***Attorney-General's Department: Response to comments made by Professor Duggan***

> [Duggan, para 4] One example is the special treatment the Bill gives security interests in bank accounts ("ADI accounts"). The provisions in question allow a bank to obtain perfection by control of a security interest in its customer's ADI account and perfection by control trumps perfection by other methods, including registration (s.75).

This issue arises when a depositor with an ADI has given a security interest in the ADI account to both the ADI and another person. Which person should have priority? Apart from its rights under the Bill, an ADI would be able to achieve an effective priority over the other person through its right of set-off in a deposit account held with it. It would be anomalous if an ADI had a super-priority under its right of set-off, but not under the Bill. In order to achieve a consistent outcome under both the right of set-off and under the Bill, the Bill would implement the same outcome regardless of whether the ADI proceeds under its right of set-off or under the Bill.

This is issue has been considered by the United Nations Commission on International Trade Law (UNCITRAL). In giving priority to an ADI in relation to a security interest in an ADI account held with it, the Bill adopts the position recommended by UNCITRAL (see http://www.uncitral.org/pdf/english/texts/security-lg/e/final-final.clean.01-07-09.pdf at page 490, recommendation 103)

Professor Duggan acknowledges that: 'The issue is a controversial one in Canada…'. This issue is controversial in Canada because the Supreme Court of Canada (*Caisse populaire Desjardins de l'Est de Drummond v. Canada*, 2009 SCC 29) has opened up an argument that an ADI may not be able to rely on its right of set-off. Some in Canada have suggested that, if an ADI is unable to rely on its right of set-off to achieve an effective super-priority, the PPS legislation should directly confer the super-priority. The arguments raised by that case will not be relevant in Australia because the Bill provides that it does not affect an ADI's right of set-off (clause 8(1)(d)).

> [Duggan, para 6] The Canadian PPSAs, in common with Article 9, define personal property to include goods (among other things) and they subdivide goods into 3 categories: consumer goods, inventory and equipment. The distinction is central to the scheme of the legislation because different rules may apply depending on the category into which the goods in question fall. … The Australian Bill adopts a different taxonomy. It subdivides personal property (not goods) into two categories, commercial property and consumer property. Commercial property means all personal property that is not consumer property. The Bill also subdivides personal property into inventory and non-inventory personal property. Commercial property includes both inventory and equipment but the Bill makes no reference to equipment as such.

In common with the approach taken in other PPS legislation, the Bill includes special rules relating to consumer property, equipment and inventory (though in some cases the Bill differs on the detail of the rule). However, unlike other PPS legislation, it only makes the distinction when to do so is necessary to achieve a particular policy outcome.

For example, the PPS Bill provides that a registration on the PPS register must indicate whether the registration relates to consumer property or commercial property. This distinction is important because different rules apply to registrations of consumer and commercial property (eg a consumer registration must have an end date not more than 7 years from the registration time, and privacy considerations apply to consumer registrations). When registering a security interest, there is no need to distinguish between registrations relating to commercial property that is inventory and

commercial property that is equipment. The approach taken by the Bill therefore makes it possible to simplify the registration of security interest.

> [Duggan , para 7] Section 47 reflects further taxonomical confusion. It provides that a buyer of low-value personal property obtains clear title if he intends to use them predominantly for personal, domestic or household purposes. The corresponding provision in the Canadian PPSAs is limited to consumer goods and it defines consumer goods to mean goods held predominantly for personal or domestic purposes. The Australian Bill defines consumer property to mean personal property held by an individual for non-business purposes. It is unclear whether the drafters' decision not to limit s.47 by reference to consumer property was a deliberate one and, if so, what it is they were hoping to achieve.

Clause 47 is limited by reference to property that the buyer intends to use predominantly for personal, domestic or household purposes: see the chapeau to clause 47(1).

> [Duggan, para 8] Section 55(4) sets out the default priority rules for competing perfected security interests in the same collateral. Priority turns on the respective "priority times" as defined in sub-s.(5) and sub-s.(6) provides that a time is a priority time for a security interest only if the security interest remains continuously perfected.

Professor Duggan concludes that:

> In principle, SP1 should have priority because SP1 was perfected on Day 2 when SP2 acquired its security interest and so SP2 had the means of discovering SP1's security interest before transacting with Debtor. However, according to s.55(4), SP2 has priority because SP1 was not perfected on Day 4.

However, this is not the position under any existing PPS legislation.

In every jurisdiction, priority among competing security interests is determined by reference to whether the security interests are currently perfected (that is, by reference to whether the security interests are perfected when the question arises, and not by reference to whether one security interest had priority at an earlier time).

In the example given by Professor Duggan, on Day 4, SP2 is a perfected security interest, while SP1 is not perfected. Professor Duggan reaches the correct result when he applies the Bill, and concludes that on Day 4 SP2 has the security interest with the highest priority. On Day 4, the priority between SP1 and SP2 should be determined by the rule at clause 55(3) of the Bill, section 66(a) of the New Zealand Act and section 35(1)(b) the Saskatchewan Act: each of which provide a perfected security interest has priority over an unperfected security interest.

Professor Duggan also reaches the correct result under the Saskatchewan legislation when he says that SP1 should have priority over SP2, though for the wrong reasons. Under the Saskatchewan Act, at section 34(7), when a registration of a security interest is discharged in error, the security interest continues to have priority over a subordinate security interest, provided the error is corrected within 30 days. In the example given by Professor Duggan, in Saskatchewan (but not in New Zealand), on Day 4, SP1's security interest would be deemed to have priority over SP2's security interest despite the accidental discharge of the registration, provided SP1 re-registered within 30 days of the accidental discharge.

Each of the New Zealand Act (at section 66 and 67), the Saskatchewan Act (at sections 35(1) and (2)) and the Bill (at clauses 55(4), (5) and (6)) employ exactly the same strategy for determining the security interest with the highest priority among currently perfected security interests.

When it becomes necessary to determine the priority among currently perfected security interests, the Bill requires the user to identify the priority time for each security interest. The security interest with the earliest priority time has the highest priority. The priority time for a security interest is the earliest time since which the security interest has been continuously perfected. The relevant provisions in the Bill and the New Zealand and Saskatchewan Acts are set out in **Attachment A**.

The principal difference is that the Bill seeks to assist the reader by providing the methodology for determining the security interest with the highest priority, by asking the reader to determine and then compare the priority time for each of the perfected security interests. The Saskatchewan and New Zealand Acts do not provide a methodology. They leave it to the reader to work out what they have to do in order to determine which security interest has the highest priority. In not providing a methodology, the Saskatchewan and New Zealand Acts make it easier for the user to fall into error in determining priority among competing security interests.

The Bill includes one error in clause 54(5)(c). This provision should refer to the time that the secured party, or another person on behalf of the secured party, first takes possession **or control** of the security interest. The additional words 'or control' were included in the Bill previously considered by the Committee, but were omitted in error in an attempt to align the drafting with that in section 66(b)(iii) of the New Zealand Act.

> [Duggan, para 9] In Canada and the United States, the rule is that the purchase-money security interest has priority even if it is later in time, but the conditions are that the holder of the purchase money security interest must … serve a notice on the holder of the competing security interest warning of its purchase-money security interest. The Australian Bill omits the notice requirement. Instead, it provides that the purchase-money security interest financing statement must disclose that the security interest is a purchase-money security interest.

In common with the New Zealand Act, the Bill does not require the holder of a purchase money security interest to serve a notice on an earlier competing registered security interest. A requirement to serve a notice on earlier registered competing security interests would be an onerous obligation for small businesses.

Consideration is being given to allowing the registrant for the earlier competing registered security interest to indicate to the PPS Registrar, when registering its security interest, that it would like to be notified whenever a later registration against the grantor includes a purchase money security interest. The result would be that the PPS Registrar would provide the notice to the earlier registered secured party, and not the secured party claiming the purchase money security interest.

> [Duggan, para 10] Section 64 provides for the case where a secured party has a security interest in Debtor's accounts as original collateral and another secured party claims the accounts as proceeds of inventory subject to a purchase money security interest.

Professor Duggan goes on to note that the Bill provides an opportunity for a secured party claiming the security interest as original collateral to have priority over an earlier registered secured party as proceeds of inventory subject to a purchase money security interest. Professor Duggan accurately describes the effect of clause 64 and the outcomes it seeks to achieve.

Clause 64 was included in all the earlier versions of the Bill, including the version previously considered by the Senate Committee (though employing different words).

Professor Duggan is correct in noting that the PPS legislation in no other jurisdiction (including the USA) includes a provision along these lines. Clause 64 has been strongly endorsed by the Australian Finance Conference.

> [Duggan, para 11] Previous drafts of the Bill defined registration by reference to registration of the collateral, rather than the security interest. This approach is open to criticism for the reasons set out in Part 3(c) of my submission to the previous inquiry. The new draft corrects the problem: registration is now defined to mean a registered financing statement with respect to a security interest (s.10). … However, vestiges of the previous fallacy remain.

Professor Duggan refers to clause 151, which provides as follows:

> **151 Registration—belief that collateral secures obligation**
>
> (1) A person must not apply to register a financing statement, or a financing change statement, **describing collateral,** unless the person believes on reasonable grounds that the collateral secures, or will secure, an obligation (including a payment) owed by a debtor to the person described in the statement as the secured party. (emphasis added)

Clause 148(1) of the Bill provides that the register is to contain 'data in registrations'. A registration may relate to a security interest, and also to personal property prescribed by regulations (see clause 8, definition of 'registration'). Consideration will be given to prescribing motor vehicles that are subject to a police 'hoon lien' or to a proceeds of crime order. This would allow a person searching the register to discover whether a motor vehicle or other property is subject to a police 'hoon lien' or to a proceeds of crime order. The existing State REVS arrangements provide a facility along these lines.

In referring to a financing statement 'describing collateral', the Bill ensures that the belief required by that clause is only required when the registration describes collateral (that is, that the registration relates to a security interest), and that the belief is not required when the registration relates to, for example, a police 'hoon lien' or to a proceeds of crime order.

Professor Duggan makes a similar criticism of clause 160(1), which provides as follows:

> **160 Registration time—general**
>
> (1) A description of collateral starts to be registered in a registration with respect to a security interest, in relation to a particular secured party, at the moment (the ***registration time***) when the description becomes available for search in the register in relation to that secured party.

However, clause 160(1) is relevant only in relation to registrations relating to security interests, and does not apply to registrations relating to, for example, a police 'hoon lien' or to a proceeds of crime order. As with clause 151, the reference to 'collateral' confines the effect of clause 160 to security interests.

Professor Duggan also notes that:

> On a related matter, the Bill is inconsistent in its references to the subject-matter of a security interest: sometimes it uses the expression "collateral" (defined in s.10) (*e.g.*, ss 151, 153, 160), while at other times it refers to the personal property to which the financing statement relates (*e.g.*, s.152) or "personal property" described in a registration (s.161). In the interests of both

> clarity and verbal economy, it would be better to use the expression "collateral", as defined in s.10, throughout.

These variations in language also reflect the fact that some clauses relate to security interests and so refer to collateral (eg clauses 151, 53 and 160); while others (eg clause152) relate to registrations for both security interest and other interests (such as a police 'hoon lien' or to a proceeds of crime order) and therefore employ different language.

> [Duggan, para 12] The new [conflict of laws] provisions are similar in many respects to the conflict of laws provisions in the Canadian and New Zealand PPSAs, but there are some differences. For example, s.239 (3) provides that, with respect to a security interest in intellectual property, the governing law is the law of the jurisdiction under which the intellectual property is granted, whereas in Canada the governing law is the place of the debtor's location.

The Department agrees that the conflict of laws provisions established by the Bill with respect to intellectual property differ from those established under both the New Zealand and Canadian legislation.

In general terms, owners of intellectual property favour the position taken by the Bill, while providers of finance prefer the position taken by the New Zealand and Canadian legislation. The Independent Film and Television Alliance, which represents owners of intellectual property, supported the position taken by the Bill at the Committee's first inquiry into the Bill.

Whether security interests in intellectual property should be governed by the law of the grantor or the law of the intellectual property is currently being considered by UNCITRAL (see http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html ). The Department considers that it is unlikely that UNCITRAL will be able to reach a consensus conclusion on this question. The arguments for and against each result are discussed at http://daccessdds.un.org/doc/UNDOC/LTD/V09/808/23/PDF/V0980823.pdf?OpenElement.

Professor Duggan goes on to comment that:

> Likewise, with respect to a security interest in an ADI account, the governing law is the law of the jurisdiction that governs the ADI account (s.239(4)), whereas in Canada, the rule is that the law of the jurisdiction in which the debtor is located applies.

In New Zealand, the result is the same as in Canada. Neither New Zealand nor Canada consider the position of an ADI account as a special case. Rather, the outcome for ADI accounts follows from the general rule that applies to intangibles. This question has also been considered by UNCITRAL, though without reaching a consensus (see http://www.uncitral.org/pdf/english/texts/security-lg/e/final-final.clean.01-07-09.pdf at page 517, recommendation 210). The position reached by the Bill should reduce compliance costs for the ADI, because all of the security interests in its accounts would be governed by the same law.

Professor Duggan goes on to comment that:

> Section 240 enacts a single set of rules for security interests in financial property, whereas the Canadian PPSAs have different rules depending on whether the security interest is a possessory or non-possessory one.

The New Zealand Act also includes different rules for security interests in financial property depending on whether the security interest is possessory (see section 26(1)) or non-possessory (see section 30(c)).

Contrary to the suggestion made by Professor Duggan, in common with both the New Zealand and Canadian legislation, the Bill also includes different rules depending on whether the security interest is possessory (see clauses 240(1) and (4)) or non-possessory (see clauses 240(3) and (5)).

> [Duggan, para 13] Section 275 provides for the making of follow-up inquiries by register searchers. For example, it allows the searcher in certain circumstances to ask the secured party to provide a copy of the security agreement. Section 275(9) lists the persons entitled to make such requests. The list does not include a prospective secured party.

Professor Duggan has accurately described the effect of clause 275 of the Bill. He has suggested that it should be possible for a prospective secured party (SP2) to obtain information from an existing secured party (SP1) without the debtor's agreement. He notes that:

> Instead, SP2 must enlist Debtor to make the request on its behalf which may involve additional transactions costs.

The Department does not express an opinion on whether a prospective secured party should be able to obtain information from a debtor's creditors without the prior agreement of the debtor. However, it notes that a provision of this kind would be at variance with the privacy protections currently included in the Bill.

> [Duggan, para 14] Section 339 is a convoluted provision that makes heavy weather of a relatively minor job. The purpose of the provision is to make it clear that references in other legislation to a floating charge include the new PPSA equivalent.

The Department notes that clause 339 has been drafted with the intention that it should reflect the existing law. The Department considers that the drafting proposed by Professor Duggan would represent a substantial departure from the existing law, and would not be supported by stakeholders.

> [Duggan, paragraph 15] The enforcement provisions in Chapter 4 of the Bill do not apply if the debtor is in receivership (s.116).

Professor Duggan accurately summarises the effect of clause 116.

The Bill adopts a position comparable to that in New Zealand: where section 106 of the New Zealand Act provides as follows:

> **106 Part not to apply to receivers**
>
> This Part does not apply to a receiver within the meaning of section 2(1) of the *Receiverships Act 1993*.

Consultations undertaken by the Department since 2006 have contemplated that the enforcement provisions of the Bill would not apply in circumstances in which the existing corresponding provisions of the Corporations Act apply. Australian stakeholders have generally supported this outcome. See for example the submission by Clayton Utz.

***Priority among conflicted perfected security interests***

**55 Default priority rules**

54(4) Priority between 2 or more security interests in collateral that are currently perfected is to be determined by the order in which the priority time (see subsection (5)) for each security interest occurs.

(5) For the purposes of subsection (4), the priority time for a security interest in collateral is, subject to subsection (6), the earliest of the following times to occur in relation to the security interest:

(a) the registration time for the collateral;

(b) the time the secured party, or another person on behalf of the secured party, first takes possession of the collateral;

(c) the time the security interest is temporarily perfected, or otherwise perfected, by force of this Act.

(6) A time is a priority time for a security interest only if, once the security interest is perfected at or after that time, the security interest remains continuously perfected.

The corresponding provision in the PPSA (NZ) provides:

**66 Priority of security interests in same collateral when Act provides no other way of determining priority**

If this Act provides no other way of determining priority between security interests in the same collateral:

(a) …

(b) priority between perfected security interests in the same collateral (where perfection has been continuous) is to be determined by the order of whichever of the following first occurs in relation to a particular security interest:

(i) the registration of a financing statement;

(ii) the secured party, or another person on the secured party's behalf, taking possession of the collateral (except where possession is a result of seizure or repossession);

(iii) the temporary perfection of the security interest in accordance with this Act;

**67 Original method of perfection applies to continuously perfected security interest**

For the purposes of section 66, a **continuously perfected security interest** is to be treated at all times as perfected by the method by which it was originally perfected.

The New Zealand provision is based on the PPSA (Saskatchewan) s35(2), which provides:

**Residual priority rules**

35(1) Where this Act provides no other method for determining priority between security interests:

(a) priority between conflicting perfected security interests in the same collateral is determined by the earliest of the following occurrences;

(i) the registration of a financing statement without regard to the date of attachment of the security interest

(ii) possession of collateral pursuant to section 24 without regard to the date of attachment of the security interest; or

(iii) perfection pursuant to sections 5, 7, 26, 29 or 74;

…

(2) For the purposes of subsection (1), a **continuously perfected security interest** is to be treated at all times as perfected by the method by which it was originally perfected. (emphasis added)