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24 December 2008

By Email - legcon.sen@aph.gov.au

Mr Peter Hallahan
Committee Secretary
Senate Legal and Constitutional Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

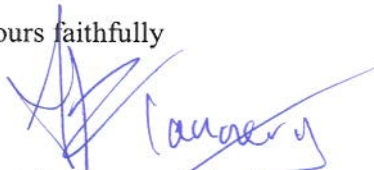
Our reference: 665

Dear Mr Hallahan

We enclose our confidential submission on the proposed personal property securities reform set out in the Personal Property Securities Bill 2008: Exposure Draft issued by the Attorney-General's Department.

If you have any questions about this submission, please contact Angela Flannery on 9353 4665 or Karen Lee on 9353 4696.

Yours faithfully



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CLAYTON UTZ

CONFIDENTIAL

Submission on Personal Property Securities Bill 2008: Exposure Draft

24 December 2008

If you have any questions about the details of this Submission

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Introduction

Clayton Utz is pleased to have the opportunity to make a submission to the Senate Standing Committee for Legal and Constitutional Affairs (**Committee**) on the proposed personal property securities reform set out in the Personal Property Securities Bill 2008: Exposure Draft (**Exposure Draft**).

In recent months, we have met with representatives of the Australian Attorney-General's Department (**AGD**) to discuss our concerns regarding particular aspects of the proposed legislation. While the Exposure Draft has taken into account many stakeholder comments, including certain issues that we have raised, there is scope for further amendments to be made to ensure that the aims of the legislative reform process are achieved. We have raised a number of key issues in this submission.

The views set out in this submission are the views of Clayton Utz and are not the views of any client of Clayton Utz.

If you have any questions about this submission, please contact Angela Flannery on 02 9353 4665 or Karen Lee on 02 9353 4696.

4 Key Issues

In this submission we have focused on 4 issues which we consider are likely to cause significant problems with the implementation and ongoing operation of the legislation.

The 4 key issues dealt with in this submission are:

1. **Accounts and assignments of accounts**

   The definition of account needs further consideration as it is simply too broad.

   We have suggested in this submission an alternative definition of "account" which is more appropriate.

   The manner in which the priority arrangements for assignments of accounts (excluding ADI accounts) are dealt with is inappropriate. If an assignment of such an account occurs in a manner that would, under the current law, transfer legal title to the account, this should be sufficient for perfection under the new legislation. In other words, we suggest that where legal title to such an account is transferred, the secured party is deemed to have perfected its security interest by control.

2. **Section 235(1)(b) and the obligation to exercise rights in a "commercially reasonable manner"**

   There are no compelling policy reasons for Australia to adopt a statutory standard of "acting in a commercially reasonable manner". Also, the inclusion of such a test

does not promote commercial certainty. Therefore section 235(1)(b) of the Exposure Draft should be deleted.

3. **The regime for providing that certain unperfected security interests are unenforceable on insolvency**

The general rule in the Exposure Draft is that security interests which are unperfected within a particular time prior to the insolvency of the grantor will be unenforceable by the secured party.

The Exposure Draft recognises that there are policy reasons for excluding certain security interests from the operation of this general rule. One policy reason is that other creditors will obtain windfall gains if certain of those exclusions did not apply. The same policy consideration should be applied to exclude from the operation of the rule all unperfected security interests where the security holder would at law be considered to be the legal owner of the relevant property and there are no competing perfected security interests.

4. **The need to include choice of law provisions**

As one of the primary aims of the legislation is to provide for legal certainty, a workable set of rules should to be included in the legislation to clarify the uncertainties of the existing choice of law rules. Our submission generally supports the regime that the AGD has put forward in the Revised Commentary subject to a number of suggested amendments.

Other issues

We also wish to raise the following subsidiary issues:

1. **Investment instrument and investment entitlement**

Further consideration needs to be given to the scope of the defined terms "investment instrument" and "investment entitlement". Those defined terms incorporate definitions from other legislation, which have particular inclusions and exclusions which are irrelevant in the context of the personal property securities legislation. Examples of such defined terms are "debenture" and "financial product", which have the meanings given in the Corporations Act 2001 (Cth).

2. **Rights on transfer of accounts or chattel paper - sections 125**

In section 125, the rights of the transferor, transferee and account debtor provided for in the Exposure Draft vary significantly from the existing law in a manner that may have unintended consequences. We have made a number of suggestions to rectify these unintended consequences.

Key issue 1: Accounts and assignments of accounts

Definition of account - section 35

Section 35 provides that an account is a monetary obligation (whether or not the obligation has been earned by performance) but does not include negotiable instruments, investment instruments, chattel paper or investment entitlements.

Even though the Exposure Draft has expanded the definition of investment instrument (thereby expanding the assets that are excluded from the definition of account) and the definition of account also now excludes investment entitlements, the definition of account remains too broad.

For example, arguably "account" could cover contractual damages claims (such as liquidated damages clauses in contracts) and commercial tort claims. There is no reason for such assets to be regulated as accounts under the personal property securities legislation. The definition should primarily cover only assets currently considered to be receivables or book debts. ADI accounts should be considered to be a separate category of accounts.

For this reason, we support a narrower definition of account that is on similar terms to the following:

> "***account*** means a monetary obligation (whether or not the obligation has been earned by performance):
>
> (a) in respect of personal property that has been or is to be sold, leased, licensed, assigned or otherwise disposed of;
>
> (b) in respect of services rendered or to be rendered;
>
> (c) arising out of the use of a credit or charge card or information contained on or for use with the card; or
>
> (d) constituting a payment obligation under a security interest,
>
> that is not evidenced by a negotiable instrument, an investment instrument, chattel paper or an investment entitlement and excludes contractual damages claims and commercial tort claims."

The suggested wording is loosely based on the US Uniform Commercial Code Article 9 drafting, with modifications to suit the Australian context.

Priority on assignment of accounts

Generally the way in which assignments of accounts are dealt with in the Exposure Draft needs further refinement.

We support the new approach in section 233(3)(a). Under that section, absolute assignments of accounts *that do not secure payment or performance of an obligation* are excluded from the general regime in section 233. If not for this exclusion, general creditors of the insolvent grantor would obtain a windfall benefit. This would be the case as an insolvent grantor would have received some form of consideration for the assignment of the relevant accounts, meaning the creditors of that grantor would receive the benefit of that consideration as well as the actual accounts.

However, registration of an account (excluding an ADI account) is still necessary to ensure priority of an assignment of an account as against a competing security interest in the same account.

This will mean that an assignment of accounts (excluding ADI accounts) which is registered on the PPS register but which at general law would be considered an equitable assignment will have priority over an assignment of the same accounts which at general law would be considered to be a legal transfer but which is not registered.

This is illustrated by the following example.

> Debtor D owes a debt to Creditor K. Bank acquires Creditor K's debts under a factoring arrangement (that is, not a sale of business). The assignment of that debt as part of a factoring arrangement does not fall under any of the exceptions to the operation of the legislation under section 6 of the Exposure Draft.
>
> Bank gives notice to Debtor D regarding the assignment from Creditor K to Bank and requires Debtor D to pay Bank rather than Creditor K. At general law, this would constitute a legal assignment of the debt. Bank does not register this security interest on the PPS register.
>
> X takes a subsequent equitable assignment of the same debt from Creditor K. X registers its security interest on the PPS register but does not notify Debtor D. Creditor K's action could be questionable or fraudulent, but this is irrelevant when determining priority. Debtor D is unaware of the equitable assignment.
>
> In a priority contest, when the default priority rules are applied, X's equitable assignment will have priority over Bank's legal assignment, even though at general law Bank has legal title to the debt and Debtor D, at general law, is in fact required to discharge the debt by making payment to Bank. This priority position will remain even if Bank later registers its security interest on the PPS register.

Although the legislation is intended to remove the distinction between legal and equitable title, the example above produces an inequitable result, particularly for the account debtor, Debtor D. To overcome the inequities of this approach, we suggest an alternative method of perfection of accounts (excluding ADI accounts) is incorporated in the legislation.

We suggest that:

1. the definition of controllable property is expanded to include accounts that are not ADI accounts (here, referred to as "non-ADI accounts") as well as ADI accounts; and

2. the following provision is inserted as the method by which a security interest over a non-ADI account may be perfected by control:

   "46A Control of accounts (other than ADI accounts)

   1. A person has ***control*** of an account that is not an ADI account if:

   (a) the person has taken a transfer or an assignment of the account, whether or not the transfer or the assignment secures payment or performance of an obligation; and

   (b) the account debtor has been notified by either the transferor or the transferee of the transfer or the assignment and, in that notice, is requested to make payment of the account to the transferee or the assignee.

   2. To avoid doubt, this section applies in relation to:

   (a) perfecting a security interest by control; and

   (b) without limiting section 52, determining whether personal property is a circulating asset under section 51."

Key issue 2: Exercise rights in a "commercially reasonable manner"

Exposure Draft section 235

Section 235(1) of the Exposure Draft provides as follows:

> *(1) All rights, duties and obligations that arise under a security agreement or this Act must be exercised or discharged:*
> *(a) honestly; and*
> *(b) in a commercially reasonable manner.*

In our view this provision will lead to confusion rather than certainty in the law of personal property securities.

The requirement to exercise rights honestly

A requirement to act honestly is a concept well established under Australian law. For example:

(a) A director has a statutory obligation to act honestly in the exercise of his or her powers and in the discharge of the duties of his or her office. For example, section 232(1) of the now repealed Corporations Law provided that an officer of a corporation is required to act honestly in the exercise of his or her powers and the discharge of his or her duties. This statutory duty was considered in cases such as ASIC v Vines (2005) NSWSC 738.

Section 232(1) of the previous Corporations Law has now been replaced by section 184 of the Corporations Act, which provides that a director or other officer commits an offence if that person is intentionally dishonest and fails to exercise his or her powers and discharge his or her duties in good faith, in the best interests of the relevant corporation and for a proper purpose. This statutory duty reflects an equivalent common law duty.

(b) A member of a registered managed investment scheme's compliance committee has a statutory obligation to act honestly under section 601JD(1)(a) of the Corporations Act.

(c) Other Australian legislation includes a statutory duty to act honestly. For example, under section 585(1) of the Water Act 2000 (Qld), an officer of a water authority must act honestly in exercising his or her powers as an officer of the authority.

There are many other examples which could be given of circumstances where either pursuant to statute or common law a particular person has a duty to act honestly.

The requirement to exercise rights in a commercially reasonable manner

Our concern is section 235(1)(b) of the Exposure Draft. It is unclear what constitutes acting in a "commercially reasonable manner". The introduction of this concept in the legislation will be contrary to one of the key purposes of Australia's personal property securities reform, being the promotion of certain and consistent outcomes in commercial transactions. In our view this subsection should be deleted.

In support of the deletion of this subsection, we comment as follows:

(a) **(No general law equivalent)** "Commercially reasonable" is not defined in the Exposure Draft and there is no general law equivalent to the requirement to exercise rights in a commercially reasonable manner.

Australian case law does not provide guidance as to how parties to a security agreement could exercise their contractual rights in a "commercially reasonable manner".

The UK case of Peregrine Fixed Income Ltd (in liq) v Robinson Department Store Public Company Ltd (unreported, High Court UK, 18/5/2000) illustrates the difficulty faced by courts in determining what is "commercially reasonable".

That case considered a derivatives agreement which provided that, on termination of the agreement, the settlement amount was to be calculated by using the "Market Quotation (MQ)" method. The agreement also provided that if, in the reasonable belief of the non-defaulting party, this method would not produce a "commercially reasonable" result, the "Loss" measure was to be used instead. When one party (Peregrine) defaulted, the other (Robinson) calculated the settlement amount. By using the MQ method, Robinson calculated the settlement amount to be US$9.5 million. Peregrine claimed that it was commercially unreasonable to use the MQ method because if the Loss measure was used, the amount would be US$87.3 million. This discrepancy was largely caused by Robinson's own low credit quality at the time (that is, the MQ method took into account the fact that Robinson may have defaulted under the agreement).

In making its decision, the court looked at whether the result departed from what was reasonably justifiable having regard to the purpose and terms of the agreement and any other relevant factors. This is not a very certain test and it is very difficult to predict an outcome from its application.

(b) **(Relevant to business transactions only?)** The primary regulation of consumer credit is under the Uniform Consumer Credit Code (**UCCC**). The UCCC provides a regime for, amongst other matters, regulating the manner in which a financier is able to exercise rights under a consumer credit transaction. For example, under Part 5 of the UCCC, financiers are required to follow certain procedures to terminate and enforce credit contracts, security interests and guarantees. The Commonwealth will assume responsibility for the UCCC by enacting it as Commonwealth law in the short term. Any perceived deficiency in the UCCC, including the manner in which rights are to be exercised, may be fine-tuned as part of that process. Accordingly, if a consumer credit contract is entered into in compliance with UCCC requirements and is enforced in a way that is UCCC compliant, there is no reason to require compliance with the vague standard set out in section 235(1)(b) of the Exposure Draft.

In the case of non-consumer contracts, parties generally have more equal bargaining power, are more likely and able to seek professional advice and can negotiate more effectively. It is therefore unclear how it could be "commercially unreasonable" for a party to exercise its rights as contained in an agreement negotiated in such a context. It is also unclear what policy reason there could be for imposing such a vague obligation on the parties in such circumstances.

(c) **(New Zealand experience inconclusive)** Section 25 of the New Zealand Personal Property Securities Act provides as follows:

(1) *All rights, duties and obligations that arise under a security agreement or this Act must be exercised or discharged in good faith and in accordance with reasonable standards of commercial practice.*

(2) *A person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.*

The wording used in this section was changed in 2004 from "in a commercially reasonable manner" to "in accordance with reasonable standards of commercial practice". The policy reason behind the amendment was to ensure that cases considering the (now repealed) Credit Contracts Act, which had an equivalent test, would be relevant to the interpretation of the New Zealand Personal Property Securities Act standard. New Zealand case law does not provide clear guidelines for compliance with this statutory requirement other than indicating that generally evidence of what constitutes "reasonable standards of commercial practice" will need to be presented before a Court can decide whether such standards have been contravened (Cambridge Clothing Co Ltd v Simpson [1988] 2 NZLR 340).

The Revised Commentary (5.12) stated that "The Bill does not use the term 'good faith'. ... The term 'good faith' has no clear and settled meeting in Australian law. Its use may have decreased certainty in transactions leaving people unsure as to where they stand before entering into a transaction". We agree with this reasoning. Similarly, the use of the standard of "commercially reasonable" suffers from the same problems.

In light of the fact that there are no compelling policy reasons for Australia to adopt a statutory standard of acting in a commercially reasonable manner and that the purpose of personal property security reform is to improve both legal and commercial certainty, section 235(1)(b) of the Exposure Draft should be deleted.

Key issue 3: Certain unperfected security interests vest in the grantor

Treatment of security interests on insolvency

If a security interest is unperfected when:

(a) where the grantor of the security interest is a company, that company is wound up, an administrator is appointed under the Corporations Act or that company grantor executes a deed of company arrangement; or

(b) where the grantor is an individual, a sequestration order is made against that person or that person becomes bankrupt in either case under the Bankruptcy Act 1966,

then the secured party's security interest vests in the grantor (section 233(2)).

Certain security interests are exempted from this rule, including:

Section 233(3)(a) security interests created by a transfer of an account that does not secure payment or performance of an obligation; and

Section 233(3)(c) a security interest created by a PPS lease that does not secure payment or performance of an obligation and is for tangible property that must be described by serial number and is for a term of 90 days or more and one year or less. (As in the Revised Commentary, we will refer to this as a short term PPS lease in the following discussion.)

These exempted transactions would remain subject to the priority rules in the legislation.

Under section 234, the lessor or bailor under a PPS lease or a consignor under a commercial consignment which does not secure payment or performance of an obligation will be able to recover compensation at least equal to the market value of the leased, bailed or consigned property and any other loss resulting from the termination of the lease, bailment or consignment.

We make the following comments.

(a) We have commented above on this regime in the context of its application to the transfer of accounts. We support the exclusion of the relevant types of account transfers from this regime.

(b) Section 233(2) is unclear. This provision should be modified to provide that the security interest is vested in the grantor *only to the extent that it creates a security interest*. This would be consistent with the regime in section 266 of the Corporations Act. In other words, it must be made clear that all of the secured party's other rights and obligations under the agreement or other document creating the security interest continue to vest in the secured party. For example, if the relevant agreement contained both the security interest and the terms on which a loan was made to the grantor, then the secured party should remain entitled to its rights under that agreement that relate to the provision of the loan.

(c) We support the exclusion of short term PPS leases from the general operation of section 233. However, we do not believe that this lease exclusion is broad enough. Section 233 should not apply to leases, bailments or commercial consignments within the meaning of section 28(3) of the Exposure Draft where there is no competing security interest on the insolvency of the relevant company. In each of these cases, the distinguishing factor for the security interests is that at general law the lessor, bailor or consignor is the owner of the relevant property.

Where there is a competing perfected security interest in the leased, bailed or consigned property, there is a clear policy reason for the unperfected lease, bailment or consignment to be avoided. However, where there is no such

competing interest it is difficult to see the policy reasons for the interest of the legal owner of the relevant assets to be defeated. The creditors of the grantor of the security interest would receive a windfall gain in those circumstances that they would not have anticipated because ownership of the leased, bailed or consigned property would have vested in the grantor. However the grantor would not have paid full consideration for that property. Notwithstanding that the lessor, bailor or consignor would be entitled to claim in the insolvency proceedings against the grantor (and that section 234 would assist in this regard), it is more likely than not that such person would not recover the full value of the relevant property, given that such person would be treated as an unsecured creditor of the grantor, ranking equally with all other unsecured creditors.

Key issue 4: Conflicts of law rules

General comments

The Exposure Draft does not contain any conflicts of law rules. As one of the primary aims of the legislation is to provide for legal certainty, a workable set of rules should to be included in the legislation to clarify uncertainties in the application of the existing conflict of law rules.

We favour the adoption of an approach which is consistent with the New Zealand regime, which is clear and simple. Section 26 of the New Zealand Personal Property Securities Act provides that, generally, the validity, perfection and effect of perfection of security interests is governed by New Zealand law if:

(a) *At the time the security interest attaches to the collateral, the collateral is situated in New Zealand; or*

(b) *At the time the security interest attaches to the collateral, the collateral is situated outside New Zealand but the secured party has knowledge that it is intended to move the collateral to New Zealand; or*

(c) *The security agreement provides that New Zealand law is the law governing the transaction; or*

(d) *In any other case, New Zealand law applies.*

We have considered the proposed model in Appendix A of the Revised Commentary released on 4 December 2008. We support that model in principle, though particular elements should be modified. Our comments on areas where change is required are as follows.

Scope

The AGD model provides that the regime will be limited to determining questions of validity and perfection. This is in line with New Zealand's Personal Property Securities Act and we support this approach.

Tangible property

We support the approach in relation to tangible property subject to:

(a) Greater certainty as to the meaning of "law of Australia" under the rule allowing parties to a security agreement to select the applicable law. The security agreement must specify a law of a particular State or Territory, not simply the law of Australia. Also, if the parties to the security interest select a law other than the law of an Australian State or Territory in circumstances where at general law that choice would be upheld, then that law should be applied to determine questions of validity, perfection and the effect of perfection and non-perfection.

(b) The rule that questions of validity, perfection and the effect of perfection and non-perfection in respect of security interests over movable collateral are generally governed by the law where the collateral is moved if the secured party believed on reasonable grounds that the collateral will be moved there. This is impractical as it relies on determining the belief of the secured party and the reasonableness of that belief. We support an alternative approach of simply applying the law of the place where the grantor is located at the time the security interest attached to the collateral. This is more definitive.

Financial property

We understand from A.12 of the Revised Commentary that financial property will include chattel paper, investment instruments, currency, documents of title and negotiable instruments. Financial property is a new concept and should be clearly defined in the legislation.

Subject to our comments in the next paragraph and our comments in relation to intangible property below, we generally support the rules that will be applied to financial property.

We understand from A.29 of the Revised Commentary that where the grantor is a foreign entity and the secured party does not have *possession or control* of the collateral, the security interest in financial property (other than non-negotiable documents of title) will be governed by the law of the location of that foreign entity. In our view this is not sensible as we do not understand why perfection by possession or control should be treated differently to perfection by registration. Therefore we suggest that if perfection in accordance with Australian law has occurred, the security interest should be governed by the law of the Australian jurisdiction in which the collateral is located. We suggest that a corresponding rule apply in respect of financial property located outside Australia which is subject to a security interest granted by an Australian entity.

Intangible property

Subject to our comments below, we support these rules in general.

There is an overlap between the types of property that fall within the definition of "financial property" and the types that fall within the definition of "intangible property". We assume the

intention is that if property is both financial and intangible, one set of rules will generally apply in priority to the other. This should be made clear. For example, the rules on intangible property contain specific rules for assignments of chattel paper. Chattel paper is financial property. Are the intangible property rules intended to apply where the security interest over the chattel paper takes the form of an assignment, with the financial property rules to apply in all other circumstances?

In the case of any security interests (including assignments) of accounts and chattel paper, the law governing validity, perfection and the effect of perfection or non-perfection should be the law of the debtor under the account or chattel paper. This reflects the current law and is the most appropriate outcome. This should not change irrespective of whether or not the grantor of the security interest is an Australian entity.

Relocation of grantor or collateral and temporary perfection

In certain cases the law governing validity, perfection and the effect of perfection or non-perfection will be the law of the location of the grantor or the location of the collateral. It is proposed that, if the grantor or collateral changes location, this law will change to the law of the new location. We do not support a regime that provides for such a change of law. The law should be determined as at the date that the security interest first attaches and should not subsequently change. This provides the greatest level of certainty for the secured party, who will then need to consider this issue on only one occasion.

If the proposal in the previous paragraph is not accepted, consideration should be given to extending the timeframes for temporary perfection where there is a change of location of the grantor or the collateral. The New Zealand Personal Property Securities Act is more generous in relation to timeframes for temporary perfection than the Exposure Draft. For example, where a security interest in "goods" has been perfected in a foreign jurisdiction and the goods are subsequently brought into New Zealand, section 27 of the New Zealand Personal Property Securities Act provides for temporary perfection, where the security interest is perfected under the laws of the relevant foreign jurisdiction, which is conditional on perfection by other means before the expiry of the earliest of 15 calendar days after the secured party is aware the goods have come to New Zealand, 60 calendar days after the goods are brought into New Zealand and perfection expiring under the foreign law.

Other comments

(a) **(Enforcement difficulties)** It appears that it is possible that a security agreement which covers more than one type of property could be subject to different governing laws. This could lead to complications regarding enforcement.

(b) **(Flexibility to select governing law)** The proposed model seem to give some flexibility to select the governing law in relation to security interests over certain categories of property but not others. This restriction is not desirable. For example, Rule 12 provides that the question of validity of an intellectual property licence will be determined by where the licence is granted irrespective of the

governing law of the security agreement. There seems to be no policy reason why the parties' choice of governing law should not be respected in such a situation.

Other issue 1: Definitions of investment instruments and investment entitlements

There are unintended consequences arising from reliance on particular Corporations Act definitions in the definitions of investment instrument and investment entitlement.

For example, in the Exposure Draft, the definition of investment instrument refers to debentures within the meaning of the Corporations Act. That Corporations Act definition excludes (amongst other instruments) promissory notes having a face value of at least $50,000 (see paragraph (d) of the definition of debenture in section 9 of the Corporations Act). There is no policy reason in the context of the personal property securities legislation for treating promissory notes with a comparatively low value in a different manner to promissory notes of a higher value.

Another example is that the definition of investment instrument includes "financial product". This is relevant to the definition of investment entitlement as well. Financial product is again defined by reference to the Corporations Act. Chapter 7 of the Corporations Act regulates "financial products". The provision of credit is not intended to be regulated by the regime in Chapter 7 and the definition of financial product excludes "credit facilities" within the meaning of the regulations (see section 765A of the Corporations Act). Credit facilities broadly cover the provision of credit for any period with or without prior agreement between the credit provider and the debtor regardless of whether or not both credit and debit facilities are available.

This means that obligations to repay loans (and other financial obligations) will arguably not be investment instruments and will instead be accounts. Therefore transfers of interests in respect of such loans, which are not made for the purposes of securing payment or performance of an obligation, will be within the definition of a security interest under the legislation. This is not appropriate. For example, in Australia there are well established primary and secondary markets for the transfer of participations in syndicated financings. As is the case for other types of interests that are considered to be readily tradable and which are excluded from the definition of accounts, participations in such financings should not be regulated by the accounts regime in the personal property securities legislation.

Also, it is now contemplated that certain types of credit facility will be regulated by the Corporations Act, particularly margin loans. When this amendment is made to the Corporations Act (which is scheduled to occur in mid 2009), margin loans will be considered to be investment instruments but other types of lending will generally be excluded from the definition of investment instruments. There is no policy reason for this approach.

Other issue 2: Rights on transfer of account or chattel paper - section 125

Section 125(1)(a) provides that the rights of a transferee of an account or chattel paper (including a secured party or a receiver) are subject to the terms of the contract between the account debtor and the transferor and any defence, remedy or claim under the general law *arising from the contract*. This does not reflect the current law which in certain circumstances allows claims which do not arise from the contract in question to be allowed. We do not support any change from the current law.

The reference to the transferor should be deleted from section 125(3)(a). As the transferor will be aware that the transfer has occurred, it would seem to be impossible for any circumstances to exist in which the transferor could have acted honestly in modifying or substituting the contract without the express consent of the transferee. In relation to the reference in this section to "commercially reasonable", we repeat our comments above in relation to section 235 of the Exposure Draft.

Section 125(4)(b) should be deleted. If the account debtor is aware that the relevant account or chattel paper has been transferred then the account debtor should not be able to continue to deal with the transferor under section 125(3).