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Dear Sir/Madam

**Submission on Personal Property Securities Bill 2008 Exposure Draft**

**My credentials**

I am a Barrister at the Victoria Bar. I have practised law both in New Zealand and Australia in private practise and also as in-house counsel with Ford Credit Australia Limited and State Bank of Victoria and Commonwealth Bank of Australia. I have had more than 25 years experience in both retail and wholesale finance, consumer finance, equipment and asset financing, project and structured finance both here in Australia and New Zealand.

I was a consultant to the Australian Law Reform Commission on its personal property security reform reference. I also made submissions to the United Kingdom Law Commission on its Company Security Interests reference while at the Commonwealth Bank. I have been a member of the Law Council of Australia's Banking Services Committee for about 20 years and participated its in submissions on the consultation draft Bill. I also drafted the Law Council of Australia's submission to the Attorney-General's Department Consultation Paper.

I have had some experience and exposure to Article 9 and its operation at least in relation to the State of California and to the New Zealand Personal Property Securities Act.

**General observations**

I take this opportunity to express my guarded support for this radical change which I regard as hasty and ill-conceived. The choice to move to an Article 9 regime simply because New Zealand has followed Article 9 and the Canadian variants of it, using the Saskatchewan model, is of particular concern. The United Kingdom Law Commission Report entitled *Company Security Interests* (Law Com No 296) (2005) recommended change to an Article 9 model but the Department of Trade and Industry decided not to implement the proposals because of the lack of consensus, particularly over the floating charge for the second time.

Earlier the Diamond Report (1989) entitled *A Review of Security Interests in Property* was rejected by the Department of Trade and Industry.

Proponents of the PPS laud its unitary approach and simplicity. They argue that the current Australian regime is fragmented and replete with problems because of the lack of a single register and the multiplicity of laws and registers across the Australian jurisdictions. This may be so but these factors have not hampered the financial markets or limited the provision of finance to corporations nor has it affected the provision of finance to consumers. What has restricted finance to consumers has been the consumer protection legislation such as the now repealed hire purchase legislation and moneylenders' legislation.

Australia currently has two main registers for securities. These are the Corporations Act charges register and the chattel security or motor vehicle security register (REV). Other forms of security are registrable on their own registers. These include the Shipping Act in the case of ships, Life Insurance Act, fishing legislation, etc. In the case of shares, these are adequately deal with under the Austraclear system. In the main charges by companies will be registered under the Corporations Act. The majority of other transactions of significance economically relate to motor vehicles and boats (over 90% it is understood) and these are registered under the REVS system.

The object of a security register is to notify security interests in property of the chargor/mortgagor. It is not to provide notice to third parties of the debtors borrowings or for obligations it may owe to others in respect of the use of property such a under a lease or hire purchase arrangement. This sort of information can be obtained from the accounts of a corporation or business. Significantly, the accounting rules require that finance lease obligations must be capitalised in the accounts of a corporation or business. This reason for this is obvious. Proponents of an Article 9 regime believe that the register performs two functions: *first*, the resolution of priorities and *secondly*, notice to creditors. It is believed that the balance sheet of a corporation or business serves the latter function best.

Owners of property under reservation of title arrangements can protect themselves adequately by the use of a trust device. The effectiveness of such a device is borne out by the decision of the High Court in *Associated Alloys v ACN 010 452 106 PL* (2000) 202 CLR 588.

**Single On-line register needed as priority**

What will gain more efficiency is a single on-line national register of security interests. It should be possible to meld into a single register the Corporations Act charges register and the REVS register of motor vehicle securities.

**Complexity of Article 9 regime**

The sheer complexity of an Article 9 scheme is a reason for not moving to it. This is particularly so when unlike the New Zealanders, Australia instead of taking the New Zealand Act and modifying it as a starting point, effectively reinvents the

wheel by taking a blank piece of paper and trying to outdo a number of tried and tested regimes in Article 9, Canada and New Zealand.

**Some problems and issues**

New Zealand has a number of problems recent case law there bears out because of its failure to deal with a number of issues and to ensure that its model was suitable for a jurisdiction that already had the equitable charge and a perfectly satisfactory motor vehicles securities act. Also the New Zealand legislation has not taken into account the 2001 Revision to Article 9. The 2001 Revision to Article 9 has not been completely taken up by a number of the Canadian provinces because of its complexity.

Stakeholders have not been given the opportunity to consider properly the changes and their legal effect because of the haste. Significantly, the Exposure draft has not been annotated as has the New Zealand Act to show the source of the provisions. This has prevented a comparison of the Article 9 provision and the Canadian equivalent. The New Zealand Act refers the reader to the relevant Saskatchewan provision on which the Act is based. This has two consequences. *First*, it enables the reader to have the benefit of the tried and tested overseas model that has been drafted after careful consideration by experienced commercial lawyers. *Secondly*, it enables the reader to reach or access the relevant overseas case law, academic articles and commentaries that have considered identical or almost identical overseas provisions and experience.

Article 9 and the Canadian statutes had the benefit of many years of consideration and input from numerous experts when drafting the original Article 9, its 2001 revision and the Canadian statutes. It is also worth noting that when the Bond Bill was drafted a huge amount of input came from Harry Sigman. Harry Sigman attended both Bond PPS Workshops organised by the late Professor David Allan. Harry Sigman is a member of the American Law Institute and was a member of the drafting committee that was responsible for the 2001 Revision of Article 9.

Significantly, New Zealand modelled its PPS Act on the Saskatchewan legislation that was the product of years of drafting and consultation with experts in the area of secured transactions. By contrast the Exposure Draft is a hastily prepared bill based on the New Zealand Act, updated to take into account the 2001 Revision to Article 9 with a number of quite inexplicable changes brought about by concerns expressed by stakeholders but without detailed consideration by experts. In other words, the Exposure Draft is an attempt to reinvent the wheel by over-engineering a tried and test model, an approach not too dissimilar to that taken by the ALRC that hastily cobbled together its Final Report to meet the Government's timeline.

**Prolixity/ cross referencing and obscure definitions**

The Exposure Draft is characterised by the use of definitions for the sake of them, cross-referencing to sections which rather than simplifying the law adds an extremely high level of complexity and confusion of concepts in a desire to do all things for all men. Striving for precision can only result in errors and a failure

to deal with issues in a simple and clear way with a clear and underlying policy objective.

The Exposure Draft is t be deplored for its complexity, prolixity, new taxonomy, cross-referencing and glaring errors. The question arises is the objective of the Exposure Draft to codify, simplify, improve and make more accessible existing secured lending law in one piece of legislation for easier reference or is it to overly complicate and change the law without considering in detail the consequences of such changes which are in truth a paradigm shift from the comfort of more than 150 years of judicial decisions and legislation. The latter seems to be the case.

The Exposure Draft is replete with unnecessary definitions and long and complex provisions that rather than simplify and clarify add unnecessarily to its complexity and introduce confusion. Examples of this are the definitions of PPS Lease (section 31) and whether a lease secures payment or performance of an obligation (section 30) containing 3 pages of confusing and unnecessary language not to mention errors such as 'merely because it provides . . . an option to renew or to become the owner' – clearly an option to purchase turns a lease into a hire purchase contract. Does the inclusion of this wording mean that a lease with an option to purchase (a hire purchase agreement of the *Helby v Matthews* type) is not a hire purchase contract but a *Lee v Butler* conditional sale contract (where the hirer is obliged to complete the purchase) is a hire purchase contract? If this is the case then the enforcement provisions may only apply to the *Lee v Butler* type.

The reason for including a lease of more than 1 year is a policy choice so that there is no need to make a distinction between a finance lease and operating or true lease. Generally, an operating lease is not a disguised sale as the hirer never pays more than the original purchase price and must return the goods at the end of the lease. A finance lease is otherwise as generally there is a 'nod and a wink' that the lessee can become the owner at the end and he assumes all the obligations of ownerhip. This is the reason why a lessee must capitalise a finance lease in its balance sheet. A hirer under a hire purchase agreement is treated as the owner of the goods for taxation purposes because of the option to purchaser.

Similar problems abound with the definitions of *circulating asset* and *current asset*. These definitions seem to have been included to deal with the floating charge concept which does it sit well with an Article 9 security interest because an Article 9 security interest always *attaches* while at common law the floating charge merely *hovers*. The effect of some of the provisions appears solely to deal with the *Seibe Gorman* and *Re Spectrum* case issues. *Seibe Gorman* had decided more than 25 years ago that it was possible to have a fixed charge over book debts. *Re Spectrum* in the House of Lords reversed this decision because of the lack of control.

Under PPS it is possible to have a security interest over accounts (books debts) if the bank account into which the proceeds of the collected books debts are paid is

controlled or blocked. The Exposure Draft provisions in a round-about way reaffirm this in a prolix and confusing way despite the fact that you can have a security interest over accounts and perfect the security interest by control. Section 50 to 54 seem confusing and otiose.

*Advance* is defined to include the interests costs and charges. These items have never been part of the principal amount (the advance) for which the tacking rules apply. They are always included because they are the costs of getting your money back and therefore run with the advance. New Zealand included this unnecessary provision because of previous problems with s80A of its Property Law Act and the uncertainty of what the word *advance* meant. Article 9 and the Canadian legislation do not contain such a provision.

Two definitions instead of one. The Exposure Draft uses the words *grantor* and *debtor*. Article 9, Canada and New Zealand all use the word *debtor* to refer to the provider of the security interest. It would have been better to stick to debtor and provide that it includes a party other than the debtor who enters into a security agreement or words to that effect. The New Zealand definition of debtor in section 16 is the preferred option.

Similarly, the Exposure Draft's use of the words *tangible property* in place of *goods* is confusing. Goods is a simple and familiar concept without having to substitute in your mind goods every time you read tangible property.

The Exposure Draft also refers to *registration of collateral* when it should refer to registration of a security interest. The register is a register of security interests not assets. Unless a prospective financier is to finance serial numbered goods, the financier will always search for a security interest using the debtor's name. If they involve serial numbered goods both name and serial numbered goods can be searched.

The Exposure Draft also refers to registration as a method of perfection. An Article 9 regime deals with the filing of a financing statement not the registration of a security instrument. An article 9 regime is a notice filing system not a document registration one. Also, registration or notice filing is but one of three methods of perfection, the others being control and possession.

One underlying policy behind an Article 9 regime is the need to have a signed security agreement as it deals with consensual security interests not those arising by operation of law, etc. The Exposure Draft does not clearly articulate the need for a signed security agreement. Contrast Article 9-102(73) that provides that a "security agreement means an agreement that creates or provides for a security interest". Further Article 9-203 refers to conditions that must be meet before a security interest is enforceable against third parties. There registration, control or possession is expressed to be pursuant to the debtor's *authenticated* or signed security agreement. This clarity is absent in the Exposure Draft. The need for signed security agreement seems to have been overlooked. Section 63 and the definitions in section 26 confuse the position.

The requirement for a writing has the effect of repealing the common law relating to part performance and avoids secret security arrangements.

Other departures include the failure to qualify goods as trees which have been *severed* and petroleum or minerals which have been *extracted*. Growing trees, etc are not personal property until severed or extracted in Article 9, Canada and New Zealand (s16).

The Exposure Draft also leaves out fixtures. New Zealand apparently regrets this. The result is that the common law rules will apply. The now repealed Hire Purchase legislation formerly contained rules dealing with part of the problem. The legislation provided that if the agreement was signed before installation the goods did not become a fixture. In Canada and the USA a security interest in a fixture is noted on the land title register. In order to prevent a windfall to a purchaser, something must be done to enable noting of a security interest on a Torrens title register where fixtures are the subject of a security interest. It is unsatisfactory to leave them out so that a purchaser is forced to search both the PPS register and the title register.

A further problem with taxonomy is the classification of personal property into broad sub-categories. It is hard to understand why the Exposure Draft refers to inventory, equipment and consumer property and commercial property (section 26) and then adds confusion by referring to consumer property, commercial property and equipment as well as inventory in sections 63(4) and (5). The reason for the 3 broad categories is broadly because of different priority outcomes not to add definitions and confusion. Commercial property is both equipment and inventory. Article 9, New Zealand and Canadian only use inventory, equipment and consumer property.

The Exposure Draft also refers to property used predominantly for personal domestic or household use in a number of places such as section 149. Contrast this with other legislation such as the Consumer Credit Code that defines a consumer transaction as such. The definition of consumer is broadly the same as is found in other domestic laws and in model international law and conventions. My point is why not follow this and use the expression consumer property. As presently cast consumer property refers to property held by an individual without reference to purpose.

The definition of business day is another example of reinventing the wheel. What is wrong with the definition in the Interpretation Act or what is wrong with a simple definition of business day, *viz:* a weekday other than a public holiday during which the PPS register is open for business.

**Tacking Rules**

A major point of distinction between the current common law security interest regime and PPS is that PPS gives the first to perfect a security interest (whether by registration mainly but including control or possession) priority for all advances including future advances if the security agreement provides for future advances. This has the effect of freezing out later financiers. The late professor

Grant Gilmore (a US academic and one of the fathers of Article 9) referred to this as hogging the register. According to Gilmore the major reason for the purchase money security interest (PMSI) was to allow a super priority to a lender who provided finance under a PMSI. That is where the advance is made and actually used to enable the acquisition.

There are good commercial reasons for the super priority. *First,* the transaction is economically neutral. *Secondly,* to allow the holder of a prior registered security interest-priority would result in the first being unjustly enriched at the expense of the second. These two points are the essential policy arguments for the super priority in Article 9. The policy behind, and operation of, the purchase money security interest under both pre-Article 9 and Article 9 itself are canvassed by Professor Grant Gilmore in his book *Security Interests in Personal Property* (1965), Volume II, chapters 28 and 29.

A further and compelling point is that without this recognised super priority secondary sources of credit would be 'frozen out' unless the debtor could persuade the prior lender with a general security agreement to concede priority for that property. The common law already recognises a PMSI although perhaps in a less certain way.

If the security agreement provides for present and future advances it will have priority for all and will rank from the time of original filing: s107. (see also s115 which deals with transferees who gain priority if the security interest has been continuously perfected).

The upshot of the priority rules is that the first to file *hogs* priority for present and future advances. The rule in *Hopkinson v Rolt* is abolished and the tacking rules codified for Victoria enshrined in s94 of the *Property Law Act* will not apply. The position is the same in NSW and other States that do not have a counterpart of s94 as the common law rules enshrined in s94 will not apply to personal property security interests.

This creates a problem for lenders who take a package of land and personal property as security. The tacking rules will apply for the purposes of land but not for personal property. This is unsatisfactory as it means every lender other than a PMSI holder will need to enter into a priority agreement where both land and personal property are involved. This is because a mortagee of land because of *Hopkinson v Rolt* will have his further advances postponed to a later lender who takes security over that land.

*Hopkinson v Rolt* does not imposes any restriction on further advances clauses but once a prior lender receives notice of a later mortgagee he is *relieved of his obligation to make further advances* because of the grant of the later mortgage unless there is a commitment such a bill facility or there is an obligation owed to a third party.

The theory behind the repeal of the rule in *Hopkinson v Rolt* in PPS is that a secured party with a perfected security interest should be entitled to continue to

make advances to the debtor whether committed to or not, and the onus should fall on the later secured party to pay out the prior secured lender or enter into a priority agreement.

**Conflict of laws**

Sections 80 to 83 of the Exposure Draft contain limited conflicts rules. They differ from the New Zealand PPS Act and the Canadian statutes. The Exposure Draft does not contain a debtor location rule unlike the other jurisdictions. This will create problems for secured lenders who take secuity from corporations and individuals with assets on both sides of the Tasman. The Exposure Draft should follow the New Zealand Act at least to avoid forum shopping.

**Accessions**

New Zealand and the Canadian provinces define accessions to "mean goods that are installed in, or affixed to, other goods" (eg NZs16). In the Consultation Draft this definition was used. Now it is changed to something quite incomprehensible. That is, an addition or replacement is *only an accession if the separate identities are lost.* This almost gets us to commingled goods. What happens to a car steering wheel, new tyres, radio, a tow bar? The Revised commentary (para 8.10) refers to an accession as something melded into the identity of the improved property such that it loses its separate identity. Sounds confusing! If these examples are not accessions what priority rules will apply as ss133 to 137 which deal with improved property possibly will not apply.

**Conclusion**

If the Government's imperative is to move to an Article 9 type regime, then we should take our time, consult widely with experts and make sure we get it right. Financiers have spent a great deal of money having to master new laws, change documents, systems and procedures to cope with Consumer Credit and privacy laws and the Banking Code of Conduct to mention a few major changes over the past 10 to 15 years.

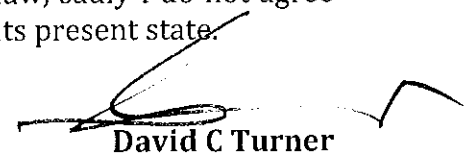
Let's make its simple, clear and relatively easy to master. We do not want an octopus that is unclear, confusing and replete with errors and interpretation and practical problems.

The purpose of this submission is to point out some of the problems so that if it goes ahead in its present form I can simply say, 'I told you so'.

I leave the Select Committee with a quote from the Preface (page x) of Professor Gilmore's book referred to above.

*"In this book I have, at many points, found occasion to point to ambiguities, inconsistencies and mistakes in the drafting of the Article [9]. It should be remembered that the anonymous 'draftsman', whose shortcomings I exhibit, was not infrequently myself. It must be a sobering experience for any draftsman to revisit, in later life, the scene of his youthful crime. It has been so for me."*

Gilmore thought that the Article 9 and the Uniform Commercial Code itself represented a substantial improvement over pre-Code law, sadly I do not agree that the Exposure Draft is a substantial improvement in its present state.



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