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The Committee Secretary
Standing Committee on Legal and Constitutional Affairs
PO Box 6100
Parliament House
CANBERRA ACT 2600
By email legcon.sen@aph.gov.au

Dear Sir

Inquiry into the Personal Property Securities Bill 2009 (2009 Bill)

We thank you for providing us with the opportunity to make a submission to the Parliamentary inquiry being undertaken in relation to the 2009 Bill.

Our firm has been an active participant in the consultation process in relation to the proposed PPS regime, having lodged submissions on the original discussion papers, and each of the previous Bills and also having appeared before the Committee and on Legal and Constitutional Affairs in relation to its inquiry into the November 2008 Bill.

Due to absences of key personnel during the month, the comments made below and in the Schedule to this letter are not necessarily those of the firm as a whole.

Desired outcomes of the Bill

We agree with Senator McClelland's statements (contained in the Second Reading Speech in relation to the 2009 Bill) in which he highlights the need to streamline lending arrangements so as to provide greater certainty for both lenders and borrowers. This is consistent with the views of the Committee which recognised the need for the November 2008 Bill to be simplified and suggested that there be substantial redrafting, clarification and simplification before it is presented to Parliament.

We also agree with Senator McClelland's statements that it is necessary to reduce the complexity and increase consistency amongst arrangements by having a single national online register of personal property securities.

As stated by Senator McClelland, 'the significance of this reform for business cannot be underestimated' and 'borrowing using personal property has the potential to assist businesses to grow – particularly small and medium–sized business'.

Despite these comments (and the recommendations of the Committee from its inquiry into the November 2008 Bill) we continue to have concerns that the 2009 Bill has not achieved the desired outcomes as it:

- continues to propose a substantial number of complex priority rules (which in many cases worsen the position of financiers relative to their current position);
- goes beyond the establishment of a national register and changes substantive laws which are familiar to the commercial community (and have been established for decades);
- will result in significant educational, administrative and legal costs being incurred by financiers, a substantial number of which deal largely with corporate counterparties and predominantly rely on 'non–consumer' assets as security for transactions;
- continues to significantly water down the rights of lessors and places them in a seriously disadvantageous position relative to the current law (and irrespective of the fact that lessors retain legal title to the assets which they lease).

Major concerns

Constructive knowledge

1 The term 'constructive knowledge' is defined in section 297 and continues to provide that if a person would have had actual knowledge of the circumstance if it had:

1.1 made the inquiries that would ordinarily have been made by an honest and prudent person in the first person's situation; or

1.2 made the inquiries that would be made by an honest and prudent person with the first person's actual knowledge in the first person's situation,

that person will be deemed to have constructive knowledge of the circumstance. It is still unclear what is required to satisfy this standard and so ambiguity continues to exist as to the meaning of constructive knowledge.

2 In addition, as contained in the previous Bill, section 300 provides that a person will not have notice or actual or constructive knowledge about the existence or contents of a registration merely because data in the registration is available for search in the register. This seems to be inconsistent with the whole purpose of having a national PPS register and substantially detracts from the circumstances in which a person will have constructive knowledge.

3 As the absence of knowledge is relevant in determining when a third party acquires an interest in personal property free of a security interest and is also relevant in determining priorities, this is a critical element of the operation of the regime and needs to be understandable and simple.

4 Having said the above, we applaud the change included in the new Section 299 which attributes knowledge to a transferee if it is related to a transferor. This provides added protection to financiers in that they will not be prejudiced as a result of fraudulent or other deliberate activities undertaken to defeat the interests of a security holder in personal property. Section 299 requires the transferee to establish beyond reasonable doubt that it did not have actual or constructive knowledge that the acquisition was a breach of the security agreement to which the personal property is subject or that of the security interest was in existence and that it did give value for the interest acquired.

Complexity of priority rules

1 In general, the rules relating to security interests (starting at the specific rules for attachment and perfection (section 30) and ending at section 77) provide for an extremely complex regime for determining the priority of security interests. This complexity is added to by the substantial number of scenarios for which rules have been developed.

2 As was the case with the previous Bills, a registered security interest can be defeated by a later security interest perfected by control (section 57). This applies whether or not the security holder with control had knowledge of the previously registered security interest. We do not understand why the concept for priority time does not apply to perfection by control in the same manner as it applies to other means of perfection (section 55(5)).

3 Section 64 provides that a non-purchase money security interest in an account (as original collateral) has priority over a purchase money security interest in the account as proceeds of inventory. This priority requires the secured party that holds the prior security interest to give notice to each secured party holding a purchase money security interest in the account within a certain time period. There is no requirement on a holder of a purchase money security interest to give notice of the creation of its security interest to any existing security holder and it is therefore difficult to see how a holder of a non-purchase money security interest in an account would ever be on notice of the existence of a subsequent purchase money security interest in the proceeds of inventory placed into the account. On this basis, the rule will not have any practical effect which means that the holder of such account will not have the priority intended to be provided by the section. The 2008 Bill required notice of a purchase money security interest to be provided where it was in relation to inventory. This requirement has been removed.

4 It is unclear how section 75 (which deals with the priority of security interests held by ADI's in an ADI account) works together with section 64.

5 Division 4 of Part 2.6 of the 2009 Bill (dealing with priority of security interests in transferred collateral) appears to override the default priority rules in section 55 (other than where one of the security interests referred to is perfected by control).

6 Section 69 (which is carried over from the 2008 Bill) has the effect of giving an unsecured creditor priority over a secured creditor in certain circumstances unless the unsecured creditor has actual knowledge that the payment it has received is in breach of a security agreement that provides for security. In order to avoid fraud, it

should be clear that this section is subject to section 299. In addition, although the heading to Division 5 refers to priority of creditors and purchasers of negotiable instruments, chattel paper and negotiable documents of title, section 69 is not so qualified and applies to any payment received by a creditor. This requires correction.

7 In addition to the priority rules contained in Chapter 2, further priority rules are contained in Chapter 3 in relation to accessions and processed and commingled goods. The appearance of priority rules in different parts of the Bill only adds to the complexity of the proposed legislation and makes it difficult to get a clear picture of the priority outcomes applicable in various circumstances.

The above examples indicate the complexity associated with the priority rules and the need for them to be considered and simplified further.

Impact on lessors

1 The potential adverse impact of the November 2008 Bill on lessors was accepted by the Committee, which recommended that consideration be given to improving the priority of unperfected lessors have against unsecured or other unperfected interests in goods.

2 Our review of the 2009 Bill does not indicate that any amendments have been made in relation to the operation of the Bill in relation to lessors. In particular, notwithstanding that a lessor will continue to hold title to the collateral, should the lessor fail to perfect its security interests by registration prior to the lessee being wound up, entering into administration or, in the case of a natural person, becoming bankrupt, the security interest held by the lessor (essentially being its interest in the collateral) will continue to vest in the grantor (lessee) (section 267(2)). This adverse consequence will only not apply in the case of a PPS lease which does not secure payment or performance of an obligation (which presumably would never be the case), relates only to serial numbered goods and has a period of between 90 days and less than one year in duration.

3 We do not understand why the exclusion from such an adverse consequence is limited to such a narrow circumstance. Given the fundamental change to the rights of a lessor, the consequence should not apply to any lessor.

4 Although the Bill provides (in section 269) that a lessor under other PPS Leases will have been taken to have suffered damage immediately before the vesting of the security interest in the grantor and may recover compensation from the grantor, this provides little comfort to a lessor who previously was the owner of goods and, under the new regime, will have lost ownership by the mere fact that it had not registered its interest under the PPS system.

5 Whereas under the current law, the lessor would be entitled to repossession of its asset which it could then sell to recover the amounts owing to it, under the 2009 Bill, in the absence of perfection by registration prior to insolvency, all that the lessor will be entitled to is to prove as unsecured creditor for its damage which, in most circumstances, will result in a far lesser recovery than under the current law.

6 The ability of a secured party to recover compensation should not be limited to a consignor, lessor or bailor but to any secured party who is adversely affected by the vesting of security interests provided for in section 267(2).

7 There are other provisions which remain in the 2009 Bill which work against the interest of lessors. For example, under section 43(1), a buyer of property leased to a lessee, if it pays value for the property, obtains such property free on an unperfected security interest in the property. This rule is not qualified by reference to knowledge (actual or constructive) nor does it require the value provided to be consistent with market value. Given the consequences to the security holder, the section should be amended to either require the market value to be paid by the buyer or alternatively by amending the references to buyer and lessee to refer to transferee and qualifying the rules by reference to the transferee not having actual or constructive knowledge of the existence of the security interest. This will then trigger section 299 (which deals with constructive and actual knowledge of related parties) which works for the benefit of the financier. In a competition between a buyer of an asset and an existing security holder over the asset, the rights of the existing security holder should prevail if the purchaser was not bona fide or had actual or constructive knowledge of the existence of the security interest. We assume this is the reason for the inclusion of the new section 299, however the rule (in section 43(1)) seems to disregard the existence of that provision.

8 Given the above comment it appears that the recommendation of the Committee in relation to improving the priority of unperfected lessors has not been accepted.

PPS Lease

1 The interest of a lessor of goods under a PPS Lease (which is defined in section 13) is taken to be a security interest whether or not the transaction concerned, in substance, secures payment or performance of an obligation. In relation to non-PPS Leases of goods, they will only amount to a security interest if they, in substance, secure payment or performance of an obligation.

2 Section 30 of the November Bill has been removed and so there is no guidance as to when a lease secures payment or performance of an obligation. In our view, all leases would be seen as securing payment or performance of an obligation and therefore will be a security interest for the purposes of the Bill. Accordingly, in relation to leases, there appears to be no need to make this distinction. If short term hiring arrangements (such as car rental) are not intended to be subject to the PPS regime, they should be expressly excluded in section 8.

New value

1 The term 'new value' has been retained from the previous Bill. This concept is relevant in determining whether or not third parties can obtain an interest in collateral free of existing security interests and is also relevant to certain priority rules. Neither the definition nor the relevant provisions require that such new value be on arms length terms or equivalent to market value. The Explanatory Memorandum mentions that the term is referring to consideration that will support a contract, other than value provided to discharge a prior debt or liability. The law does not require consideration to be adequate for the promise in respect of which it is

made. It is therefore possible for nominal value to be provided from a transferee to a transferor or by a subsequent security holder and if the other requirements of the provisions are met, the transferee may obtain its interest in the collateral free of existing security interests or, in the case of a security provider, obtain priority. Given the context in which the term 'new value' is used, either the definition or the relevant provision should require the new value to be on arms length terms or alternatively equivalent to the market value of the property. This is consistent with the obligations on the holders of security interests on enforcement.

Transitional provisions

1 The Transitional Rules will determine such things as the appropriate priority and enforcement rules to apply after the commencement of the PPS regime in relation to securities in existence prior to the commencement of the PPS regime as well as the priority rules to apply between such security interests and those which are granted after the commencement of the PPS regime). The need for clear and understandable Transitional Rules is fundamental to ensure the smooth transition to the new system and to minimise adverse outcomes to the holders of existing security interests, which were enforceable and had their intended priority prior to the new regime starting.

2 The Transitional Rules are overly complex and difficult to understand and so require further consideration and simplification.

Suggested approaches to overcoming above concerns (other than those raised in relation to Transitional Rules)

1 For the national register to be given the effect intended (being to streamline lending arrangements, lower risk for lenders and improved efficiency of secured financing (Second Reading Speech paragraph 16)), the registration of a financing statement should provide the security holder which has registered that financing statement (and who is a bona fide security holder in relation to relevant personal property) with comfort that it will not lose either its priority or have the assets the subject of the security interest transferred to third parties free of the security interest unless the registered security holder has consented to such dealing.

2 To achieve this result, persons dealing with personal property should be deemed to have constructive knowledge of information contained in the register in relation to the personal property. Given the ease by which the register will be able to be searched (as mentioned in paragraph 22 of the Second Reading Speech), this should not be an impediment to dealing with personal property and it will be consistent with the whole notion of granting a security interest over personal property to a financier. Financiers do not expect that the grantor of the security interest should be free to deal with the personal property the subject of the security interest without the consent of the financier unless the terms of the security interest itself allows such dealings to occur.

3 Of course, there will be certain types of personal property where on-market dealings cannot be hampered by the existence of a security interest in the personal property (eg listed investment instruments) and accordingly the above suggested rules will need modification to account for these types of property.

4 In relation to such property, financiers should be able to obtain control (thereby protecting their security interest) which should then prevent any on market dealings.

5 A further exception (which would assist in commercial activity without requiring constant searching of the register) could apply to consumer property valued below a particular threshold. We note this concept is already included in the Bill in section 47 and could be given broader application to achieve the above result.

6 By including a system as suggested above, the myriad of complex priority rules could be removed and the number of rules contained in the Bill could be reduced to a limited number of clearly understandable rules.

7 Given the legal position of a lessor of property, it is not appropriate that its interest in the personal property the subject of a lease can be vested in the grantor of the security interest (being the lessee) on insolvency of the lessee merely because the lessor has not registered a financing statement. This outcome (as proposed in each of the previous Bills and which continues to be included in the 2009 Bill) cuts across centuries of established common law and is not necessary to achieve the desired outcomes.

Other matters

We attach, as a Schedule to this letter, a more detailed listing of areas in the 2009 Bill which we believe require clarification, simplification or amendment.

We hope that the above comments (and those contained in the Schedule to this letter) are seen as a genuine attempt to ensure that the Bill, as passed, in fact achieves the desired outcomes and also takes account of the significant costs which will be borne by business (and their customers) in complying with the new regime.

We would be more than happy to discuss any of our comments with you.

Yours sincerely

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Schedule

Definitions

1 The term ***'document of title'*** is defined in a way which would not seem to extend to registration papers for motor vehicles, or share or unit certificates or holding statements. It seems to be limited to trade finance type documents such as bills of lading. Was this intended?

2 The term ***'financial property'*** is a new definition but does not appear to extend to an account (which is essentially an unsecured or non-lease monetary obligation). It is unclear why an account would not be financial property.

3 The term ***'investment instrument'*** includes an interest in, or a unit in an interest in, a managed investment scheme. It is unclear what is meant by 'a unit in an interest in a managed investment scheme'.

4 The term ***'land'*** includes all estates and interests in land, whether freehold, leasehold or chattel, but does not include fixtures. It is unclear what estate or interest in land would be a chattel interest.

5 The term ***'new value'*** has been retained from the previous Bill. This concept is relevant in determining whether or not third parties can obtain an interest in collateral free of existing security interests and is also relevant to certain priority rules. Neither the definition nor the relevant provisions require that such new value be on arms length terms or equivalent to market value. It is therefore possible for nominal value to be provided from a transferee to a transferor or by a subsequent security holder and if the other requirements of the provisions are met, the transferee may obtain its interest in the collateral free of existing security interests or, in the case of a security provider, obtain priority. Given the context in which the term 'new value' is used, either the definition or the relevant provision should require the new value to be on arms length terms or alternatively equivalent to the market value of the property. This is consistent with the obligations on the holders of security interests on enforcement.

Flawed asset arrangement

6 Flawed asset arrangements are now expressly included as being security interests even though any right of set-off or right of combination of accounts and any right or interest held by a person, or any interest provided for by any transaction, under an approved netting arrangement, close out netting contract or market netting contract are expressly excluded from the operation of the Bill.

7 As a flawed asset arrangement is generally linked to a set-off arrangement, it is unclear why it is expressly included as a security interest when the set-off arrangements (and market netting arrangements) are expressly excluded from the Bill.

8 In addition the term 'flawed asset arrangement' is not defined.

Security interests

9 Section 12(3) provides that a security interest also includes the interest of a transferee under a transfer of an account or chattel paper. As the term 'account' is defined as essentially meaning an unsecured monetary obligation, we do not understand why a transferee of an unsecured monetary obligation should be taken to have a security interest.

PPS Lease

10 The interest of a lessor of goods under a PPS Lease (which is defined in section 13) is taken to be a security interest whether or not the transaction concerned, in substance, secures payment or performance of an obligation. In relation to non-PPS Leases of goods, they will only amount to a security interest if they, in substance, secure payment or performance of an obligation.

11 The previous section 30 of the November Bill has been removed and so there is no guidance as to when a lease secures payment or performance of an obligation. In our view, all leases would be seen as securing payment or performance of an obligation and therefore will be a security interest for the purposes of the Bill. Accordingly, in relation to leases, there appears to be no need to make this distinction. If short term hiring arrangements (such as car rental) are not intended to be subject to the PPS regime, they should be expressly excluded in section 8.

Purchase money security interest

12 This term is defined in section 14.

13 It means a security interest taken in collateral to the extent that it secures all or part of its purchase price. Previously, it was indicated that the security interest was taken by the seller, however these words have been removed.

A security interest taken in collateral by a person who gives value for the purposes of enabling the grantor to acquire rights in the collateral is also a purchase money security interest to the extent that the value is applied to acquire those rights. It is unclear what rights this refers to.

These matters should be clarified.

14 Importantly, the interest of a lessor or bailor of goods under a PPS Lease is a purchase money security interest and therefore provides (if perfected) superior priority over other security holders (although it is important to note it does not provide protection to the holder of such security interest which is unperfected at the time of insolvency).

15 If a purchase money security interest is not perfected, it provides no additional benefits to the holder of such security interest relative to the holder of non-purchase money security interests. This appears to be inconsistent with the logic which provides such security interests super priority if they are perfected.

Enforceability of security interests against third parties

16 The general rule in relation to this matter is set out in section 20. Interestingly, it would appear that a security interest is enforceable against a third party even if it is not perfected by registration. Provided the security interest is attached to the collateral and the secured party either possesses or controls the collateral or there is a written security agreement in place between the grantor of the security and the secured party, that agreement is enforceable (although its priority position will be affected if it is not perfected either by control, possession or registration). Was this intended?

17 Section 20(4) refers to a number of concepts which are no longer defined. In particular the reference to equipment should be deleted. In addition reference is made to personal property more particularly described by reference to item or class, however the terms 'item' or 'class' are not defined.

18 Section 22(1)(d) refers to the concept of 'negotiable document of title', however this definition has been removed from the Bill.

Possession and control

19 There does not appear to be any rule as to how a secured party may possess a negotiable instrument that is evidenced by electronic record. There is however a rule relating to control of such negotiable instrument (section 29). Is this intended?

20 Similarly, there appears to be no rule regarding possession of an investment instrument evidence electronically whereas there is such a rule in relation to control (section 27). Is this intended?

21 Section 25 deals with control of an ADI account. It does not however appear to apply to at call accounts. This will depend on whether or not an at call account results in the ADI being under a present liability to pay the debtor. This should be clarified.

22 In relation to investment instruments evidenced by a certificate, there does not appear to be a need for the secured party to hold a transfer in blank in order for it to control such investment instrument (section 27(3)) provided that it is in possession of the certificate and is able to transfer the instrument to the controller or another person or otherwise deal with the instrument. This could arise from the appointment of a receiver or the utilisation of the power of attorney contained in the security agreement.

23 In relation to investment instruments that are not evidenced by a certificate, section 27(4) is unclear whether a tripartite agreement (such as that used in respect of financing of listed securities) will satisfy the requirements of the section. The section refers to an agreement between the person and the grantor and the agreement having the effect that the person, or a person who has agreed to act on the instructions of the first person, is able to initiate or control sending instructions by which the investment instrument can be transferred or otherwise dealt with. A similar comment applies to section 27(5). We recommend this section be amended to contemplate tripartite agreements.

Proceeds

24 Section 32(2) provides that if a secured party enforces a security interest against both the collateral and proceeds (other than in relation to an investment instrument), the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral immediately before the collateral gave rise to the proceeds. It is unclear why this restriction applies.

Temporary perfection when collateral transferred

25 The Bill continues to allow a grantor of a security to transfer the collateral, the subject of the security, even though the security restricts such transfer from occurring. Section 34 allows the original security interest to be re-perfected notwithstanding the transfer, however it is unclear how this can occur. As the transfer will have resulted in the grantor of the security interest no longer being a position to provide security and the transferee would not be a party to any security agreement with the secured party, it is unclear how the secured party can actually re-perfect its security.

26 It is unclear also as to how this section works together with section 67 which provides that a transferor granted security has priority if it was perfected immediately before the transfer and it has been continuously perfected since the transfer. Logically, it is also not consistent with section 32(5).

Returned collateral - negotiable instruments and investment instruments

27 Section 36 allows for a secured party to re-perfect its security interest even if it allows the grantor of the security interest to take possession or control of negotiable instruments or investment instruments for up to five days for certain purposes. No provision is included to extend this period. If any delay was experienced completing the transaction for which control or possession was given back to the grantor, the secured party may not be able to re-perfect within five business days, and therefore will not be able to perfect its security interests. This should not be the case. We note there are other provisions where the period of five business days has been extended to ten. This should apply throughout the Bill (including to this section).

Complexity of priority rules

28 In general, the rules relating to security interests (starting at the specific rules for attachment and perfection (section 30) and ending at section 77) provide for an extremely complex regime for determining the priority of security interests. This complexity is added to by the substantial number of scenarios for which rules have been developed.

29 As was the case with the previous Bills, a registered security interest can be defeated by a later security interest perfected by control (section 57). We do not understand why the concept for priority time does not apply to perfection by control in the same manner as it applies to other means of perfection (section 55(5)).

30 Section 64 provides that a non-purchase money security interest in an account (as original collateral) has priority over a purchase money security interest in the account as proceeds of inventory. This priority requires the secured party that holds

the prior security interest to give notice to each secured party holding a purchase money security interest in the account. There is no requirement on a holder of a purchase money security interest to give notice of the creation of its security interest to any existing security holder and it is therefore difficult to see how a holder of a non-purchase money security interest in an account would ever be on notice of the existence of a subsequent purchase money security interest in the proceeds of inventory placed into the account. On this basis, the rule will not have any practical effect which means that the holder of such account will not have the priority intended to be provided by the section. The 2008 Bill required notice of a purchase money security interest to be provided where it was in relation to inventory. This requirement has been removed.

31 It is unclear how section 75 (which deals with the priority of security interests held by ADI's in an ADI account) works together with section 64.

32 Division 4 of Part 2.6 of the 2009 Bill (dealing with priority of security interests in transferred collateral) appears to override the default priority rules in section 55 (other than where one of the security interests referred to is perfected by control).

33 Section 69 (which is carried over from the 2008 Bill) has the effect of giving an unsecured creditor priority over a secured creditor unless the unsecured creditor has actual knowledge that the payment it has received is in breach of a security agreement that provides for security. In order to avoid fraud, it should be clear that this section is subject to section 299. In addition, although the heading to Division 5 refers to priority of creditors and purchasers of negotiable instruments, chattel paper and negotiable documents of title, section 69 is not so qualified and applies to any payment received by a creditor. This requires correction.

34 In addition to the priority rules contained in Chapter 2, further priority rules are contained in Chapter 3 in relation to accessions and processed and commingled goods. The appearance of priority rules in different parts of the Bill only adds to the complexity of the proposed legislation and makes it difficult to get a clear picture of the priority outcomes applicable in various circumstances.

The above examples indicate the complexity associated with the priority rules and the need for them to be considered and simplified further.

Subordination

35 The 2009 Bill continues to refer to voluntary subordination of security interests (section 61) rather than the use of priority deeds. The concept of subordination is relevant to subordination of debts however in relation to amending the priorities applicable to securities, these are dealt with by deeds of priority. As the distinction between these two terms is well known in the finance markets, the 2009 Bill should be amended to be consistent with market practice and refer to priority arrangements not subordination arrangements.

Adverse consequences for lessors

36 The Bill continues to prejudice the interests of lessors in a number of ways.

36.1 If a lessor fails to perfect its security interest, its title to the leased goods (being its security interest) will vest in the grantor/lessee on insolvency and will not (other than in very limited circumstances) allow the lessor to claim damages for the loss of its interest in the goods.

36.2 Under section 43(1), a buyer of property leased to a lessee, if it pays value for the property, obtains such property free on an unperfected security interest in the property. This rule is not qualified by reference to knowledge (actual or constructive) nor does it require the value provided to be consistent with market value. Given the consequences to the security holder, the section should be amended to either require the market value to be paid by the buyer or alternatively by amending the references to buyer and lessee to refer to transferee and qualifying the rules by reference to the transferee not having actual or constructive knowledge of the existence of the security interest. This will then trigger section 299 (which deals with constructive and actual knowledge of related parties) which works for the benefit of the financier. In a competition between a buyer of an asset and an existing security holder over the asset, the rights of the existing security holder should prevail if the purchaser was not bona fide or had actual or constructive knowledge of the existence of the security interest. We assume this is the reason for the inclusion of the new section 299, however the rule (in section 41(1)) seems to disregard the existence of that provision.

Importance of serial numbers

37 Sections 45 and 45 provide that a buyer or lessee of personal property, for new value, will take the property free of security interests if it is personal property of a type which is to be described by serial number in the PPS registration and on searching the register, immediately before the time of sale or lease of the property, (by reference only to the serial number), the existence of the security interest will not be disclosed.

38 It is therefore imperative that financiers and lessors dealing with personal property (which the regulations prescribe as requiring description by way of serial number) ensure that their financing statements set out the serial numbers.

39 This will require ongoing diligence as additional property (which is to be described by a serial number) becomes subject to the security interest or is leased by the lessee. Appropriate financing change statements (being a new concept) will need to be registered to ensure maintenance of the registration and the avoidance of the adverse consequences of these sections applying.

Modification or substitution of contracts between grantor of security interest and transferee

40 The Bill continues to allow an account debtor and the transferor to agree to modify or amend the contract being transferred and for such modification to be effective against the transferee (including a secured party or a receiver). The right of the transferor and the account debtor to make modifications should cease immediately on transfer of the chattel paper and this should be specifically provided for in the Bill.

Enforcement of security interests

41 On reviewing previous drafts of the Bill, the commercial community raised a concern in relation to the proposed requirement that parties 'act in a commercially reasonable manner'. The main reason for the concern was the uncertainty as to what this duty required and the possibility of parties taking advantage of the uncertain wording to frustrate secured lenders in the exercise of their rights in circumstances of default (or otherwise).

42 Although the Committee recommended that this duty be retained, the 2009 Bill has taken account of commercial concerns. The requirement has been narrowed so that instead of applying to all rights, duties and obligations that arise under a security agreement or the Act having to be exercised honestly and in a commercially reasonable manner, the 2009 Bill now provides that this requirement is limited to rights, duties and obligations arising under the enforcement provisions of the Bill (see section 111 of the 2009 Bill).

43 Notwithstanding this, section 131 of the Bill also imposes an obligation on a secured party which is disposing of collateral on enforcement to exercise all reasonable care:

- if the collateral has a market value at the time of disposal, to obtain at least that market value, or
- otherwise, to obtain the best price that is reasonably obtainable at the time of disposal, having regard for the circumstances existing at that time.

44 Although this duty is consistent with section 420A of the *Corporations Act*, it does raise the question as to how this duty works together with the general duty contained in section 111.

45 Section 118 continues to provide the opportunity for a secured party who holds a security interest in personal property to disrupt enforcement of another secured party's security interest in that property (after having decided to enforce such interest in accordance with the provisions of land law). It is unclear whether the secured party with a security interest over the relevant personal property may only request a judicially supervised sale in respect of the personal property or also in relation to the land. This needs to be clarified.

46 Section 120 provides that in relation to securities held in liquid assets (being an account, chattel paper or negotiable instrument), a subsequent ranking security holder must, prior to seizing the collateral, provide notice to any prior ranking security holders and provide the higher ranking security holder with ten days prior written notice of the date on which the subsequent security holder intends to seize the property. The higher ranking security holder then has a period of time in which to notify the subsequent security holder that the higher ranking security holder will seize the property. If such notice is given the subsequent ranking security holder cannot take the action proposed. The Bill is unclear as to the consequence of the higher ranking security holder not providing such notice. Does this mean it loses its priority over the liquid asset? Once again, this appears to be inconsistent with the priority rules in Chapter 2. In addition, no mention is made of the possibility of such

rights being qualified by an appropriate priority deed. Both of these need to be clarified.

47 Similarly, if two security holders hold collateral and one security holder (being the lower ranking security holder) seeks to seize the secured property on enforcement, the higher ranking security holder may at any time issue a notice to the enforcing party requiring the enforcing party to give the higher priority party possession of the seized collateral (section 127). This provides no certainty to the subsequent ranking security holder as to its ability to enforce. In addition, the higher priority party who is given possession after notifying the enforcing party to do so, must pay the enforcing party any reasonable expenses paid or incurred by the enforcing party in relation to the enforcement of the security.

These amounts rank ahead of moneys owing to the higher priority security holder (although the amount payable is limited to the lesser of the amount of such expenses or the amount of proceeds from the higher priority party's disposal of the collateral). This provision can result in the higher priority security holder postponing its recoveries to the subsequent holder (enforcing party) and again should be specifically qualified by reference to any priority arrangements. In addition, the higher priority security holder should not have to make such payments if the enforcing party had actual or constructive knowledge of the higher priority party's security interest.

48 Section 130 requires certain notices to be provided by a secured party who proposes to dispose of collateral on default by a debtor. Notice is to be provided not only to the grantor, but also any other secured party with a security interest in the collateral that has a higher priority. The secured parties to whom such notice should be given should be limited to those of which the enforcing party has actual or constructive knowledge. There is no such qualification at the moment.

49 On disposal of collateral, the proceeds received are to be distributed in accordance with section 140. This requires, amongst other things, the reasonable expenses incurred in relation to enforcement to be satisfied. Section 18(5) allows the parties to agree to remove the reasonableness qualification however this is not reflected in the statutory distribution of proceeds waterfall. Section 140(2)(b) should be subject to any contrary agreement. By qualifying it to reasonable expenses, this opens the matter up for litigation and disruption to completion of enforcement procedures.

Registration

50 Under Part 5.3, the Registrar is responsible for giving verification statements (in relation to registration on the Register) to secured parties who must, in turn, give notice of the statements to grantors. We do not understand why the Registrar cannot provide the verification statements to the grantors as well as the secured parties.

51 As mentioned above, the Bill continues to use the concept of subordination rather than priority. Following on from our comment above, the data to be contained in the financing statements to be registered (section 153) should be amended so that item 6 of the table in that section refers to priority rather than subordination.

52 It is unclear why the class of collateral, in respect of which an indication is to be given whether or not the security interest is a purchase money security interest, needs to be regulated. Surely this should apply to any form of collateral in respect of which purchase money has been advanced by the secured party. It should not be limited by regulations.

53 Under section 160, reference is made to the registration time commencing at the moment when the description becomes available for searching the register in relation to the secured party. The register will be noting the name of the secured party, the name of the grantor and details of the collateral. When searching the register, most people will not be searching against the name of the secured party but rather the grantor of the security interest. Accordingly, the registration time referred to in section 160(1) needs to be amended to refer to being able to search the register in relation to the grantor, not the secured party.

54 The Registrar may impose maintenance fees on secured parties under section 168. Failure to pay such fees can result in the Registrar amending the registration and essentially removing the registration or ending its effect. This is a draconian consequence for the non-payment of fees and should be removed. It should be replaced by an ability to charge default interest on the amounts not paid and allowing the Registrar the right to take action to recover such amounts.

55 The grantor of a security may demand the secured party to whom the security interest has been granted to amend the registration in certain ways (section 178). This includes requesting the registration to be removed from the Register. The grantor may also provide a copy of the amendment demand to the Registrar. If the requested amendment is not implemented by the secured party, the Registrar may initiate a process to make the required amendment (including removal of the security interest from the register). Unless the secured party provides submissions to the Registrar indicating why the amendment demand should not be complied with, the Registrar may give effect to the required amendment. The secured party only has a period of five business days after receiving an amendment notice from the Registrar (unless agreed to be extended by the Registrar) to provide such submissions. This period is too short and should be extended to at least ten business days (consistent with other amendments made in the Bill to various periods referred to). These provisions are likely to lead to disputes and litigation. It is unclear what duties apply to grantors in requesting such amendments. Such a request should only be made in good faith and honestly.

Meaning of 'located'

56 Section 235 sets out various rules indicating where personal property is deemed to be located for the purposes of application of the PPS regime. In relation to investment instruments (which includes shares and interests in managed investment schemes), the rule proposed is different to that applicable in the NSW duties legislation. Query whether they should be consistent?

Vesting of unperfected security interests in insolvency

57 The potential adverse impact of the 2008 Bill on lessors was accepted by the Committee, which recommended that consideration be given to improving the

priority of unperfected lessors have against unsecured or other unperfected interests in goods.

58 Our review of the Bill does not indicate that any amendments have been made in relation to the operation of the Bill in relation to lessors. In particular, notwithstanding that a lessor will retain a title to the collateral, should the lessor fail to perfect its security interests by registration prior to the lessee being wound up, entering into administration or, in the case of a natural person, becoming bankrupt, the security interest held by the lessor (essentially being its interest in the collateral) will vest in the grantor (lessee). This adverse consequence will not apply in the case of a PPS lease which does not secure payment or performance of an obligation (which presumably would never be the case), relates only to serial numbered goods and has a period of between 90 days and less than one year in duration.

59 We do not understand why the exclusion from such an adverse consequence is limited to such a narrow circumstance.

60 Although the Bill provides that a lessor will be taken to have suffered damage immediately before the vesting of the security interest in the grantor and may recover compensation from the grantor, this provides little comfort to a lessor who previously was the owner of goods and, under the new regime, will have lost ownership by the mere fact that it had not registered its interest under the PPS system.

61 Whereas under the current law, the lessor would be entitled to repossession of its asset which it could then sell to recover the amounts owing to it, under the 2009 Bill, in the absence of perfection prior to insolvency, all that the lessor will be entitled to is to prove as unsecured creditor for its damage which, in most circumstances, will result in a far lesser recovery than under the current law.

62 There are other provisions which remain in the 2009 Bill which work against the interest of lessors and so it appears that this recommendation of the Committee has not be accepted.

63 The ability of a secured party to recover compensation should not be limited to a consignor, lessor or bailor but to any secured party who is adversely affected by the vesting of security interests provided for in section 267(2).

Provision of information by secured parties

64 Any person with an interest in the collateral may request a secured party to provide certain information (Part 8.4). The secured party only has a period of ten business days in which to respond to the request. The only way to extend the period is to apply to Court. The parties, ie the person making the request and the secured party, should be allowed to agree to extend the period in which to provide the response. If administrative errors are made in answering the request, the secured party is denied various rights. The rights denied include the right to assert that the copy of the security agreement provided is a true copy of the agreement and, if the information provided corrects certain information, the accuracy of the information provided. In addition, if a Court Order is made following an application of a person who made a request to provide the information requiring the information to be provided, failure to

comply with the Court Order may result in the Court extinguishing the security interest to which the request relates.

65 As mentioned above in relation to amendment demands, in making such request, the interested persons should be required to act honestly and in a bona fide manner so as to avoid unnecessary disputes and litigation.

Constructive knowledge

66 The term 'constructive knowledge' is defined in section 297 and continues to provide that if a person would have had actual knowledge of the circumstance if it had:

66.1 made the enquiry that would ordinarily have been made by an honest and prudent person in the first person's situation; or

66.2 made the enquiry that would be made by an honest and prudent person with the first person's actual knowledge in the first person's situation,

that person will be deemed to have constructive knowledge of the circumstance. It is still unclear what is required to satisfy this standard and so ambiguity continues to exist as to the meaning of constructive knowledge.

67 In addition, in continuing with the previous Bill, section 300 provides that a person will not have notice or actual or constructive knowledge about the existence or contents of a registration merely because data in the registration is available for search in the register. This seems to be inconsistent with the whole purpose of having a register and substantially detracts from the circumstances in which a person will have constructive knowledge.