wappett is one of the aforementioned senior legal practitioners who has contributed to these submissions;
 - (b) The work of the learned authors, Professorial Fellow Anthony Duggan, and Associate Professor David Brown, of *Australian Personal Property Securities Law*¹, who identified in Chapter 17 of their book numerous sections of the Act that may warrant consideration as part of the statutory review – Associate Professor Brown is one of the aforementioned highly respected academics who has contributed to these submissions.

Response to earlier submissions

We set out in paragraphs 3 and 4 our observations and submissions in relation to the first round of submissions made by other parties as part of the review of the Act.

3. PPS Lease definition

- 3.1 The primary purpose of the PPS lease definition in s 13 is to provide a bright line test for lease transactions that are subject to the PPSA. Finance (or capital) leases will satisfy the 'in-substance' definition of a security interest in subsection 12(1) of the Act but it is not always easy to distinguish

¹ Duggan, A & Brown, D: *Australian Personal Property Securities Law*, (2012, Lexis Nexis)

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

BLS

between a finance lease and an operating lease. The concept of a 'lease for a term of more than one year' was introduced into the Canadian PPSA legislation for the purpose of providing a bright line test for determining when a lease would be subject to that Act. This followed a significant amount of litigation in Canada as to when a lease would be considered to secure payment or performance of an obligation.² New Zealand subsequently took the same approach. The PPS lease concept in Australia's PPSA is an adaptation of this approach.

- 3.2 As has been noted in a number of submissions to the review, there will always be a degree of arbitrariness about where the bright line for leases should be drawn.
- 3.3 With this in mind we suggest the following:
- (a) repeal the 90 day sub-rule for leases of serial numbered goods (we note that this is already under consideration);
 - (b) remove all references to 'bailment' from the definition of PPS lease (refer to our earlier submission in relation to this issue);
 - (c) give consideration to extending the bright line time period specified in the definition of PPS lease from one year to two years. It would be extremely rare for a finance lease to have a term of two years or less and extending the bright line from one year to two years would exclude many more simple hiring and rental arrangements for equipment used in mining services, construction and various other industry sectors from the application of the PPSA;
 - (d) expressly recognise that a lease with a maximum term of one year or two years (depending on whether the bright line is shifted from one to two years), but able to be terminated earlier by the parties, will not fall within the ambit of the Act.³ This would also assist short term rental and hiring businesses and their financiers;
 - (e) if the above changes are made, we suggest that the definition of 'PPS lease' be changed to 'lease for a term of more than [one/two] year[s]', as appropriate. This would help to make the concept easier to understand.
- 3.4 These changes would:
- (a) ensure that the Act continues to apply to leases that in substance secure payment or performance of an obligation and would deem leases for an indefinite term or for a term of more than one or two years (depending on where the bright line is drawn) to be subject to all of the provisions of the Act;
 - (b) preserve the application of the Act to secured financing transactions regardless of their legal form; and
 - (c) eliminate the application of the Act for shorter term rental and hiring arrangements, provided the appropriate term cap is included in the rental or hire conditions.
- 3.5 The removal of the references to 'bailment' from s 13 would also ensure that bailment arrangements that are not in the nature of lease or rental arrangements would also be outside the application of the Act unless, in substance, they secure payment or performance of an obligation (refer to our earlier submission on this point).
- 3.6 The suggestions in 3.3 would be preferable to either:
- (a) scrapping the bright line altogether – this would simply recreate the characterisation problem that existed in Canada before it adopted the bright line approach; or

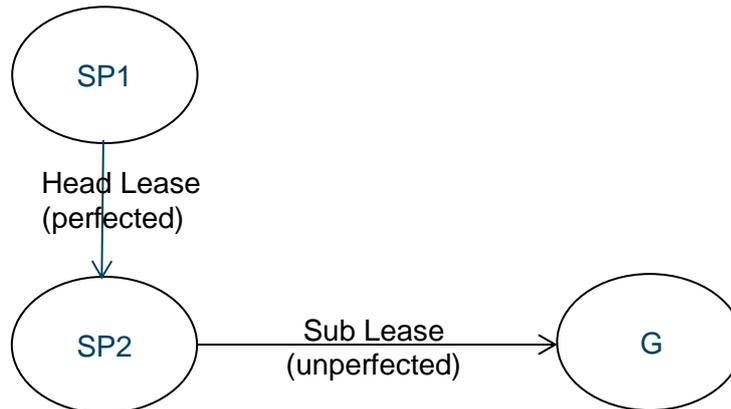
² The earliest versions of the PPSA legislation in Canada did not include the bright line test for leases. As a consequence it was necessary to apply the 'in substance' test in each case.

³ It is very likely that para 13(1)(b) already has this effect.

- (b) directly or indirectly excluding all leases from some or all of the provisions of the PPSA – this would treat one common form of security arrangement (ie the finance lease) differently from other forms of secured transaction (see further comments in 4 below).

4. Sub-leasing and other chains of security interests

- 4.1 There have been a number of submissions made to the review regarding the situation where there is a chain of lease transactions or other security interests. For example, where an owner of goods (SP1) leases the goods to a lessee (SP2) who in turn leases them to a sublessee (G) and the head lease and sublease are both PPS leases but the sublease is not perfected.⁴ This scenario is illustrated in the following diagram:



- 4.2 It has been submitted that “As a policy matter, it should be the case that if the head-lessor/owner [SP1] does everything necessary to protect its position, by perfection, a failure by the lessee [SP2] to protect its interests as a sub-lessor by perfection, should not prejudice the head-lessor’s/owner’s interest”.⁵ This proposition is linked to proposals that alter the application of the ‘taking free’ rules in respect of leases. In a similar vein the Australian Bankers Association has suggested “abolishing reliance on the vesting rules if any PPS registration (at the time of insolvency) is in place on serial numbered goods.”⁶ A similar submission has been made by the Australian Finance Conference and the Australian Equipment Lessors Association.⁷
- 4.3 These proposals are intended to ensure that a lessee does not obtain any greater interest in collateral the subject of a lease than the lessee has under the terms of the lease.

Intentionally blank

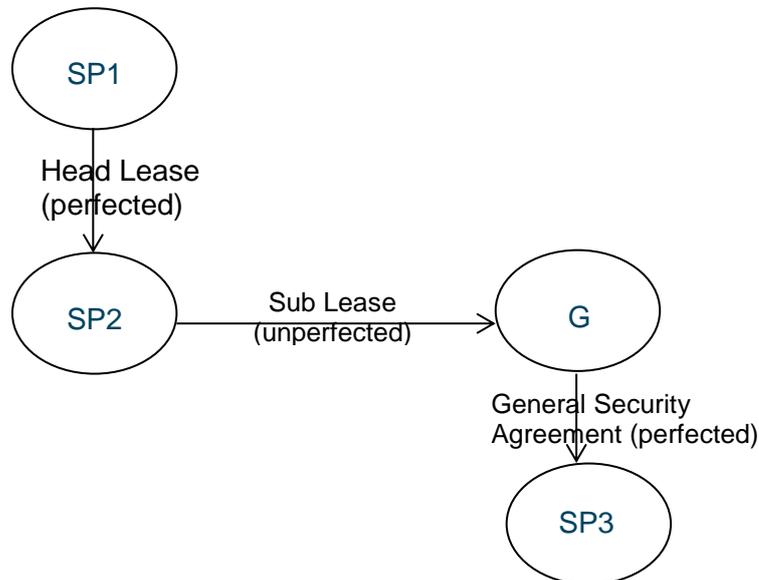
⁴ Presumably one or both leases may also satisfy the ‘in substance’ definition of a security interest in subs 12(1).

⁵ Allens, Ashurst, Herbert Smith Freehills, King & Wood Mallesons and Norton Rose Fulbright submission, at page 28.

⁶ Australian Bankers Association submission, at page 2.

⁷ AFC/AELA submission, at page 3.

- 4.4 The submissions supporting such changes to the treatment of leases that are security interests fail to fully explore the impact these changes would have on the operation of the taking free, priority and vesting rules as a whole.⁸ The proposed changes would create a separate regime for security interests that are leases by reinstating the *nemo dat* principle. Consider the following example:



- 4.5 As the Act currently stands, G would take free of SP1's interest for the duration of G's sub-lease (assuming s 46 applies) but SP1's security interest would remain attached to SP2's reversionary interest. However, because:

- (a) SP2's reversionary interest can be extinguished if G becomes insolvent (s 267);
- (b) SP3 will always defeat SP2 in a priority contest (subs 55(3)); and
- (c) SP1's security interest will not reattach in the leased asset itself unless SP2 is able to recover possession of the leased asset (s 37).

In short, SP1 will be in no better position than SP2 in relation to the leased asset unless the leased asset is recovered by SP2 prior to G's insolvency or enforcement by SP3. This is the case regardless of whether SP1's security interest is in the form of a lease or some other form.

- 4.6 If the proposed changes are adopted some of the consequences would be as follows:

- (a) if SP1 has title and has perfected against SP2 the proposed changes would mean that any vesting of SP2's interest in G, upon G's insolvency, will be subject to the interest of SP1 and, presumably, SP1 would always be in a position to defeat SP3 in a priority contest between SP1 and SP3;
- (b) if SP2 fails to perfect by registering against G, a person searching against G would have no knowledge of SP2's or SP1's security interest (unless SP1 has made a serial number registration and the person searching against G also conducts a serial number search);
- (c) the priority, extinguishment and taking free rules would apply differently depending on whether SP1's security interest takes the form of a lease or some other arrangement;

⁸We agree that the operation of these various rules should be clarified in the context of sub-leasing arrangements but not that their fundamental effect should be altered.

- (d) preserving SP1's interest in the leased property even though neither SP1 or SP2 has registered against G, would significantly reduce the utility of the register for someone dealing with G. Commercial transparency would be compromised;
 - (e) it would be possible for parties to easily circumvent the application of the PPSA by artificially creating upstream security interests in favour of parent or related companies so that they do not have to register downstream security interests. This would result in security interests that are not discoverable by search against the party actually in possession of an asset.
- 4.7 If these outcomes are intended they would involve substantial changes throughout the PPSA (much more substantial than those contemplated in the submissions proposing such changes) and, as noted above, create a sub-regime for security interests in the form of a lease. In our view this would be a most undesirable development and the proposed changes would create greater problems than those they purport to address.
- 4.8 There is no good reason why SP1's security interest should be treated differently because it is a lease. Introducing such a distinction cuts across key principles and concepts in the PPSA.
- 4.9 If the changes to the definition of PPS lease contemplated in 3 above are adopted, a large proportion of the practical problems that have arisen for leasing and hiring businesses would be addressed. In particular, leasing and hiring arrangements with a maximum term of one or two years (depending on where the bright line is drawn) would not be subject to the application of the Act and the *nemo dat* principle would continue to apply in relation to rights on insolvency and priority issues in these circumstances. This would in turn assist financiers and other suppliers to leasing and hiring businesses. However, where the PPSA does apply:
- (a) a lease should not be treated any differently to any other form of security interest; and
 - (b) the taking free, priority and extinguishment rules should apply equally to all security interests, regardless of their legal form.
- 4.10 It is submitted that it is not unduly burdensome for secured parties to take responsibility for the manner in which collateral will be dealt with by a grantor, including where the grantor itself leases collateral to a third party under a lease that is a security interest subject to the PPSA.

Exclusions from the Act

We set out in paragraphs 5 to 8 our observations and submissions in relation to certain exclusions from the Act.

5. *Exclusion: Annuity and insurance – s 8*

- 5.1 As PPSA does not apply to the transfer of an interest or claim in a contract of annuity or policy of insurance, except the transfer of a right to an insurance pay-out for loss of, or damage to, collateral or its proceeds, per para 8(1)(f)(v).
- 5.2 The explanation for the exclusion varies. In Ontario it was rationalised on the ground that the insurer (or other party) would hold all titles/policies making a separate register redundant. The drafters of Article 9 were of the view that the transactions do not fit easily under a general commercial statute and are adequately covered by existing law.
- 5.3 As a general policy, the more forms of personal property that are covered by the PPSA the better, as this increases collateral available for use in secured lending. Further, either of the explanations fail to address the exclusion for contracts of annuity at large.

6. *Exclusion: Pawnbroking – s 8*

Excluding pawnbrokers (subject to subs 8(6) of the PPSA) and leaving that to pawnbroker legislation entirely ignores the fact that there may be third party claims regarding a security interest. This should be compared to Canada where pawnbrokers are only exempt from enforcement procedures, as that's

left to specialised legislation, and in New Zealand where there is no exclusion at all. The PPSA overlooks the fact that third parties could have competing claims with property pawned to pawnbrokers. It is suggested that the review considers removing the pawnbrokers exemption.

7. Exclusion: Fixtures – s 10

- 7.1 In the Canadian PPSAs, 'goods' is defined to include fixtures and the legislation enacts special rules for disputes between a secured party with a security interest in a fixture and a third party with an interest in the land on which the fixture is located.
- 7.2 By not including fixtures Australia & New Zealand have missed an opportunity to clean up the law relating to competing fixtures claims. This is anomalous because in both countries the PPSAs do address the analogous cases of security interest in growing crops and security interests in accessions.
- 7.3 The main reasons why the Australian and New Zealand PPSAs did not apply to fixtures was due to fears that the application of PPSAs to fixtures could somehow interfere with land laws. These fears are not borne out by the Canadian experience and it is submitted that the review should consider extending the scope of the PPSA to fixtures.

8. Exclusion: Licences – s 10

- 8.1 The proprietary status of statutory licences at common is unsettled. At one level, the definition of 'licence' in Australian PPSA s 10, resolves the uncertainty as to whether a licence will be considered personal property. The definition makes it clear that a statutory licence is personal property for the purpose of the statute unless:
 - (a) The licence is non-transferable; or
 - (b) The licensing statute declares the licence not be personal property for the purposes of the PPSA.
- 8.2 There was a rush by Commonwealth and State governments to take advantage of the exclusions in the definition, which was apparently inspired by concerns that allowing security interest in a statutory licence might compromise the public policy underlying the licensing statute and, in particular, undermine the licensing authority's power to determine who may hold a licence. Where a government has excluded the operation of the PPSA to a particular licence, the implications appear to be as follows:
 - (a) The licence is not personal property for the purposes of the PPSA and so the PPSA does not apply to a security interest in the licence;
 - (b) The general law applies to determine whether the licence is personal property for other than PPSA purposes;
 - (c) If the licence is personal property at general law then, subject to any restrictions imposed by the licensing statute, the licence-holder may use the licence as collateral;
 - (d) Any such security interest would not be subject to the PPSA; and
- 8.3 Questions concerning the validity of the security interest, perfection, priorities and enforcement would be subject to any relevant provisions in the licensing statute and otherwise the general law.
- 8.4 On the other hand, if instead the licensing statute provides that the licence is non-transferable, the consequences seem to be as follows:
 - (a) The licence is not personal property for the purposes of the PPSA and so it cannot be used as collateral for a PPSA security interest;
 - (b) The common law applies to determine whether the licence is personal property for other than PPSA purposes; and

(c) Given that the licence is non-transferrable, a court is likely to conclude that it is not property at common law and therefore it cannot be used as collateral for a security interest outside the PPSA.

8.5 These different outcomes increases the complexity for secured lenders when determine what collateral could be used to secure payment or performance of an obligation. Subsection 112(3) of the PPSA provides that a secured party may only seize, purchase or dispose of a licence subject to the terms and conditions of the licence and any applicable laws. Given the limitations on the rights of a secured party to transfer a licence upon default, the reasons given for excluding licences from the scope of personal property for PPSA purposes falls away. If a transfer of a licence is subject to a Minister's consent, then the secured party will still not be entitled to sell that licence to a third party without the Minister's consent. It is suggested that the scope of licences that are covered by the PPSA be broadened to include more statutory licences and that the review should consider whether removing the possibility for State and Territory governments to opt out of the PPSA regime so far as it applies to security interests in licences granted by those governments.

8.6 Many businesses, such as fisheries and taxis, cannot operate without a licence. The exclusion of licences from the scope of the PPSA can have the effect of deterring lenders from lending to such businesses on secured terms, as the sale of these business as a going concern would be much more attractive prospect than selling off the businesses' individual assets which may carry little value when compared to the business as a whole. This can have the effect of increasing lending costs for small business which rely on statutory licences, as lenders will factor in this risk when providing the loan.

Definitions

We set out in paragraphs 9 and 10 our observations and submissions in relation to certain definitions contained in the Act.

9. Definition: Account – s 10

9.1 The definition of an account under para (b) of the definition in section 10 expressly includes 'credit card receivables'. It is not clear if a standard loan would fall within the definition of an account, as a loan probably does not qualify as the provision of a service. However, a loan could fall within the definition as the loan agreement vests in the recipient the right to receive financial accommodation, so this could fall within the part of the definition that applies to "granting a right".

9.2 This issue is relevant as transfer of an account gives rise to a security interest irrespective of whether it secures payment or performance of an obligation (subs 12(3)). If the loan is not an account, it still falls within the definition of "intangible" so the PPSA would apply to security interest granted in the loan obligation but would not apply to a mere transfer of the loan. We suggest that this issue should be clarified in the Act.

10. Definition: Future advance – s 10

10.1 The concept of a 'future advance' in the PPSA contains an element of circularity in the relevant provisions in the Act. Subsection 18(4) provides that a security agreement may provide for future advances. Section 10 defines a 'future advance' to mean an advance secured by a security interest (whether or not made pursuant to an obligation), if the advance is made after the security agreement was made. Subsection 18(4) depends on the s 10 definition which, in turn, presupposes the proposition in subs 18(4). This has an impact on the priority rules in section 58 and 68 of the PPSA.

10.2 It is suggested that to remove the circularity the definition of future advance be amended to:

"future advance means an advance, whether or not made pursuant to an obligation, if the advance is made after the security agreement was made."

PMSIs

We set out in paragraphs 11 to 13 our observations and submissions in relation to the treatment of PMSIs in the Act.

11. PMSI: Refinancing and priorities – subs 14(5)

- 11.1 Another complication arises in relation to refinancing of loans that gave rise to a PMSI. Subsection 14(5) of the PPSA provides that a PMSI does not lose its status as such only because the purchase money obligation is financed (whether or not by the same secured party). However, if a purchase money obligation is paid out by a third party on the condition that the third party obtains a PMSI in the goods, the third party is unlikely to register its PMSI within the timeframes required by section 62 of the PPSA. Section 62 of the PPSA requires a secured party to register a security interest within 15 business days of the date the grantor obtained possession of the goods (other than inventory). It is unclear whether the third party will maintain its PMSI status if it registers its PMSI within 15 business days from the date of the refinance, which is how some Canadian decisions have dealt with the issue.
- 11.2 It is suggested that this issue is clarified in the PPSA, otherwise the third party would have to obtain an assignment of the PMSI from the secured party to maintain its security position.

12. PMSI: Mixed PMSIs and non-PMSIs: allocation of payments – subs 14(6)

- 12.1 The drafting of subs 14(6) of the PPSA can give rise to difficulties for suppliers of goods on retention of title terms. For example, a secured party supplies the same goods on two separate occasions, with the security interest covering the purchase price of the goods and also all amounts due under any other contract with the secured party. If the goods are indistinguishable and the grantor defaults, the secured party may be unable to prove to which goods its PMSI interest relates as the secured party may fail to satisfy the burden of proof to demonstrate it has a PMSI in the relevant goods.
- 12.2 In the United States, Article 9 subs 9-103(b)(2) provides that a security interest is a PMSI “if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase money security interest” – This would give both contracts PMSI status thus making proof that items supplied under either first or second contract irrelevant. It is suggested that a similar provision to that contained in Article 9 is adopted in Australia.

13. PMSI: Super priority for accounts financier – s 64

- 13.1 Section 64 provides for a receivables financier who takes a security interest in a grantor’s accounts as original collateral to obtain a priority over an inventory financier who has a security interest in the accounts as proceeds of inventory that was supplied on a retention of title basis. There is no explanation in the Explanatory Memorandum for the approach adopted by the Australian PPSA in relation to such a dispute.
- 13.2 Further, the inventory financier can merely state in its security agreement that the security interest extends to the grantor’s present and after-acquired accounts and provided the inventory financier registers first in time, subs 55(4) applies to give the inventory financier priority over any subsequent accounts. It is submitted that the review should consider whether the further step of giving super-priority to the accounts financier is justifiable.

CHESSE

We set out in paragraphs 14 to 16 our observations and submissions in relation to the treatment of CHESSE securities in the Act.

14. CHESSE: Classification of intermediated securities – s 10

- 14.1 Intermediated securities are defined and regulated under an entirely different part to financial products and investment instruments, despite being a form of such investment. This could lead to confusion.

15. CHESSE securities treated as intermediated securities – s 15

15.1 As CHESSE securities are directly held, it may be better to group them with other directly held investments (under investment instrument heading) rather than under indirectly held investments (intermediate securities heading).

15.2 Because of its current location as indirectly held, s 26 applies to CHESSE securities rather than s 27 (which applies to directly held assets). This is relevant because CHESSE securities have an additional method of perfection by control that is not available to anything else. We query whether s 27 would be a more appropriate place for this provision.

16. CHESSE: Taking free application to CHESSE securities – s 51

16.1 Section 51 is written with indirect holding systems in mind. An investor in the indirect holding system does not actually buy the shares or other financial product, but rather purchases a portion in the broker's holding of the financial product and the broker credits the investor's payment to a securities account maintained by the broker in the investor's name. This explains the terminology in s 51, 'transferee' rather than 'purchaser', 'takes an interest in' rather than 'purchases' etc. The drafting of this section overlooks the point that 'intermediated security' includes not only the product of an investment instrument in the indirect holding system, but also a security traded on the CHESSE system. Securities on the CHESSE system are directly held securities and s 51, as drafted, makes no sense in its application to them.

16.2 Therefore the terminology makes little sense when the investment is indirectly held but is traded on the CHESSE system (which is directly held).

17. Requirements for attachment – s 19

17.1 Section 19 of the PPSA does not expressly provide that there needs to be a valid security agreement as a prerequisite to attachment. However, in our view this requirement is implicit because s 12 limits the application of the Act to consensual security interests and a consensual security interest depends on agreement between the parties. It is suggested that section 19 should contain another requirement for attachment, namely that there is a valid security agreement between the parties to remove any doubt on this matter.

18. Collateral description in security agreement – s 20

18.1 The extent to which a security agreement requires a description of the collateral in order to enforceable against third parties is unclear. Subsection 20(2) requires a description of the *particular* collateral. This wording suggests that a description by a class, for example motor vehicle may be insufficient for the purpose of subs 20(2) where the security interest attaches to a particular vehicle. However, the definition of 'description' in s 10 suggests that a description which identifies the class to which the item belongs is sufficient.

18.2 We note the regulations specify classes for the purposes of a collateral description in the *financing statement* and a description by reference to one of these classes may be sufficient for the purposes of subs 20(2). It is suggested that the description of collateral in a security agreement should be sufficient to identify the particular collateral to which the security interest attaches. This will increase the efficacy of the information requests pursuant to section 275, as the party obtaining the copy of the security agreement will be able to determine exactly which collateral a prior security interest has attached to.

18.3 Our recommendation is consistent with the New Zealand PPSA, which requires 'an adequate description of the collateral by item or kind that enables the collateral to be identified'.

19. Transferred collateral and enforceability against third parties – s 20

19.1 Where collateral is transferred, subs 32(1) provides for a perfected security interest in most circumstances to continue in the collateral in the hands of the transferee. However, a prerequisite to

perfection is that the collateral is enforceable against third parties pursuant to s 20. One of the most common ways of satisfying s 20 is by having a security agreement that is signed by the grantor per para 20(2)(a)(i). If the collateral has been transferred without the secured party's consent then it is unlikely that the transferee will have signed the security agreement, which when reading para 20(2)(a)(i) strictly could result in the security interest becoming unperfected.

- 19.2 It is suggested that the Act makes it clear that the security agreement only needs to be signed by the original grantor/transferor in order for the security interest to be enforceable against third parties pursuant to s 20.
- 19.3 This is hard to follow, ie to show what the problem is. The answer might be to point out that the definition of 'grantor' in s10 includes (see (e)) a transferee of the grantor's interest in the personal property.

Investment instruments

We set out in paragraphs 20 to 22 our observations and submissions in relation to the treatment of investment instruments in the Act.

20. Investment instruments: possession – s 24

- 20.1 Subsection 24(6) prescribes rules for perfection of certificated registered form investment instruments (not bearer form). It is unclear whether that section is intended to preclude perfection of bearer form instruments by possession. If so, this would contradict para 21(2)(b) which allows for perfection of security interests by possession.
- 20.2 A security interest in an investment instrument may also be perfected by registration or control, with the later giving the secured party a higher priority status than the other methods. It is suggested that a note should be inserted below subs 24(6) indicating that the methods for perfection by possession set out in the section are not intended to exclude perfection by possession by any other means in respect of an investment instrument that is not evidenced by certificate.

21. Investment instruments: control – subs 27(2)

- 21.1 The heading at subs 27(2) of the PPSA read "Control over any investment instrument" (our emphasis), meaning applicable for both certified and uncertified instruments. However, the method of control in subs 27(2) is only appropriate for instruments in a registered form.
- 21.2 It is suggested that this heading is amended to "Control over particular investment instruments", to reflect that the method of control is not appropriate for investment instruments that are not in registered form.

22. Investments instruments: control – subs 27(4)

- 22.1 Subsection 27(4) has seemingly permitted an approach of perfection by control that allows the grantor to issue a power of attorney to a secured party. This opens the door for the grantor to issue multiple powers of attorney without the subsequent secured parties ever being able to discover the other interests. This has the potential for multiple secured parties to have perfected their security interest by control over the same collateral.
- 22.2 It is suggested that the review consider whether a priority rule should be included in the Act for dealing with such a scenario.

Proceeds

We set out in paragraphs 23 and 24 our observations and submissions in relation to the treatment of proceeds in the Act.

23. Proceeds: limitation of value – subs 32(3)

- 23.1 Subsection 32(2) limits a secured party's recovery to the market value of the collateral at the time of an unauthorised transfer to a third party. This is to prevent a windfall gain to the secured party, where they could seize both the proceeds of sale and the original collateral. However, in a provision unique to Australia's PPSA, subs 32(3) states that subs 32(2) does not apply in circumstances where the transferee has actual/constructive knowledge of the security interest. Having regard to the policy underlying subs 32(2), this policy makes no sense.
- 23.2 The purpose of subs 32(2) is to avoid a windfall to the secured party to the detriment of other creditors and the transferee's state of knowledge has nothing to do with this concern.
- 23.3 It is suggested that subs 32(3) be repealed.

24. Proceeds: security interest continuing in collateral

- 24.1 If a grantor deals with collateral, then the security interest will continue in the collateral (subject to the taking free rules) if the dealing gives rise to proceeds, unless (subs 32(1)):
- (a) in the case of disposal, the secured party expressly or impliedly authorised the disposal; or
 - (b) the secured party expressly or impliedly agreed that the dealing would extinguish its security interest.
- 24.2 This section does not appear to allow for the possibility that a secured party might want to authorise a disposal on the basis that its security interest is to remain attached to the collateral in the hands of the transferee. In this situation, the secured party would need instead to take a fresh security interest over the collateral from the transferee. However, that security interest might have a lower priority position than the secured party would have enjoyed if its existing security interest had continued after the transfer.
- 24.3 Section 34 suggest that it might be possible for a security interest to continue in collateral after it has been disposed of with the secured party's consent . However, it difficult to see how s 34 can be relied upon to read down the otherwise clear language in para 32(1)(a)(i). This is particularly relevant for leasing transactions that would be considered 'in substance' security interests where a lease is assigned to a third party with the secured party's consent.
- 24.4 It is suggested that the Act be amended so it is clear that a secured party can consent to a disposal of collateral on the condition that its security interest continues in the collateral.

Taking free rules

We set out in paragraphs 25 to 30 our observations and submissions in relation to the 'taking free' rules in the Act.

25. Taking free: serial number – s 44

- 25.1 The taking free rule at subs 44(1) applies where the collateral is personal property which, according to the regulations 'may, or must, be described by serial number'. This wording suggests that the provision applies whether the collateral is commercial or consumer property. However, in cases of consumer property a misstated serial number will mean that the security interest is unperfected (as the grantor's details are not recorded for serial numbered goods where the collateral is consumer property). In this case the buyer can rely on s 43, removing the need for s44 in regards to consumer property.

25.2 It is suggested that the review considers amending the Act so that the taking free rule for serial numbered goods only applies where the collateral 'may be described by serial number'.

26. Taking free: low value transactions: policy – s 47

26.1 The taking free rule for personal, domestic or household goods in section 47 of the PPSA will not apply where the transferee knows that the market value of the property is more than \$5,000. These provisions were designed to cover situations where there is a large discrepancy in price and market value (e.g. valued at \$10 000, sold at \$2 000) so that it should put a purchaser on notice that there may be something wrong and make further enquiries. However, there is no explanation as to why it applies where there is only a minor discrepancy (for example goods valued at \$ 5.100 and sold at \$4.900) OR garage sales (where there is a big discount). The Explanatory Memorandum provides no clues to the thinking behind this aspect of the provision.

26.2 It is submitted that a higher threshold for the exclusion in para 47(2)(c) be adopted.

27. Taking free: low value transactions: drafting – s 47

27.1 Given the typical applications of subs 47(1), it is also suggested that the level of knowledge in para 47(2)(b) should be broadened to be "knowledge of the security interest" instead of "knowledge that purchase would constitute a breach of the security agreement". The discussion in the Explanatory Memorandum proceeds on the basis that this is what para 47(2)(b) means.

28. Taking free: currency – ss 48 and 69

28.1 Section 48 provides for a holder of currency to take the currency free of a security interest in the currency if the holder acquires the currency with no actual or constructive knowledge of the security interest. This should be compared to the level of knowledge that applies in s 69. Section 69 provides for creditors who receive payment of a debt by electronic funds transfer, debit or similar payment (for example, payment by credit card) or negotiable instrument (for example, a cheque) to take the payment free of any security interest unless the creditor had actual knowledge that the payment was made in breach of the security agreement that provides for the security interest.

28.2 It is hard to see the justification for discriminating between the different payment methods in the context of the Act and it is suggested that one knowledge limitation should be adopted for both s 48 and 69.

29. Taking free: application to secured parties – s 50

29.1 The definition of 'purchaser' in subs 50(1) applies in favour of not just buyers, but also a person who acquires a security interest. This impression is strengthened by para 42(b), which provides that *with the exception of ss 50 and 51*, the provisions of PPSA Part 2.5 do not apply to the acquisition of an interest in personal property if the interest taken is itself a security interest. The rule as stated in subs 50(1) itself, however, is expressed not to apply if the purchaser is a secured party. Furthermore, the section heading reads 'Taking investment instrument free of security interest' and this supports the conclusion that the rule is limited to SP-Transferee disputes and does not apply to SP-SP disputes.

29.2 Since subs 50(1) does not apply to SP-SP disputes, the priority rules in ss 55-57 should apply. This should be clarified in the statute.

30. Taking free: application to secured parties – s 51

30.1 It is unclear whether subs 51(1) applies in favour of a transferee who is a secured party. On the one hand, para 42(b) suggests that it does but s 51(1)(a) indicates otherwise ('the transferee gives value for the interest (*unless the interest acquired is itself a security interest*)') (emphasis added). It is true that the italicised words could be read as qualifying just the value requirement in para (a), as opposed to subs 51(1) in its entirety, and the layout of the provision supports this construction. But, as a policy matter, it makes no sense to exempt a secured party-transferee from the requirement to give value.

30.2 It is suggested that the statute should be amended to clarify the correct position.

31. Continuity of perfection – s 56

- 31.1 Section 56 which provides for when a security interest is continuously perfected is not entirely clear. The Saskatchewan PPSA s23(1) is much clearer and provides: '[i]f a security interest is originally perfected pursuant to this Act and is again perfect in some other way pursuant to this Act without an intermediate period when it is unperfected, the security interest is continuously perfected for the purposes of this Act'.
- 31.2 It is suggested that the review consider whether s 56 is amended for clarity.

32. Priority of security interests perfected by control – subs 57(2A)

- 32.1 Subs 57(2A) appears to contain a drafting error, that provides for a party with a security interest over proceeds of original collateral that was perfected by control to rank behind a secured party that has a security interest in proceeds of original collateral. This is contrary to the Explanatory Memorandum's account of how subs 57(2A) should operate.
- 32.2 It is suggested that the Act be amended to reflect the intention outlined in the Explanatory Memorandum.

33. Circular priorities – s 59

- 33.1 Section 59, which is aimed at resolving circular priority disputes has little relevance where the secured parties have entered into a subordination agreement.
- 33.2 It is suggested that the priority rule in s 59 be treated as a default priority rule, like all the other PPSA priority rules, leaving the parties free to contract around s 59 by indicating their preference for a different priority order.

34. Priority between security interests and declared security interests – s 73

- 34.1 Section 73 should address the priority of a trustee's lien as against a secured party with a perfected security interest in the trust assets. A secured party who has perfected against the trustee's ACN but not the trust ABN may seek to rely on the trustee's general law lien to defeat a secured party who has perfected against the trust ABN but not the trustee's ACN?
- 34.2 The trustee's lien should probably be subordinated to a security interest perfected against the trust ABN, otherwise registration against the trust ABN becomes meaningless.

Priority of security interests in returned goods

We set out in paragraphs 35 and 36 our observations and submissions in relation to priority disputes in returned goods.

35. Security interest held by account transferee – subs 76(2)

- 35.1 Paragraph 76(2)(b)(ii) applies only to repossessed goods and not goods that are returned following a rescission of a sale contract or upon expiry of a lease. It is hard to see the justification for treating the two cases differently, as it can produce inconsistent results for priority disputes based on the method of termination or repossession of a contract of sale or lease.
- 35.2 It is suggested that para 76(2)(b)(ii) should have a uniform application to determine priority interests in returned goods and not only apply where the goods are repossessed.

36. Security interest granted by buyer or lessee – subs 76(3)

- 36.1 Subsection 76(3) applies to resolve priority disputes between a security interest in goods that reattaches pursuant to section 37 or 38 and another security interest in goods that is granted by a buyer or lessee prior to a sale contract or lease being terminated.
- 36.2 In determining the priority position of the various secured parties, the buyer/lessee granted security interest can only take priority if the security interest attaches while the goods are in the possession of the buyer/lessee. This should be compared to the Saskatchewan PPSA s 29(7), which applies if the goods are in the possession of the buyer [or lessee] or the *debtor* [grantor]. If the Saskatchewan provisions were adopted it would be unnecessary to determine whether the buyer/lessee granted security interest attaches before or after the grantor delivers the car to the buyer/lessee.
- 36.3 Further, para 76(3)(b) implies that subs 76(3) will only apply where the goods are repossessed in accordance with paras 37(1)(d) or 38(1)(d). It is unclear why subs 76(3) should only apply where goods are repossessed and not where a contract of sale is rescinded.
- 36.4 It is suggested that para 76(3) should have a uniform application to determine priority interests in returned goods.

Accessions and commingled goods

We set out in paragraphs 37 and 38 our observations and submissions in relation to priority disputes in relation to accessions and comingled goods.

37. Secured party's right of removal for accessions – s 92

The PPSA does not expressly provide for a secured party who has an interest in an accession with the right to remove the accession. This should be expressly provided for in the PPSA.

38. Priority limited to value of goods that are processed or commingled goods – s 99

- 38.1 Section 99, which deals with security interests in processed or commingled goods, has a limitation placed on it by s 101 whereby a secured party's security interest that has continued in a product or mass is limited to the value of the secured party's collateral at the time it became inextricably mixed with the product or mass. However, the limitation in s 101 only applies to resolve a priority dispute between two secured parties and does not apply where there is only one secured party claiming an interest in goods, for example against a liquidator of the grantor. This could result in the secured party obtaining a windfall if the secured party was previously under collateralised. Similar windfalls can be achieved from the rules in ss 101 and 102(4).
- 38.2 It is suggested that the limitation on the secured party's rights should not apply in situations where there is not a priority conflict with another secured party.

Enforcement and Chapter 4

We set out in paragraphs 39 to 45 our observations and submissions in relation to priority disputes in relation to accessions and comingled goods.

39. Enforcement: non-application of Chapter 4 to goods located outside Australia – subs 109(2)

- 39.1 Subsection 109(2) of the PPSA provides that the enforcement provisions in the PPSA do not apply to a security interest in goods that are located outside Australia. Where a grantor and secured party are both Australian entities and a contract is governed by Australian law, subs 109(2) can give rise to difficulties when determine the proper law for the enforcement of a security interest in property of the grantor located outside Australia. Paragraph 6(1)(b) provides that the Australian PPSA applies to a security interest in goods if the grantor is an Australian entity, even if the goods are located outside Australia. Reading subss 6(1) and 109(2) together, the PPSA, with the exception of the enforcement provisions, applies to the secured party's security interest. The Explanatory Memorandum sheds no light on whether it is intended that the foreign law or general law principles will apply to the enforcement of the security interest.

39.2 The Saskatchewan PPSA at subs 8(1) provides for procedural issues involved in the enforcement of a security interest to be governed by the law of the jurisdiction in which the enforcement rights are exercised, while substantive issues are governed by the proper law of the contract between the secured party and the debtor. Although the Saskatchewan approach is not without its flaws (for example drawing a line between procedure and substantive issues), it is suggested that a similar approach to the Saskatchewan PPSA be adopted in the Australian PPSA.

40. Enforcement: chapter 4 inapplicable to receivers – s 177

40.1 Section 116 provides that Chapter 4 does not apply if there is a receiver or receiver and manager in control of the collateral except if the grantor is an individual. Exempting receivers from Chapter 4 of the PPSA in cases of corporations makes enforcement of PPSA subject to arbitrary variables, namely whether it is an individual/corporate receivership.

40.2 It is submitted that the distinction between individuals and companies where receivers are appointed should be removed.

41. Enforcement: security interests in liquid assets – s 120

41.1 Subsection 120(4), which is one of the provisions that applies to enforcement of security interests in liquid assets, provides that the secured party must apply any amount received under s 120 towards the secured obligation, while subs 120(5) provides that if any amount received is in the form of currency, it must be distributed in accordance with s 140. In our view it makes no sense for s 140 to apply if the obligor pays in cash but not if, for example, she pays by cheque. Besides, subs 120(4) and (5) appear to contradict subs 140(1), which clearly states that s 140 applies in any case where the secured party receives an amount under s 120.

41.2 It is suggested that s 140 applies to all amounts received pursuant to s 120.

42. Enforcement: notice of disposal of collateral – s 130

42.1 The s 130 notice requirement serves several purposes, including providing notice to the grantor to allow them the right to redeem the collateral or reinstate the security agreement, giving other secured parties notice in relation to the disposal of collateral and enabling the recipient to monitor the sale to ensure it is being conducted in a commercially reasonable manner.

42.2 In cases where the security interest is provided by a third party, the grantor has an interest in learning about the sale because the grantor may want to redeem the collateral. The debtor also has an interest because the conduct of the sale may affect the size of the deficiency for which the debtor is personally liable. However, the secured party is required to serve a s 130 notice on the grantor, but not the debtor.

42.3 It is suggested that the statute require service of the s 130 notice on the debtor as well as the grantor.

43. Enforcement: objections to purchase or retention and no provision for challenges – s 137

43.1 Sections 137 and 138 deal with the s 135 notice recipient's right of objection. Section 137 provides that if the secured party receives a notice of objection, it may not proceed with the proposed foreclosure but must revert to its Division 3 power of sale. Section 138 provides that if the objector is not the grantor, the enforcing secured party may require proof of its interest and that the objector must comply within 10 business days. Section 137 does not say that the notice must set out the grounds of objection and there is no provision for the secured party to challenge an objection, for example on the grounds that it is frivolous or vexatious.

43.2 The Australian approach should be contrasted with, for example, the Saskatchewan PPSA subs 61(2), which limits objections to persons 'whose interest in the collateral would be adversely affected by the secured party's proposal and subs 61(2) which provides that the secured party may apply to the court for an order that the objection is ineffective.

43.3 It is suggested that the Australian PPSA adopts similar provisions to the Saskatchewan PPSA in this regard.

44. Enforcement: distribution of proceeds and higher ranking secured parties – s 140

44.1 Section 133 provides that, on sale of repossessed collateral, the buyer takes the property free of various interests, but not a higher-ranking security interest. This makes it advantageous for the highest-ranking secured party to sell collateral, as the buyer would then obtain clear title to the collateral. However, s 140 muddies the waters by providing that a higher-ranking secured party is entitled to be paid out of the collateral sale proceeds ahead of the enforcing secured party. If a party buys the goods subject to a higher-ranking security interest then it is unclear as to why an enforcing secured party (whose security interest has been extinguished) would be obliged to pay over any proceeds received to the higher-ranking secured party. This creates indifference as to who enforces and may even result in lower enforcement parties being unwilling to spend money enforcing their security interests in collateral. The Canadian PPSAs do not provide for payment to a higher-ranking secured party.

44.2 Subsection 140(4) makes it clear that s 133 does not affect the rights of the parties under subs 140(4) (which deals with priority of payments on enforcement of a security interest). Subsection 140(5) provides that a payment to a secured party under subs 140(2) discharges the security interest to the extent of the amount paid. Subsection 140(5) effectively means that, contrary to what s 133 says, the purchase takes the collateral free of the higher-ranking security interest.

44.3 We query whether s 133 needs to specify that the transferee obtains the collateral subject to a higher-ranking security interest, when it is likely to be discharged out of the proceeds of sale. The only circumstance where this will not occur is where the sale proceeds may be insufficient to satisfy the higher-ranking secured party's claim in full, in which case the lower-ranking secured party is unlikely to take the enforcement proceedings in the first place.

45. Enforcement: distribution of proceeds with no provision for deficiency – s 140

45.1 Section 140 provides that any surplus remaining at the end of the distribution process is payable to the grantor. In contrast to the Canadian PPSAs, s 140 does not address the reverse case where, following the distribution, there is a shortfall between the amount paid to the enforcing secured party and the amount of the secured obligation. Although this is addressed in the Explanatory Memorandum, which provides for the deficiency action, there is no basis for this in the statute itself and so the secured party's entitlement must depend on the terms of the security agreement.

45.2 It is suggested that the PPSA should expressly provide for deficiency actions against the debtor, as the courts may be reluctant to imply such a term into the contract in the case of conditional sale agreements.

PPS Register

We set out in paragraphs 46 to 53 our observations and submissions in relation to the accessibility, functionality and operation of the PPS Register, as well as the process for registering security interests generally..

46. PPS Register: belief about security interest – s 151

The restrictions imposed by s 151 diminishes the attractiveness of advanced registration. It is suggested that the review consider whether the removal of section 151 is warranted.

47. PPS Register: individual grantor's name and appropriateness of AML-CTF Act rule – s 153

47.1 Now that the transitional period is over, the AML-CTF Act customer identification procedures will become the first point of reference for determining the grantor's details for the purposes of registering security interest on the PPS Register.

47.2 The problem with the rule is that the information is not equally available to registrants and parties conducting searches. Also, different institutions may use different identifying documents (birth

certificate vs drivers licence) and this can result in the grantor's name for the purposes of the AML-CTF Act being different to that contained on the grantor's driver's licence.

47.3 It is suggested that the grantor's details are contained on their driver's licence be the primary source of information for the PPS Register.

48. PPS Register: corporate grantor's details (trading trusts) – s 153

48.1 The number system search is better than a name based search mechanism but a problem arises in the case of trustee companies whereby a search would need to be done by an ABN not an ACN. This makes inquiries before searching important. Also, when registering a security interest over a trustee company, the secured party must expressly state that the organisation does not have an ACN, which is counterintuitive.

48.2 The registration process should be changed so that a registration against a trustee company should not require the user to state that the grantor does not have an ACN.

49. PPS Register: separate registration for each collateral class – s 153

49.1 The registration process is made more complex due to not being able to register against multiple collateral classes in the same financing statement.

49.2 We adopt our earlier submission that the registration process should permit registration against multiple collateral classes.

50. PPS Register: change in use of collateral – s 153

50.1 Some household objects (e.g. cars and computers) may be used for consumer or commercial purposes and this can change over time. This requires initial and continuing monitoring of the usage in order to keep the Financing statement accurate.

50.2 We recommend that the review consider whether the purpose of the collateral at the time the security interest attaches to it should be used to determine the validity of a security interest in the collateral. Alternatively, s 166 of the PPSA may apply to cure any defect temporarily.

51. PPS Register: defects in registration – ss 164 and 165

51.1 Paragraphs 164(1)(a) and (b) overlap in their application to serial number errors and errors in the grantor's details. The reason is that, in the PPSA context, the main test of whether a financing statement error or omission constitutes a seriously misleading one is whether it makes the registration potentially unsearchable. It follows that a serial number error to which paras 164(1)(b) and 165(a) apply, or an error in the grantor's details to which paras 164(1)(b) and 165(b) apply, is necessarily also an error that is seriously misleading.

51.2 It is suggested that subs 164(1) be amended so that it is clear that either paras 164(1)(a) or (b) could apply to the one scenario.

52. PPS Register: amendment of collateral description – s 178

52.1 Section 178 provides that the grantor or another interested party may serve an amendment demand requiring the secured party to narrow an overly broad collateral description. According to s 178, the secured party may amend the collateral description by registering a financing change statement. But this overlooks the requirement in subs 153(1) that the collateral described in a financing statement must belong to a single class. So, for example, if the collateral description is 'all present and after-acquired personal property' and the secured party wants to substitute 'commercial property; intangible property' and 'commercial property; other goods' to reflect the fact that its security interest is in a grantor's inventory and accounts, the logic of the system demands that the secured party register a new financing statement. Further, the limitation on a financing statement to specify various classes of collateral does not appear to be taken into account when considering the Registrar's powers under s

180, which does not entitle the Registrar to register subsequent financing statements to cover the various classes of collateral.

52.2 As noted in our earlier submission, it is suggested that one financing statement can cover multiple collateral classes.

53. PPS Register: registration and amendment demands

53.1 The utility of the PPS Register will be undermined by secured parties who make overreaching registrations if there is no practical mechanism for grantors to require the amendment of such registrations.

53.2 This is a critical issue for small businesses that have limited negotiating power when dealing with large companies, including financial institutions.

53.3 Our earlier submission suggested that one registration should be able to cover multiple specific collateral classes. Furthermore, one free text description should be capable of being used in a registration covering multiple specific collateral classes. We also submitted that:

(a) it should be mandatory for a free text description to be used with registrations other than those related to 'all present and after acquired property – no exceptions' and serial number registrations; and

(b) a new collateral class being 'all present and after acquired property related to' should be introduced into the PPS Register.

53.4 These suggestions are intended to give secured parties greater flexibility when registering and minimise the inconvenience of overreaching registrations for grantors. We also support most of the submissions that have been made regarding removal of various unnecessary fields that currently form part of the PPS Register registration process.

53.5 We have a particular concern that a number of submissions continue to promote the inappropriate use of the 'all present and after acquired property - with exceptions' collateral class. All too often the exceptions are described as "any property that is not the subject of a security agreement between the grantor and the secured party from time to time," or words to that effect. From the perspective of persons searching the PPS Register the effect of such a registration is the same as a registration over 'all present and after acquired property - no exceptions.'

53.6 It has been argued that the 'all present and after acquired property - with exceptions' collateral class should be used by secured parties:

(a) to avoid uncertainty as to which specific collateral classes might be covered by a security agreement – While this is a legitimate issue in some circumstances it has been wildly overstated and, as a consequence, this collateral class has been overused. In the vast majority of cases it is relatively easy to determine the correct collateral class or classes to register against;

(b) to address the release of property from a security interest from time to time – We submit that this is also overstated. If property is released from a security interest because that property is being sold by the grantor then it should not be necessary to change a registration related to that property as the property will no longer be property of the grantor. If no other property continues to be subject to the security interest or a registration specifically identifies the released property then of course the registration could be removed from the register. More commonly, particularly in the context of all assets security, when property is sold other property will continue to be subject to the security interest and no change to the registration will be necessary. If property is being released from the security interest in circumstances where it is not being sold by the grantor it may be legitimate to argue that this release should be reflected in the relevant PPS Register registration. In our experience, this is a rare occurrence. It is not usual for property to be released after an all assets security interest is taken in circumstances where the property is not being

disposed of by the grantor.⁹ If another party is seeking to take security over particular property and have priority in respect of that property, it would be more usual for the parties to agree a priority arrangement in relation to the particular collateral rather than releasing it from a prior security altogether.¹⁰ In the event it is necessary to reflect the release of property on a PPS Register registration, it should be possible to amend the collateral description in an existing registration (with the amendment not having any retrospective effect) and/or link a new registration to a prior registration which could then be released (refer to our earlier submission); and

- (c) because there are often assets of the grantor which cannot be subject to a security interest, including where a consent requirement has not been satisfied – In this situation the exceptions can either be specifically identified (i.e. the purpose for which the ‘all present and after acquired property - with exceptions’ collateral class was intended) or the secured party could simply use the ‘all present and after acquired property - no exceptions’ collateral class if the relevant security is intended to cover all assets once the appropriate consents have been obtained (this reflects the way in which security agreements are usually drafted, i.e. they cover all assets but, to the extent applicable, only take effect once relevant consents have been obtained). Secured parties should not lose sight of the fact the PPS Register is a notice register, not a document register. Irrespective of what the financing statement says, a party will only have the security coverage provided for in its security agreements. If a security agreement only takes effect once relevant consents are in place then that is what will happen. Registering an ALLPAP does not alter this and nor does it contravene the PPSA.

53.7 Unfortunately, the ‘all present and after acquired property - with exceptions’ collateral class is frequently used because of the actual or perceived inflexibility of the PPS Register’s current functionality. Being able to register against multiple specific collateral classes in the one registration and amend collateral descriptions (using one or both of the mechanisms mentioned above) would go a considerable way to addressing the inappropriate and counterproductive overuse of this collateral class.

53.8 In addition to providing greater flexibility for the way in which parties can register on the PPS Register, we feel it is essential to preserve and strengthen, rather than weaken, a grantor’s ability to make requests for amendment demands pursuant to s 178 of the Act. Grantors, particularly small business grantors with limited negotiating power, are often in a position where an overreaching registration is made against them and they are contractually required to waive their rights to issue an amendment demand under s 178. The circumstances in which an amendment demand can be made under s 178 need to be preserved and we submit there should be a prohibition on the parties contracting out of their rights to request an amendment demand pursuant to s 178 of the Act. Furthermore, some practitioners have stated that the Registrar has been reluctant to take steps under the Act to remove a registration even where a secured party has not been able to point to evidence of a security interest, and that in any event, the process is insufficiently expeditious in practice. In relation to the latter, we note that in the recent case of *Sandhurst Golf Estates Pty Ltd v Coppersmith Pty Ltd*. [2014] VSC 217 (1 July 2014), the Court relied also on its power to make injunctions to restrain a party that was seeking to register a further financing statement where there was found to be no security interest under the PPSA, the Court noting (at para 118) that ‘the process of removing a financing statement is time consuming and costly. In my opinion the Court should exercise its jurisdiction to protect the plaintiffs from this unnecessary and unwarranted trouble and expense’. The Court found it was unnecessary in those circumstances to rely on its powers under s182 PPSA.

54. Vesting of security interests – subs 267(2)

54.1 Subsection 267(2) deals with the rights of secured parties who have not perfected their security interests when a grantor is declared bankrupt or wound up. The language used in the section is that the unperfected security interest ‘vests’ in the grantor immediately before insolvency event.

⁹ If particular property is intended to be excluded from what is otherwise an all assets security when the security is taken then it is appropriate to register against ‘all present and after acquired property – with exceptions’ and clearly identify those exceptions.

¹⁰ Among other reasons, secured parties face an administration moratorium risk if they do not have security over all or substantially all of the grantor’s assets.

54.2 It is suggested that the wording in the section be amended so that the security interest is 'ineffective' or 'void' against the trustee in bankruptcy or liquidator.

55. Information requests – s 275

55.1 The list of interested persons who are entitled to make enquiries pursuant to s 275 does not cater for all categories of parties who may have a legitimate interest in the information that can be requested pursuant to s 275. The list excludes a person with an existing interest in the collateral other than a competing secured party or an execution creditor (for example, a transferee for value). A prospective execution creditor, in other words, a judgment creditor who is contemplating judgment enforcement proceedings is in the same position. Another class of searcher who may want to make follow-up inquiries is the grantor's liquidator, administrator or trustee in bankruptcy – but these parties presumably qualify as an authorised representative of the grantor.

55.2 It is suggested that the categories of persons entitled to make a request pursuant to s 275 be expanded.

Conflict of law issues

We set out in paragraphs 56 to 64 our observations and submissions in relation to priority conflict of law issues and the application of the Act where the grantor conducts business in multiple jurisdictions.

56. Conflict of law: business in multiple jurisdictions - s 6

56.1 Section 6 of the PPSA sets out the circumstances in which the Act will apply. Part 7.2 of the PPSA sets out the conflict of law provisions. In some circumstances section 6 of the PPSA and Part 7.2 of the PPSA will produce inconsistent results where the grantor conducts business in multiple jurisdictions.

56.2 For example, a grantor that is an Australian entity enters into a security agreement with a secured party in Australia over goods located in New Zealand and the grantor subsequently transfers the goods to a third party in New Zealand in breach of the security agreement. Because the grantor is an Australian entity para 6(1)(b) of the PPSA indicates that the PPSA applies. However, the New Zealand PPSA s 26 suggests that the New Zealand PPSA applies on the basis that the collateral is located in New Zealand. Assuming the case is litigated in Australia, the Australian court must give effect to PPSA para 6(1)(b) and the result is that the Australian PPSA applies. However, Part 7.2 of the PPSA and s 238 indicates that the New Zealand PPSA applies.

56.3 We note there is no corresponding provision in the New Zealand or the Saskatchewan PPSAs to section 6 of the Australian PPSA.

56.4 Section 6 (PPSA applies where grantor is an Australia entity) has the potential to conflict with:

(a) S238: If goods: law of the jurisdiction the goods reside is applicable

(b) S239: If intangible: applicable law is where grantor is located

(c) S240: if financial property: applicable law is where grantor located

57. Conflict of law: where grantor is foreign entity – s 6

57.1 Another example would be where a grantor being a company incorporated in New Zealand, carries on business in both jurisdictions, gives a security interest in its Australian accounts and subsequently transfer the accounts without the secured party's consent. In such an example the Australian PPSA does not apply as the grantor is not an Australian entity. Because the Australian PPSA does not apply, s 239 (which indicates that the New Zealand PPSA applies) cannot then be relied upon to resolve any dispute as the Australian PPSA does not apply (s 6 of the Act). So the situation regarding the Australia

collateral falls between two stools and the courts will be forced back to the common law choice of law rules which would favour the application of the New Zealand PPSA.

58. Conflict of law: intermediaries – subs 6(1A)

58.1 Another concern is the possible application of multiple pieces of legislation in diversified intermediary portfolios, due to the interaction between subs 6(1A) and Part 7.2.

58.2 The Australian PPSA applies to Intermediaries where the intermediary is located in Australia or the grantor is in Australia. This should be contrasted with the Saskatchewan PPSA where applicable law is the legislation of the intermediary's jurisdiction and does not depend on whether the grantor is a Canadian entity. In the Saskatchewan PPSA only the law of intermediary's location applies, whereas in Australia multiple jurisdictions could potentially apply.

58.3 It is suggested that the review should consider whether the Act should be amended to clarify which law will apply in the circumstances referred to above.

59. Conflict of law: destination of goods rule – subs 238(2)

59.1 The 'destination of goods rule' in subs 238(2) provides, in effect, that if at the time a secured party's security interest attaches to goods, it was reasonable to believe that the goods would be moved to a foreign jurisdiction, then the foreign law applies from the outset in respect of priority and perfection issues. The purpose is to avoid the need for a secured party to register its financing statement in Australia and in the foreign jurisdiction where it was intended that the goods would be shipped to the foreign jurisdiction.

59.2 However, complications can arise where the grantor does not ship the goods for some time, a third party registers a security interest over the goods in Australia prior to shipment and a dispute arises. In such an example, if the goods are still located in Australia, then subs 238(2) does not apply (due to para 238(2)(b)) and the priority dispute will be determined in accordance with Australian law and the secured party who registered on the foreign register only will lose out.

59.3 It is suggested that the approach taken by the Saskatchewan PPSA, which provides for the 'destination of goods rule' to still apply if the goods are removed from the destination no later than 30 days from attachment, be adopted in Australia.

60. Conflict of law: mobile goods rule– subs 238(3)

60.1 In contrast to the other provisions in Part 7.2 which expressly exclude the doctrine of *renvoi*, subs 238(3) expressly includes it (as does the New Zealand and Saskatchewan PPSAs). It is understood that this was adopted due to the PPSAs debtor location rule for mobile goods being somewhat novel. However, the grantor's location rule for mobile goods now has UNCITRAL's endorsement and it is open to question whether defence to other jurisdictions on this score is still warranted.

60.2 It is suggested that the review consider whether to exclude the doctrine of *renvoi* so far as the Act otherwise adequately addresses conflict of law issues in respect of mobile goods.

61. Conflict of law: ADI accounts – subs 239(5)

61.1 Subsection 239(5) allows for opting out of subs 239(4) rule in favour of the grantor's location, subject to obtaining the ADI's consent. Subsection 239(5) compromises the PPSA's publication objective, because it means that a third party checking for security interests in the ADI account will not necessarily know where to search.

61.2 It is suggested that subs 239(5) be removed from the Act.

62. Conflict of law: financial property – s 240

62.1 Subsection 240(3) creates an exception to the validity rules for security interests in financial property. It provides that Australian law applies if:

- (a) the security interest has attached 'under the law of a place in Australia'; and
- (b) at the time of attachment, the collateral is located in Australia and the secured party has possession or control of the collateral.

62.2 It is difficult to understand the application of subs 240(3) as drafted. If Australian law applies, attachment of a security interest is governed by the Act, not state and territory laws, and so the reference to attachment 'under the law of a place in Australia' is misconceived. Further, attachment is a matter going to the validity of a security interest. Subsection 240(3) provides, in effect, that Australian law governs the validity of a security interest if the security interest has attached under Australian law, but to conclude that the security interest has attached under Australia law, the court must already have decided that Australian law applies. In determining whether Australian law governs the attachment of a security interest, the court must have regard to subs 240(1), which refers to the law of the grantor's location at the relevant time. If the grantor is located in Australia, Australian law applies by force of subs 240(1) and the court can disregard subs 240(3). On the other hand, if the grantor is not located in Australia, subs 240(1) indicates that Australian law does not apply and subs 240(3) cannot affect this outcome because it is predicated on the assumption that Australian law applies.

63. Conflict of law: proceeds – s 241

63.1 Subsection 241(1) provides that the validity of a security interest in proceeds is governed by the law of the jurisdiction (other than the law relating to conflict of laws) that governed the validity of the security interest in the collateral that gave rise to the proceeds. Subsection 241(1) and 239(1) creates different outcomes depending on if the collateral is original collateral or proceeds. Canadian law has the same outcome for both. This is the same issue when it comes for perfection of collateral under s 241(2) and 239(2).

63.2 It is suggested that the review consider whether the Canadian approach should be adopted in Australia.

64. Conflict of law: exclusion of vesting rule – subs 268(1)

64.1 Paragraph 268(1)(aa) provides that subs 267(1) and s 267A do not apply to a security interest for which perfection, and the effect of perfection or non-perfection, is governed by the law of a foreign jurisdiction. It is hard to see the point of this provision because if the law of a foreign jurisdiction applies, PPSA subs 267(1) and s 267A will be inapplicable in any event.

65. Further discussion

65.1 The BLS would be pleased to discuss any aspect of this submission.

65.2 Please contact Greg Rodgers of the Insolvency & Reconstruction Committee (who is the Law Council's representative on the PPSA Stakeholder Forum) on 07 3009 9303 if you would like to do so.

Yours faithfully,



John Keeves
Chairman, Business Law Section

28 July 2014