



# Personal Property Securities Reform



## Personal Property Securities Bill 2008

### Revised Commentary

December 2008



Australian Government Attorney-General's Department

# **Personal Property Securities Bill 2008**

## **Revised Commentary**

**December 2008**

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## GLOSSARY

A selection of key concepts is provided to assist readers with the explanatory material.

### *Accessions*

An accession is an item of tangible personal property that is installed in, or affixed to, other personal property and has lost its separate identity as a result of being installed or affixed.

### *Account*

An account is an obligation to pay an amount of money to another person. It includes 'book debts' but does not include negotiable instruments, investment instruments, investment entitlements or chattel paper.

### *ADI account*

An ADI account is an account held with an authorised deposit taking institution such as a bank.

### *Advance*

An advance is the payment or obligation that is secured by a security interest. It also includes the debtor's liability to pay costs associated with the enforcement of the security interest.

### *After-acquired property*

After-acquired property is personal property acquired by the grantor after the security agreement is created, arises or provided for.

### *Attachment*

Attachment describes the successful creation of a security interest in personal property that can be enforced against that personal property. Attachment is a prerequisite for creating an enforceable security interest in personal property. A security agreement which has not attached would create merely personal or contractual rights between the parties.

### *Bailment*

A bailment involves the delivery of tangible personal property to another party who holds possession of it. A bailment does not transfer ownership rights in the property and the bailor has the right to take possession of the property at any time or in accordance with the terms of the bailment.

### *Chattel paper*

Chattel paper is one or more writings that show the existence of both a monetary obligation and a security interest in or lease of specified tangible property or a security interest in intellectual property or an intellectual property licence. It does not include a negotiable instrument, an investment instrument, an investment entitlement or a document of title. An example of chattel paper is a hire-purchase agreement.

### *Circulating assets*

A circulating asset is an asset that can be used or transferred in the ordinary course of business even if it is subject to a security interest. Circulating assets include currency, negotiable instruments, inventory and certain types of accounts, except where the secured party has possession or control of them.

### *Collateral*

Collateral is personal property that is subject to a security interest although collateral may be registered on the PPS Register prior to the security interest attaching.

### *Commercial consignment*

A commercial consignment occurs when tangible property is delivered to a consignee for sale, lease or disposal and the consignor retains an interest in the property. The consignor and consignee must deal in tangible property of that kind in the ordinary course of their businesses. For the purposes of the Bill, deliveries of tangible property to auctioneers for sale are excluded. A floor plan financing arrangement is an example of a commercial consignment.

### *Commingled property*

Commingled property means tangible property that has become part of a product or mass and has lost its original identity in the product or mass. Examples of commingled goods are the ingredients used to make processed food products, such as the flour and yeast used to make bread.

### *Consumer property*

Consumer property is personal property that is held by an individual and which is not used in the course of an enterprise to which an ABN has been allocated.

### *Control*

Control is one way of perfecting a security interest in controllable property.

### *Current asset*

A current asset is currency, a negotiable instrument, an ADI account (other than a term deposit) or inventory.

### *Debtor*

A debtor is a person who owes payment or performance of an obligation that is secured by a security interest in property, or a transferee of, or successor to, such an obligation. A debtor is often, but not always, the grantor of the security interest.

### *Future advances*

A future advance is the payment of currency, the provision of credit, the giving of value or the performance of an obligation by the secured party and which is secured by the security interest.

The advance occurs after the security agreement has been assented to in writing or has otherwise arisen. Future advances include enforcement costs.

#### *General financier*

A general financier is a person who in the ordinary course of their business provides finance to another person, secured against all of that person's present and after acquired personal property (even if the security interest is subject to specific exceptions).

#### *Grantor*

A grantor is the person who has the interest or right in personal property to which a security interest has attached. This person may also be a consignee of a commercial consignment, a lessee under a PPS lease, a transferor of an account or chattel paper or a transferee or successor of any of the above.

#### *Intangible property*

Intangible property is personal property that has no physical existence, such as an account or chose in action. Intangible property includes all personal property that is not tangible property, chattel paper, documents of title, investment instruments, investment entitlements, currency or negotiable instruments.

#### *Inventory*

Inventory is personal property used in the ordinary course of a business by a business with an ABN. It includes property that is held for sale or lease, provided under a contract for services, held as raw materials or work in progress, or held, used or consumed as materials by the person.

#### *Intellectual property*

Intellectual property is a right (or rights) in a design, patent, trade mark, plant breeders' right, circuit layout or copyright that arises under Commonwealth legislation.

#### *Inventory financier*

A person who in the ordinary course of their business provides finance to another person and that finance is secured against personal property held as inventory.

#### *Investment entitlement*

An investment entitlement is one or more rights of an investment entitlement account holder that arise from the crediting of a financial product to the account. The rights include, but are not limited to, rights to dividends and voting rights.

#### *Investment instrument*

An investment instrument is a financial product such as a share, stock, bond, derivative, interest or unit in a managed investment scheme, traded financial product, assignable option, foreign exchange contract that is not derivative or other product as prescribed. Negotiable instruments, investment entitlements and documents of title are excluded.

*New value*

New value means value other than value provided to reduce or discharge an earlier debt or liability.

*Original collateral*

A person has a security interest in personal property as original collateral when the security interest attaches to the personal property otherwise than as proceeds.

*PPS Register*

The Personal Property Securities Register would be established by the Personal Property Securities Act. Secured parties would be able to register personal property to which a security interest is or will be attached, and other persons would be able to search the PPS Register to identify personal property to which a security interests may be attached.

*Perfection*

Perfection means that a security interest has attached to collateral and is effective against third parties. A security interest may be perfected by registration, possession, control, temporary perfection or a combination of these methods. Perfection provides some protection against purchasers of the collateral. It is also necessary to determine the priority between competing security interests and a perfected security interest would always have priority over an unperfected security interest.

*Personal property*

Personal property is any form of property, other than land or a right or entitlement under a Commonwealth, State or Territory that declares that the right, entitlement or authority is not personal property for the purposes of the PPS Bill.

*PPS lease*

A lease or bailment of tangible property, where the lessor or bailor regularly engages in the business of leasing or bailing tangible property, for a term of more than one year, an indefinite term, a term of less than one year that is renewable or a term of up to one year where the lessee or bailee retains possession after one year. Where tangible property may or must be described by a serial number, a PPS lease need only be for a term of 90 days, a term of less than 90 days that is renewable or a term of less than 90 days where the lessee or bailee retains possession for at least 90 days.

*Priority*

Priority is used to rank competing interests in collateral. In general terms, the priority time for a security interest is when the security interest was perfected, or if the perfection is by registration, when the registration was made. For unperfected interests, the priority time would be the time the security interest attaches to the collateral.

### *Proceeds*

Proceeds are the identifiable or traceable personal property derived directly or indirectly from dealing with collateral or the proceeds of collateral.

### *Purchase money security interest (or PMSI)*

A purchase money security interest is a security interest in collateral created by: a seller who secured the obligation to pay the purchase price; a person who provided the value to purchase the collateral; the interest of a lessor or bailor under a PPS lease; or the interest of a consignor who delivers property under a commercial consignment. A PMSI confers 'super-priority' on the secured party.

### *Receivables financier*

A receivables financier is a person who buys accounts receivable (book debts) for new value in the ordinary course of their business (also known as a factor). A person may be a receivables financier even if the receivables are not the proceeds of inventory.

### *Registration*

A registration is data recorded on the PPS Register, on application by a secured party or their agent, as required by the PPS Act and Regulations. Some registrations would be made by government officials to record other interests in property such as confiscation orders made under proceeds of crime laws and 'hoon' liens.

### *Secured party*

A secured party is a person who holds a security interest in collateral. In a registration on the PPS Register, a secured party includes the person registered as such even though they may not hold a security interest in the collateral described in that registration.

### *Security agreement*

A security agreement is an agreement or other act (such a deed of execution or a declaration of trust), or a writing evidencing such an agreement or act, that creates, arises or provides for a security interest.

### *Security interest*

A security interest is any interest in personal property which is created by an agreement that secures the payment or performance of an obligation, without regard to the form of the transaction. Other interests in personal property are deemed to create a security interest such as the transfer of rights in an account or chattel paper, the rights of a lessor or bailor under a PPS lease and the rights of a commercial consignor. Some arrangements are excluded such as licences, prescribed interests and other interests to which the Act does not apply (including security interests in water rights and turnover trusts).



*Temporary perfection*

Temporary perfection provides automatic temporary protection to a secured party for a limited period. It would apply in a range of circumstances, for example, where collateral is moved to Australia, converted into proceeds; or transferred to another party.

*Trust Receipt*

A written agreement under which a financier loans money for the acquisition of property and the debtor promises to hold the property in trust for the benefit of the financier and to keep the property, as well as any proceeds, separate from its own property until the loan is repaid. Trust receipts allow importers to take possession of property for sale before paying the financier.

*Turnover trust*

An agreement between a junior creditor and senior creditor under which the junior creditor pays amounts received from their mutual debtor to the senior creditor. Failing payment by their mutual debtor, the junior creditor holds amounts received on trust as security against the amount owed by the mutual creditor to the senior creditor.

*Writing*

Writing includes the recording of words or data in any way (including electronically), or the display or other representation of words or data by any form of communication that is recorded in any way (including electronically) if, at the time that it was made, it was reasonable to expect that the words or data would be readily accessible so as to be useable for subsequent reference.

## 1. INTRODUCTION

This commentary provides a guide to the Exposure Draft Personal Property Securities Bill 2008 (the Exposure Draft PPS Bill). The Department hopes that the commentary will provide useful information to newcomers to PPS reform as well as those who have been closely involved in PPS reform over an extended period. The commentary includes a short history of the reforms, a synopsis of the key elements of the Bill and a more substantial commentary outlining the individual provisions. The revised Exposure Draft PPS Bill and this commentary draw upon an extensive consultations undertaken over a three month period following the release of a consultation draft Bill by the Attorney-General, the Hon Robert McClelland, on 16 May 2008.

1.2. The Exposure Draft PPS Bill does not contain any conflict of laws provisions. Instead, the common law would apply to resolve disputes that have an international dimension. The Department considers that this approach creates uncertainty and therefore invites people to consider the proposed model set out in Appendix A. The model is based on overseas PPS laws that acknowledge and draw upon the prominence of registration as a method of public alert to the existence of a security interest.

### *What is a personal property security?*

1.3. Many Australians are affected by personal property securities laws—as buyers of property that is or may be subject to an encumbrance; as consumer or business borrowers who, for example, borrow money to buy a new car or to expand their businesses; as investors who might be contemplating buying into a business whose assets are heavily geared or owned by others; or as financiers who provide the funds to facilitate such activities.

1.4. A personal property security is created when a financier takes an interest in personal property as security for a loan or other obligation, or enters into a transaction that in substance involves the provision of secured finance. Paradigm examples of personal property securities include car loans and company charges.

1.5. Early securities took the form of legal mortgages. Over time, the concept has extended to a variety of transactions such as hire purchase and lease arrangements, conditional sale agreements, commercial consignments, the factoring of book debts and retention of title arrangements. More sophisticated financing options have emerged, and will continue to emerge.

1.6. Personal property is any form of property that is not land or buildings. It includes tangible property such as motor vehicles, machinery, office furniture, currency, artworks and stock-in-trade. It covers crops and livestock, and extends to fixtures (such as an indoor fire sprinkler or PABX telephone system), accessions (like an engine that is affixed to a boat) and commingled goods (such as steel rods transformed into machinery). It also includes intangible property such as contract rights, uncertificated shares and intellectual property rights (for example, trademarks and patents).

1.7. Personal property securities have extensive reach throughout the community so that all Australians will benefit from PPS reform.

### ***Why is PPS reform necessary?***

1.8. In recent decades, strong international trade growth, technological advance and deregulation of financial markets have hastened the development of a modern, sophisticated domestic economy and finance sector. However, Australian finance law has failed to keep pace with these changes.

1.9. Current finance law is characterised by a complex network of regulation developed over time by Commonwealth, State and Territory parliaments and courts. It is built on artificial distinctions around the legal form of the security taken, the legal personality of the grantor and the nature and location of the collateral. There is now widespread recognition that such considerations are immaterial to the substance of secured transactions.

1.10. To meet the demands of a competitive economy, Australian finance law must be reorientated around the rights of parties to enforce their interests in personal property in the event of a debtor default. The essential concern should be about who gains priority where competing interests exist. The law should not be seized by concerns about whether a grantor is an individual or a company, whether the property is wool, contract rights or a motor vehicle, or the location of that property.

1.11. Australian finance law imposes unnecessary red tape on consumers and businesses. In some cases, a security interest must be registered in more than one jurisdiction and on multiple registers to be fully effective. Some registers are electronic, while others are paper-based. In other cases, there is no registration scheme to provide notice of personal property interests to prospective buyers and lenders. This situation is confusing and inefficient. It results in unnecessary compliance and transaction costs for all parties.

### ***Australia's history with PPS reform***

1.12. Australia's history with PPS reform demonstrates long held support, and a sound basis, for change. Reforms have been flagged on several occasions dating back to the early 1970s with more robust proposals surfacing in the 1990s. During that period, Australian law reform bodies produced two significant discussion papers advocating reform. To further debate, the Australian Law Reform Commission circulated a draft Bill.

1.13. In April 2006, the Standing Committee of Attorneys-General (SCAG) commenced a new round of reform discussions with the release of an options paper. The paper called for public comment about the level of support for, and possible focus of, PPS reform. Following strong public interest, the Department issued three further discussion papers outlining detailed reform proposals in November 2006, March 2007 and April 2007. Responses to the various papers showed strong stakeholder support for reform and resounding approval for the development of a single national law that focuses on the substance of secured transactions.

1.14. The PPS project is being overseen the Council of Australian Governments and SCAG in consultation with other key Ministerial Councils. The Department has also convened a specially constituted PPS Consultative Group to guide the reform process. The Consultative Group, which meets quarterly, comprises experts drawn from industry, governments, consumer groups, legal practitioners and academia.

1.15. On 16 May 2008, the release of a consultation draft PPS Bill by the Australian Attorney-General bolstered further support for PPS reform. This milestone signalled real progress to Australian governments, industry, consumers and public interest organisations.

1.16. To generate debate and further interest in the reforms, the Department conducted series of public seminars in Sydney, Melbourne, Perth and Brisbane. The seminars were well attended, with over 500 participants in total. Speakers were drawn from industry, law firms, academia and the Department. After these seminars, Departmental representatives participated in various forums conducted by State and Territory Law Societies and industry organisations. The Department also conducted one-to-one discussion with various stakeholders on request, and maintained a website for providing information about the reforms to members of the public.

1.17. The formal consultation period on the consultation draft PPS Bill closed on 15 August 2008. Within a short period of the close, the Department has received over 60 submissions from industry, professional firms, public interest organisations, members of the public and government organisations. Many of the submissions contained suggestions and observations that led to amendments being made to the Exposure Draft PPS Bill.

1.18. Following the consultations, the Department released a Discussion Paper on the Regulations to be made under the PPS Act. The consultation period for this paper commenced on 29 September 2008 and closed on 17 October 2008. Many of the regulations proposed concern the operation of the PPS Register, but also some key concepts such as the meaning of 'motor vehicle' and serial numbered property, which are important for special rules governing extinguishment and registration requirements. The Department received over 60 submissions on the Discussion Paper, each of which informed its view of aspects of the PPS Bill.

1.19. The Discussion Paper on the Regulations to be made under the PPS Act is available at [http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews\\_personalpropertysecuritiesreform\\_PPSTDownloads](http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_personalpropertysecuritiesreform_PPSTDownloads).

### ***Key features of the Bill***

1.20. Consistent with PPS reforms implemented in New Zealand, Canada and the USA, the Bill would apply to all security interests in personal property. Other key objectives are to remove the uncertainty arising from the vast amount of Commonwealth, State and Territory legislation and the uneasy interaction of statutes, the common law and equitable legal principles. The new arrangements would apply consistently throughout Australia. They will be less complex than the existing arrangements, and lower costs for all parties involved in personal property securities transactions.

1.21. The Bill would establish rules for creating valid security interests as well comprehensive and coherent rules governing the priority of competing security interests (including where property or security interests are transferred). These rules would be complemented by provisions that establish when a person acquires personal property free of a security interest, such as where the transaction occurs in the ordinary course of business or in relation to low value consumer goods. A streamlined and effective enforcement regime has also been developed to supplement contractual arrangements in this area. Finally, the new regulatory regime would be underpinned by a modern, technologically

advanced register that would provide advance notice to the world of any prospective or actual security interests taken in personal property.

1.22. The Bill is modelled on the laws of New Zealand, Canada and the USA. It draws on work by the United Nations Commission on International Trade Law (UNCITRAL) and the International Institute for the Unification of Private Law (UNIDROIT). The differences between the Bill and its international counterparts reflect issues raised by stakeholders, differences in the Australian consumer and commercial environment, advances in information technology, and drafting styles adopted to improve legal certainty and consistency with Australian drafting practices.

1.23. The Bill would preserve the operation of the Consumer Credit Code.

1.24. It would create a PPS regime that would benefit individuals and consumers by delivering more certain, consistent, less complex and cheaper arrangements applying in relation to personal property securities.

1.25. Since the release of the consultation draft PPS Bill in May 2008, the Department has initiated a number of changes to reflect modern financing practices and stakeholder concerns. These are set out in Appendix A. Some important themes were to ensure that:

- investment products supported Australia as an emerging global financial centre with innovative financial products,
- enforcement arrangements are simpler and better recognises the interests of higher order priority holders, and
- issues that impact upon the operation of State and Territory Governments are appropriately addressed.

## **2. OUTLINE OF THE EXPOSURE DRAFT PPS BILL 2008**

This outline of the Exposure Draft Personal Property Securities Bill 2008 provides a ready reference guide to the provisions of the Bill and a summary of the key outcomes to be achieved by the Bill.

### ***Overview***

2.2. The Bill would establish a single national law governing security interests in personal property. In broad terms, it would address the creation and extinguishment of security interests in personal property and set out rules for determining priority among competing interests in personal property. Operating alongside the Consumer Credit Code, the Bill would outline the circumstances in which, and the procedures to be undertaken to, enforce a security interest in personal property upon debtor default. Importantly, it would also establish a single national online register of personal property securities (the PPS Register). The new national registration system would help prospective purchasers and lenders determine whether personal property is or may be subject to a security interest and would facilitate the resolution of priority disputes.

2.3. The Bill is based on the New Zealand *Personal Property Securities Act 1999* but has been modified in the light of the Australian consumer and commercial setting, to take best advantage of technological advances, and to promote greater clarity in Australian law. Drafting of the Bill has also been influenced by personal property securities legislation in Canada and the United States.

### ***Constitutional application and relationship of the Bill with other laws***

2.4. It is proposed that the Bill would rely on various Commonwealth constitutional powers and be supported by a text based referral of power from all States pursuant to paragraph 51(xxxvii) of the Commonwealth Constitution. In the absence of a referral of power by one or more of the States, the Bill would still apply in those States except as to transactions between solvent individuals. The Bill would operate outside Australia to the extent permissible under section 51 of the Constitution.

2.5. The Bill deals with its interaction with other laws, particularly conflicting State and Territory laws as well as the general law. The Bill specifies circumstances under which other laws would prevail over it or limit the application of certain provisions. A State or Territory law would be able to expressly exclude a licence, right, entitlement or authority created by or under a State or Territory law from the application of the Bill. The Bill also specifies when other laws do not prevail over it, for example, in terms of registration requirements, formal requirements relating to agreements, assignment and the attachment and perfection of security interests.

### ***Application of the Bill to security interests***

2.6. The Bill would apply to transactions involving personal property that secure payment or the performance of an obligation, apart from some limited exceptions. The adoption of a functional approach means that the Bill would apply to most security interests in personal property regardless of the form of the transaction, the nature of the debtor or the jurisdiction in which the property or parties are located or in which the transaction occurred.

2.7. The Bill would apply to tangible and intangible property as well as certain writings evidencing rights (such as documents of title, negotiable instruments and letters of credit). Some transactions would be deemed to be security interests, regardless of whether the transaction secures the performance or payment of an obligation. These include the transfer of accounts and chattel paper, commercial consignments, and certain leases or bailments for terms of 90 days or more.

2.8. The Bill would not apply to a tradeable water right or a water access entitlement within the meaning of the *Water Act 2007* or tangible property that is affixed to land. Other notable exclusions include non-consensual charges and liens, turnover trusts, netting, combination and set-off arrangements, transfers of future wages and unearned rights to payment, transfers of insurance claims and certain interests arising under the *Bankruptcy Act 1966*.

### ***Enforceability, attachment and perfection of security interests in personal property***

2.9. A security agreement would be effective according to its terms and could provide for future advances and interests in after-acquired property. It would be enforceable between the parties upon attachment of a security interest in the collateral.

2.10. Generally, a security interest would attach to personal property when the grantor has transferable rights in the collateral and the secured party has given value or the grantor has done an act by which the interest is created or arises such as declaring a trust or executing a deed. An interest would attach to after-acquired property upon the acquisition of that property as the notion of crystallisation at default would become redundant. The parties to a security agreement would be free to vary the time of attachment by written agreement.

2.11. A security agreement would only be enforceable against third parties when the security interest has attached to the collateral and the secured party has possession and/or control of the collateral or where the security agreement is in writing and signed, and the collateral is properly described. An oral security agreement would be enforceable between the parties, but not against third parties such as a liquidator, administrator or trustee in bankruptcy. This is an important issue for inventory suppliers who might not be accustomed to reducing supply agreements to writing.

2.12. Perfection would occur when a security interest has attached to personal property and the secured party has taken possession and/or control of the property or registered it on the PPS Register. The Bill would provide short term 'temporary perfection' following certain events such as a transfer of collateral from one grantor to another and where collateral has become proceeds, is returned to the grantor or debtor, or is commingled with other property. It contains special perfection rules dealing with bailees, and security interests in negotiable instruments, investment instruments, returned property and crops.

2.13. The Bill would provide that a security interest can be 'continuously perfected' by different methods over time (or even at the same time) provided that it is perfected at all times throughout the relevant period. This concept is important for determining a secured party's priority when the security interest is to be enforced.

2.14. Where collateral is transferred or disposed of prior to enforcement, the Bill would provide that a security interest continues in the transferred collateral as well as the proceeds of collateral. The value secured by the security interest would be limited to the value of the collateral immediately before the dealing.

### ***Acquiring personal property free of security interests***

2.15. The Bill would establish a number of circumstances in which a security interest may be extinguished in respect of personal property generally as well as specifically for motor vehicles. The provisions set out alternative means of extinguishment, which have concurrent operation. Where a security interest in tangible property is extinguished, any security interest in any intellectual property relating to that tangible property would also be extinguished.

2.16. Generally, the Bill would provide that third parties take personal property free of a security interest in circumstances where the personal property is:

- subject to an unperfected security interest,
- purchased in the ordinary course of business, or from a motor vehicle dealer,
- serial numbered and a search of the PPSR by the serial number immediately before the transfer would not have disclosed the registration (the day and a half rule),
- not serial numbered, is predominantly used for domestic purposes and its value at purchase, and the price paid for it, are below \$5,000,
- money, an investment instrument or investment entitlement,
- a constitutional security interest (that has ceased being a non-constitutional security interest), or
- temporarily perfected.

2.17. In most cases, where a security interest is extinguished, the Bill would require that when the third party acquires the interest, the third party give new value and have no knowledge of the security interest, or no knowledge that the transaction was a breach of the security agreement. The term 'knowledge' would encompass actual knowledge as well as (constructive) knowledge that would ordinarily be obtained by an honest and prudent person making enquiries. The knowledge of bodies corporate can be proven by reference to the knowledge of an employee or agent.

2.18. The Bill would establish that in any proceedings in an Australian court, the onus of proving that a security interest has attached to personal property and was perfected by registration rests with the person asserting those facts. Further, the onus of proving that a person has acquired an interest in property free of a security interest perfected by registration would rest with the person asserting those facts. The Bill would contain rebuttable presumptions that a purchaser who acquired an interest in property and was related to the seller, did not give value and had knowledge of the relevant security interest or breach of the security agreement.

### ***Priorities between security interests in personal property***

2.19. The Bill would establish general and specific rules for determining priority among competing security interests in the same property.

2.20. The general rules would provide that:

- a perfected security interest would have priority over an unperfected security interest,
- a security interest perfected by control would have priority over security interests perfected by other means (including registration on the PPS Register),



- where the above rules do not resolve a competition between security interests:
  - as between two or more security interests perfected by control, priority would be determined by the order that the interests were perfected by control,
  - as between two or more security interests perfected other than by control, priority would be generally determined by the order of continuous registration and/or possession, and
  - as between unperfected security interests, priority would be determined by the order of attachment of the security interests.

2.17. The transfer of a security interest would not affect the priority of that interest.

2.18. The Bill would provide that when a security interest in collateral attaches to proceeds, enforceability and priority over the proceeds would be the same as for the original collateral.

2.19. The Bill would maintain the parties' freedom to vary the outcome of the statutory priority rules through subordination agreements. Future advances (that is, money lent after the security agreement has been signed) would have the same priority position as other advances.

2.20. In the event that collateral is transferred by the debtor to another person, the Bill balances the interests of the secured party against the interest granted by the transferee in the collateral. In general terms, the original security interest would have priority if the secured party re-registers against the transferee within 5 business days of becoming aware of the transfer, or within 24 months of the transfer. This rule is intended to provide an incentive for secured parties to monitor the collateral.

2.21. A priority rule for 'purchase money security interests' (or PMSIs) would give priority to a secured party who provides new value to enable the grantor to acquire the collateral. A secured party with a PMSI would have a 'super-priority' in the collateral, that is, the PMSI would generally prevail over other security interests provided that the PMSI is perfected by registration and notice has been provided to all other secured parties who have a registration describing the property. As an example of the operation of the PMSI rule, an inventory financier could assert priority over a general financier's earlier registered interest in the same property.

2.22. The Bill recognises the special nature of negotiable instruments, chattel paper and documents of title. It also deals with priority between security interests and other interests, such as interests arising under a law in the ordinary course of business, those of an execution creditor, security interests held by authorised deposit-taking institutions and interests in returned goods.

2.23. The Bill would contain special rules for crops and livestock under which priority would be given to an otherwise subordinate interest where value is given for the purpose of growing, feeding or developing the crops or livestock. A pre-existing security interest in real property would not be prejudiced by these rules.

2.24. The Bill contains priority rules for accessions and commingled goods. For accessions, the default rule would provide that a security interest in an accession would have priority over a security interest in the whole property unless an exception applies. There would be two exceptions, namely, where the interest in the accession is unperfected and where a person purchases the property and the security interest attaches to the accession after having been installed or affixed. For commingled goods, the Bill provides that a security interest that exists in tangible property

would carry over into the new product where, through assembly, commingling or manufacturing, the identity of the tangible property is lost.

***Enforcement of security interests in personal property***

2.25. The Bill would set out the processes for enforcing a security agreement following debtor default. These would operate in conjunction with enforcement provisions in the Consumer Credit Codes and security agreements between the parties. In exercising rights and remedies provided by the enforcement provisions, a secured party may only deal with collateral to the same extent as the grantor would be entitled to deal with the collateral. The parties to a security agreement would be able to contract out of a number of the enforcement provisions in the Bill.

2.26. In the event of a default, any secured party would be able to initiate enforcement action regardless of their priority. However, a lower-ranking secured party who enforces against the collateral would be required to meet those obligations owed to higher-ranking secured parties, including enforcement costs, before satisfying any obligations owed to it. Where the secured party is unable to determine the amount of proceeds, or the order of application of proceeds, the enforcing secured party would be required to pay the undistributed amount to the Commonwealth to be held in a special account created for this purpose.

2.27. The Bill would provide remedies in relation to tangible and intangible property. A secured party would be able to collect and apply liquid collateral such as money, accounts, negotiable instruments and investment property.

2.28. Where the property is not liquid collateral, enforcement would entail two steps: possession and disposal of the collateral. The secured party would be entitled to dispose of the property through sale or lease, and may decide to purchase or retain the collateral. An objection process would enable the debtor and/or other interested parties to prevent self-purchase or retention by a secured party. Self-purchase is only available in respect of commercial property.

2.29. In all cases, a secured party would be required to observe notice requirements. The grantor and other secured parties who have a registration describing the collateral must be notified of impending enforcement action. For PMSIs, there would be a requirement to notify lower ranking secured parties, such as a general financier. A person entitled to receive notice of disposal (including the debtor) would have an opportunity to redeem the collateral. A person would also be entitled to reinstate the security agreement on one occasion.

2.30. All remedies are subject to a duty on the enforcing party to act in a commercially reasonable manner. Where disposal occurs by sale, the secured party would have an additional duty to obtain at least the market value of the good or otherwise the best price reasonably obtainable in the circumstances. A secured party may only purchase collateral at a public sale for the market price of the collateral.

2.31. Where a secured party undertakes enforcement action, security interests held by the grantor, the enforcing secured party and subordinate interest holders at the time of disposal or collection would cease to subsist in the collateral.

2.32. A secured party may seize, and purchase or dispose of a licence only in accordance with the terms and conditions of the licence and as provided under a law of the Commonwealth, a State or a

Territory. This would prevent a secured party from dealing with the collateral in a way that was not consistent with the way the grantor was entitled to deal with the collateral. This is particularly important where the collateral is a licence granted under State or Territory laws for services to be performed or provided (such as taxi and bus services).

### ***Registration of security interests in personal property***

2.33. The Bill would provide for a Register of Personal Property Securities to be established and maintained by a Registrar of Personal Property Securities. The Register would be operated at all times subject to limited exceptions.

2.34. The Register would contain registrations of personal property made on the application of secured parties before or after the parties have entered into a security agreement or a security interest has attached to the property. A person must not apply for a registration of personal property (or an amendment to a registration) unless they have reasonable grounds to believe that a security interest has, or will be granted in the property.

2.35. A registration would include the following information about an item of personal property: the secured party's details, the grantor's details, an address for service of notices on secured parties (usually an email address), a description of the collateral and proceeds, the period of registration, the existence of subordination agreements, amendment details, any matter prescribed by the Act or regulations and a reference number provided by the secured party. Much of this detail would be set out in regulations. Property would be described as commercial or consumer property. Some property would have to be identified on the register by a serial number affixed to the property (for example, motor vehicles, boats and aircraft used for consumer purposes).

2.36. A collateral registration would be registered from the moment that it becomes available for search on the Register. The period of registration would be 7 years for consumer property and serial numbered property, and 25 years or indefinite for commercial property, extendable by amendment. Secured parties could amend collateral registrations, including by adding or omitting property.

2.37. A registration would be ineffective where it contains a seriously misleading error or if the registration is affected by a specified defect such as where the registration is not disclosed by a search of the PPS Register: by reference to the grantor's details or a serial number where required; or in other prescribed situations. However, where an effective registration becomes defective because of an event external to the PPS Register, such as where a grantor has a name change, the secured party would have a grace period to cure the defect.

2.38. A debtor or other person with an interest (other than a security interest) in property would be able to demand that the secured party end the registration of particular collateral in accordance with the demand. If the secured party fails to amend the registration within a period of the request, the person may apply to the Registrar or a court to have the registration amended or discharged.

2.39. The Registrar would be empowered to remove data in other circumstances such as where the data is frivolous or vexatious or for purposes prohibited by the regulations. This power would be subject to a 'show cause' procedure allowing the secured party time to respond to the Registrar's proposed action. The Registrar would also be empowered to amend, remove or archive old data.

Where the Register is amended or data is restored, corrected or removed, the Registrar must send a verification statement to the secured party who, in turn, must send a copy to the grantor.

2.40. The Bill would provide for AAT review of discretionary decisions by the Registrar such as a decision to refuse to give effect to an application for a collateral registration or to remove data.

2.41. The Bill would provide that the Register can be searched for authorised purposes upon application provided the person has paid a search fee or has made an arrangement with the Registrar for the payment of fees. Written search results would be admissible as evidence in a court of tribunal as proof of the matters stated in those results.

2.42. A person must not search the register or use data obtained from the PPS register for an unauthorised purpose. To do so would constitute a failure to discharge an obligation to the person whose personal information was inappropriately accessed or used, and would allow individuals to complain to the Privacy Commissioner as though under the *Privacy Act 1988*. Such action may also give rise to a claim for damages.

### ***Transitional arrangements***

2.43. The Bill would set out transitional provisions necessary to facilitate the operation of the Bill when enacted. In general terms, the transitional provisions would:

- set up a legal framework for the transfer of data from existing registers to the newly created PPS Register, and
- provide special priority rules for security interests existing before the Bill is enacted and comes into force.

2.44. The Bill would preserve the priority position of migrated security interests that arise out of security agreements entered prior to its enactment. For those interests that arise out of pre-PPS Act security agreements that are not migrated, there would be a 24 month transition period within which a secured party may choose to register in order to protect their priority position.

2.45. The transitional provisions are supported by the same referral of legislative power from the States as the remainder of the Bill.

### 3. SECURITY INTERESTS: GENERAL PRINCIPLES

#### *Security agreements*

The parties to a security agreement are free to draft their security agreement according to their needs, subject to the laws of the Commonwealth, State or Territory (except as mentioned in Subdivision C, Division 3 of Part 1.2)(section 58, section 19 ).

3.2. A security agreement may provide that the security interest secures payments made or obligations incurred before or at the same time as the agreement is made. Alternatively, the parties may agree that the security interest would secure payments made or obligations incurred after the agreement is made (section 60(2)). A security agreement would only secure future advances if it provides for this.

3.3. The security agreement can also provide that the payments and obligations that it secures are secured against property that is acquired by the grantor after the agreement is made (section 59(1)).

#### **Example**

DealerA grants a security interest to BankA to secure 'all accounts owed by DealerA to BankA from time to time' against DealerA's 'all present and after acquired ride-on mowers'. When the agreement is made, DealerA has 5 ride-on mowers, to which the security interest attaches. DealerA later acquires another 10 commercial ride-on mowers as inventory, which DealerA finances through a further \$10,000 advance from BankA. DealerA's total liability to BankA is now \$20,000. BankA's security interest will secure the \$20,000 owed against any ride-on mowers held by DealerA, including those acquired after the security agreement was made.

#### *Security interests*

3.4. A security interest is an interest in personal property provided for by a transaction that secures the payment or performance of an obligation (section 28). In determining whether or not an interest is a security interest, the Bill takes a functional approach to determine whether a security interest exists rather than focusing on the form of the transaction or the identity of the grantor.

3.5. Certain kinds of transactions would create security interests provided that they secure the payment or performance of an obligation, for example: a fixed charge; a floating charge; a chattel mortgage; a conditional sale agreement; a hire-purchase agreement; a pledge; a trust receipt; a consignment; a lease of tangible property (including a PPS lease); an assignment and a transfer of title (section 28(2)). It is important to note that these kinds of transactions (such as a pledge) do not include a security interest unless they secure payment or performance of an obligation.

3.6. A licence is not a security interest (section 28(4)). For example, a licence granted by an owner of copyright is not a security interest. However, the licensee may be able to grant a security interest in the licence. The right, entitlement or authority conferred by a licence would not be a licence for the purposes of the Bill unless the right, entitlement or authority is transferable by the licensee (whether or not the right etc is exclusive and whether or not a transfer is restricted or requires the licensor's consent). A licence does not include a right etc granted under legislation if

that legislation declares that the right is declared not to be personal property under the Bill (section 40).

### *Deemed security interests*

3.7. Security interests can also include the following interests or rights where the transaction does not secure payment or the performance of an obligation:

- (a) interests or rights of a transferee in a transfer of accounts or chattel paper,
- (b) interests or rights of a lessor or bailor under a PPS lease, and
- (c) interests of consignor under a commercial consignment.

3.8. These interest or rights are all deemed to be security interests for the purposes of the Bill (section 28(3)).

3.9. Deeming these interests to be security interests would ensure that the basis on which grantors have possession of personal property is transparent and does not form a basis of 'false wealth' held by the grantor.

3.10. The deeming provisions would also ensure that debtors cannot avoid the functional approach of the Bill by structuring transactions as leases or commercial consignments instead of as chattel mortgages.

3.11. The deeming provisions would also make it possible to determine the priority between these deemed security interests and other security interests, for example the priority between the transferee of an account and an inventory financier who claims the account as inventory proceeds (section 111).

3.12. The enforcement provisions in the Bill would not apply to these transactions (section 149(1)).

### *Attachment of security interests*

#### *Attachment distinguished from perfection*

3.13. A security interest attaches to personal property when:

- (a) the grantor acquires an interest in the property or the power to transfer rights in the interest to the secured party (even if this power is subject to limitations, such as the requirement of the consent of another)(section 61(1)(a)), and
- (b) the secured party provides value for the security interest or the grantor creates the security interest (section 61(1)(b))(value is defined as any consideration that is sufficient to support a contract (section 26, definition of 'value')).

3.14. The time of attachment of a security interest to the collateral is important because once the security interest attaches to the collateral, the grantor's rights in the collateral are limited by the rights of the secured party and the secured party acquires enforceable rights against the collateral.

3.15. But attachment must be distinguished from perfection. A security interest that is merely attached is enforceable against the grantor, while a security interest that has been perfected would be enforceable against any third parties who claim a competing interest in the collateral. It would be important to know when attachment occurred because a security interest would be unperfected unless it had attached to the collateral (section 62).

3.16. A security interest over collateral is perfected once the security interest has attached to the collateral and the secured party provides public notice of its security interest by either:

- (a) registering its security interest in the collateral, or
- (b) taking possession of the collateral, or
- (c) temporarily perfecting its security interest in the collateral, or
- (d) taking control of collateral that is controllable property (section 64).

3.17. Attachment and perfection can occur in any order (section 64(3)).

### ***Time of attachment***

3.18. Unless the parties specify otherwise in a security agreement, a security interest would attach when the requirements for attachment are satisfied. The parties can agree to postpone the time for the attachment of a security interest (section 61(2)), but any reference to ‘floating charge’, without any specific agreement, does not mean that the parties have agreed to postpone attachment (section 61(2)).

3.19. For the purposes of property which is:

- (a) leased to a (lessee) grantor,
- (b) consigned to a (consignor) grantor, or
- (c) sold to a (purchaser) grantor under a conditional sale or retention of title agreement,

the grantor is deemed to have an interest or right in the tangible collateral when the grantor obtains possession of the property (section 61(4)). This provision is required because the grantor would not have rights in the collateral for the purposes of section 61(1)(a).

### ***Perfection of security interests***

3.20. Perfection of a security interest provides important protection for a secured party against third parties with competing interests or rights in the collateral. When a security interest is perfected, a secured party is able to enforce their security interest against a third party asserting a competing interest in the property – although it is important to note that some forms of perfection take priority over others.

3.21. A security interest can be perfected in one of the following ways:

- the property is in the control or possession of the secured party (section 64(2)(a)(i) and (b)), (definition of control or possession, sections 43 to 49), or

- the personal property is registered on the PPS Register (section 64(2)(a)(ii)), or
- the security interest is temporarily perfected under sections 69 or 74 (section 64(2)(a)(iii)).

3.22. A security interest would be continuously perfected provided it is perfected at all times in one of these ways (section 65). This is important for the purpose of determining the priority time for a security interest. A time is the 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.

3.23. Perfection of a security interest also requires that the security interest be attached to the property (section 64(1)), although the security interest does not have to attach prior to perfection (section 64(3)). For example a security agreement could be concluded after the registration of a security interest.

#### **Example 1**

A security interest attaches to the collateral on 1 January. The collateral is registered on 1 February, and remains effective from then. The security interest is perfected on 1 February and the priority time will also be 1 February.

#### **Example 2**

The collateral is registered on 1 February. The security interest attaches on 1 March. Although the security interest is perfected on 1 March, the priority time is 1 February.

3.24. Perfection may occur without the collateral being registered on the PPS Register if the secured party has possession or control of the collateral. In the case of tangible property, possession by the secured party would be a sufficient act of public notice to perfect a security interest and in the case of controllable property, control by the secured party would provide sufficient public notice to perfect a security interest.

3.25. Temporary perfection is also important for determining the priority between competing security interests. A security interest may be temporarily perfected without the need for registration of the security interest or possession or control of the collateral in the following cases:



- (a) collateral moved to Australia—temporary perfection after move (section 81),
- (b) collateral moved to Australia—effect of previous perfection (section 82),
- (c) proceeds—perfection when not covered by registered description (section 70),
- (d) transferred collateral—temporary perfection after transfer (section 73),
- (e) tangible property possess by bailee—temporary perfection while negotiable instrument in transit (section 75),
- (f) tangible property possessed by bailee—return to grantor or debtor for dealing (section 76),
- (g) negotiable and investment instruments—return to grantor or debtor for dealing (section 77), and
- (h) account or chattel paper in returned tangible property—security interest (section 79).

3.26. A single registration of collateral may perfect more than one security interest and multiple registrations of collateral may perfect the one security interest (section 66).

#### *Enforceability of security agreements against third parties*

3.27. A security interest is enforceable against a third party only if the security interest has attached to the property (section 63(1)).

3.28. In addition, enforcement against third parties requires that the security interest be perfected (section 63(2)).

3.29. These requirements ensure that it is possible to identify the secured property, that the grantor has consented to the security interest and that third party creditors are on notice that the collateral is subject to a security interest.

3.30. The description of the collateral can either:

- (a) describe the particular personal property,
- (b) refer to the grantor's present and after-acquired property, or
- (c) refer to the grantor's all present and after-acquired property, except for particular personal property (as described)(section 63(3)(b)).

3.31. A description of collateral as 'consumer property', 'consumer goods' or 'equipment' would not be effective to attach a security interest to property unless the personal property were described more particularly by reference to the item or class (section 63(4)).

3.32. If personal property gives rise to proceeds, the security agreement would be enforceable against a third party in respect of the proceeds even if the agreement does not include a description of the proceeds (section 63(6)).

3.33. When collateral is described as ‘inventory’, the security interest is enforceable against the personal property only while that property is held as inventory (section 63(5)).

3.34. Where a registration of tangible property perfects a security interest in property and the exercise of the secured party’s rights would necessarily involve the exercise of intellectual property rights (including under an intellectual property licence), the description of tangible property in a security agreement, notice or registration would be taken to include a description of those intellectual property rights (section 38(1) and (2)).

3.35. This is subject to the parties indicating a contrary intention in the security agreement, registration or notice (section 38(3)).

#### **Example**

GrantA owns a factory that produces car parts using robots. The only thing that the robots can do is manufacture those particular car parts. The process employed by the robots to manufacture the car parts relies on an invention. GrantA is the registered owner of the patent for that invention. GrantA approaches a bank for a loan, offering the robots as security for the loan. The security agreement gives BankA a security interest in any robots used by GrantA in any enterprise it operates in its factory. Neither the bank nor the owner think of specifically including the intellectual property rights associated with the robots in the description of the collateral.

Some time later GrantA defaults under the security agreement. BankA seeks to enforce the security interest. The exercise of BankA’s rights under the security agreement would necessarily involve exploiting the patent rights exploited by the robot in the car part manufacturing process. As the parties did not indicate a contrary intention in their security agreement, BankA’s security interest in the robots would include the intellectual property rights required by BankA to enforce its rights under the security agreement.

3.36. A security agreement may be enforceable against a third party in relation to particular collateral even if it is not enforceable in relation to other collateral covered by the security agreement (section 63(7)).

## 4. ATTACHMENT AND PERFECTION: PARTICULAR SITUATIONS

The Bill provides special rules for attachment and perfection in relation to particular types of collateral, dealings with the collateral which give rise to proceeds and transfers of the collateral to third parties.

### *Attachment of security interests to after-acquired property*

4.2. Under the common law, it is not possible to have a security interest in future property without specific appropriation of that property following its acquisition by the debtor (appropriation is an act by the grantor indicating an intention that an interest in the property should pass to the secured party). Without appropriation, the security interest holder would only acquire an equitable interest in the property, which would be subordinate to the interest of a purchaser or mortgagee of the property who had no notice of the interest.

4.3. The Bill would achieve a similar outcome but without the existing complexity in the common law and equity. A security agreement would be able to provide for security interests in after-acquired property (section 59). The common law requirement of appropriation in relation to after-acquired property would not apply so that where a security agreement provides for a security interest in after-acquired property, the security interest would attach to that property without specific appropriation (section 67).

4.4. For a security agreement to be enforceable against a third party in respect of the debtor's after-acquired property, the security agreement would need to include an appropriate description of the collateral (section 63(3)(b)). It would be sufficient for the security agreement to describe the collateral as 'all after-acquired property' or 'all after-acquired property except' specified collateral.

4.5. There are two exceptions to the rule that a security interest attaches to after-acquired property without specific appropriation by the debtor (section 67(3)).

4.6. The first exception is designed to protect consumers. A security interest cannot attach to after-acquired property acquired predominantly for a personal, domestic or household purposes (section 26, definition of 'predominantly') unless:

- (a) the security interest is a purchase money security interest (for example, finance provided to purchase a motor vehicle),
- (b) the security agreement provides for security interests in tangible property and accessions and the after-acquired property becomes an accession to the property (for example, when a security interest attaches to a motor vehicle and a stereo is later installed in the vehicle).
- (c) the after-acquired property replaces property to which the security agreement relates (for example, when the property is replaced under a warranty agreement with the seller) (section 67(3)(b)).

4.7. This exception broadly corresponds to the prohibition in the Consumer Credit Code against consumer mortgages in after-acquired property (Consumer Credit Code, section 41).

4.8. The second exception allows regulations to be prescribed in the regulations to ensure that the exceptions are consistent with those in the Consumer Credit Code.

***Dealings with collateral subject to security interests***

4.9. The Bill retains the common law principle that a person cannot give better title than he or she holds. The principle means that security interests would mostly survive unauthorised dealings in the original collateral by the debtor.

4.10. In some cases, when a grantor transfers collateral to a third person, it may be necessary to determine whether the security interest continues to be attached to the collateral.

4.11. A security interest would not continue in transferred collateral where the Bill specifies that a transferee would acquire the collateral free of the security interest (Part 3).

4.12. A security interest would not continue in collateral after a dealing that gives rise to proceeds when the secured party has given express or implied authority for the transfer to be made free of the security interest (section 68(3)).

***Attachment of security interest to proceeds***

4.13. A security interest cannot be enforced against proceeds unless it attaches to those proceeds (section 69(1)). The attachment of a security interest to proceeds ensures that the secured party has rights in the proceeds as against the grantor.

4.14. A security interest in original collateral would attach to the proceeds arising from a dealing in the collateral, unless the security agreement provides otherwise (section 68(2)(b)).

4.15. The proceeds of collateral must be identifiable or traceable personal property derived directly or indirectly from either:

- (a) a dealing with the collateral (or proceeds of the collateral)(section 42(1)(a)),
- (b) a right to an insurance payment or other payment as indemnity or compensation (section 42(1)(b)),
- (c) a payment to discharge or redeem the collateral where the collateral consists of chattel paper, intangible property, an investment instrument, an investment entitlement or a negotiable instrument (section 42(1)(c)), or
- (d) rights arising out of property collected or distributed from an investment instrument or investment entitlement (section 42(1)(d)).

4.16. 'Identifiable' proceeds are defined as particular items of personal property that arise from a dealing in the collateral by the debtor. There is also existing common law on the definition of 'traceable' proceeds.

4.17. Livestock are not the proceeds of collateral merely because they are the unborn young, or the offspring, of collateral in livestock (section 42(3)). A security interest would include the offspring of livestock when the collateral description includes after-acquired livestock.

*Enforcement against collateral and proceeds*

4.18. A secured party can enforce their security interest against either or both the collateral or the proceeds (section 68(4)).

4.19. When the secured party proceeds against both the collateral and the proceeds, the amount recovered would be limited to the market value of the collateral immediately before the collateral gave rise to the proceeds unless, at the time of the transfer, the transferee knew that the transfer was in breach of the security agreement (section 68(5)).

4.20. When the secured party proceeds against the collateral alone, the innocent purchaser would have rights against the transferor to recover the consideration they have provided.

4.21. When the secured party proceeds against the proceeds alone, the innocent third party would be able to retain the collateral. The Bill would allow the innocent third party retain any increase in the value of collateral after the dealing, when the secured party elects to proceed against both the collateral and the proceeds.

*Perfection of proceeds when original collateral perfected by registration*

4.22. As is the case with original collateral, a secured party would only have priority over competing security interests in proceeds, depending on the nature of the perfection of the security interest.

4.23. A security interest in proceeds would continue to be perfected by an existing registration if the description of the original collateral also describes the proceeds (section 69(2)(b)) or the description includes a description of proceeds which is sufficient for an original registration of the proceeds. This depends on the description of the collateral registration and whether the definition of proceeds is sufficient for the registration of original collateral or the proceeds are of a class that is covered by the registered description of the collateral (section 69(2)).

4.24. For this reason, a secured party whose registration describes the collateral as all the grantor's present and after acquired property, would have a perfected security interest in proceeds held by the grantor. If proceeds are a type of property which requires description by serial number, it is unlikely that perfection would be continued as the description of the original collateral would not include the serial number of the proceeds.

4.25. A security interest in proceeds would continue to be perfected when the proceeds are in the form of currency (section 69(3)(a)) or the right to an insurance payment or any other payment as indemnity or compensation for loss or damage to the collateral or proceeds (section 69(3)(b)).

### ***Perfection of proceeds not otherwise perfected***

4.26. A security interest in proceeds that is not continuously perfected by these rules, and that arises from a perfected security interest, would have the benefit of temporary perfection.

4.27. The security interest in the proceeds would continue to be perfected until the end of 5 business days after the collateral gave rise to the proceeds (section 70(2)).

4.28. During this period of temporary perfection the secured party can arrange for the continuous perfection of the security interest after this period by perfecting their interest by one of the usual methods of perfection (section 70(3)).

### ***Perfection of tangible property possessed by bailee***

4.29. Tangible collateral may be held by a bailee. In this situation, provided that the security interest has attached to the collateral, the security interest may be perfected by either:

- (a) the secured party registering the collateral in the usual way (section 74(1)(b)(i)),
- (b) the bailee taking possession of the collateral on behalf of the secured party (section 74(1)(b)(ii)),
- (c) the bailee issuing a negotiable or non-negotiable document of title to the collateral in the name of the secured party (section 74(1)(b)(iii)), or
- (d) the secured party having a perfected security interest in a negotiable document of title issued by the bailee (section 74(1)(b)(iv)). One of the ways in which a secured party can perfect its security interest in the document is by taking possession of the document of title.

#### **Example**

BankA finances DebtA's purchase of portable steel toilets manufactured in Melbourne. DebtA is located in Sydney, so DebtA arranges for the toilets to be freighted to Sydney. The carrier issues a negotiable document of title and forwards this to BankA. Once BankA receives possession of the negotiable document of title, it has perfected its security interest in the toilets.

4.30. Where the secured party is not able to take possession of the document, the Bill provides a period of temporary perfection. If a secured party takes possession of the document of title within five business days of its issue, they are deemed to have possessed it and the security interest is deemed to be perfected from the moment it was issued (section 75(2)).

4.31. Where it is necessary for the bailor to return the property or the document of title to the grantor for them to sell, exchange or prepare for sale or exchange (section 76(5)), the security interest would be temporarily perfected for 5 business days provided that the security interest was perfected by:

- (a) the bailee's possession of the property, or
- (b) the secured party's possession of the negotiable document of title.

4.32. This 5 day temporary perfection period gives the secured party time to perfect their interest in the property in another way (in effect this would be by registration). During that period, the security interest remains enforceable against third parties (section 76(4)).

### ***Perfection of interests in collateral returned to the grantor***

#### *Negotiable instruments and investment instruments returned to grantor or debtor for dealing*

4.33. When a security interest in a negotiable or investment instrument is perfected by control or possession, and is given to the grantor or debtor for sale, exchange, presentation, collection, renewal or registration (section 77(5)), the security interest would remain temporarily perfected for 5 business days thereafter (section 77(2)).

4.34. Provided that the secured party perfects their interest in some other way within that 5 day period, the security interest would remain continuously perfected and enforceable against third parties and the security interest's priority is protected (section 77(4)).

#### *Perfection of security interests in returned tangible property following sale or lease*

4.35. Where a person acquires an interest in collateral free of security interests but the grantor regains possession of the property as a result of:

- (a) the original contract of acquisition being rescinded or cancelled,
- (b) the transferee seizing the property to enforce the security agreement,
- (c) the grantor repossessing the property to enforce the contract of acquisition,
- (d) a lease expiring or being rescinded (section 78(1)),

provided that the obligation remains unpaid or unperformed (section 78(2)) and the security interest was effective and perfected by registration prior to acquisition (section 78(3)(b) and (c)), the security interest would reattach to the returned collateral.

4.36. The perfection of the security interest is determined as if the interest in the tangible property had not been acquired (section 78(3)).

#### *Perfection of security interests in accounts or chattel paper in returned property*

4.37. A transferee of an account or chattel paper (created by a contract of acquisition) would be deemed to have a security interest in returned goods if the contract of acquisition is later rescinded or annulled (section 79).

4.38. If a transferor transfers an account or chattel paper to a third party (section 79(1)) and the tangible property which is the subject of the chattel paper comes back into the possession of a transferor or transferee where:

- (a) the contract of acquisition is rescinded,
- (b) the transferee seizes the property to enforce the security agreement,
- (c) the transferor enforces the contract by repossessing the property,
- (d) the lease expires or is rescinded (section 79(1)(d)),

the transferee would have a deemed security interest in the property to secure the payment of the account (section 79(2)(a)) or the monetary obligation in the chattel paper (section 79(2)(b)). The security interest is deemed to attach to the property at the time of possession (section 79(3)).

**Example**

DealerA sells flaring and beading machines on credit to PurchaserA. DealerA sells the proceeds of these transactions, in the form of accounts to DiscountA. DealerA gives notice to PurchaserA to pay DiscountA under the credit agreement. The flaring and beading machines turn out to be defective and PurchaserA rescinds the contract and returns the machines to DealerA. DiscountA acquires a security interest in the machines to secure the payment of the balance of the account.

4.39. If the transferee has a security interest perfected by possession or registration, then the security interest is temporarily perfected for 5 days after possession starts (section 79(4)). At the end of 5 days, the security interest would be unperfected unless perfection occurs in another way before the end of those 5 days (section 79(5)).

***Collateral moved to Australia***

*Collateral moved to Australia—temporary perfection*

4.40. Where collateral is located in a foreign jurisdiction and is moved into Australia and, immediately prior to being moved, a security interest was attached to the collateral and continues to be attached to the collateral, the security interest would be temporarily perfected from the time of relocation until the earlier of:



- (a) 5 days thereafter (if the collateral was unperfected), or
- (b) in cases where the collateral was perfected in the foreign jurisdiction:
- (c) 56 days after relocating the collateral in Australia,
- (d) 5 business days after the secured party acquires actual knowledge of the relocation,
- (e) the time when the security interest is no longer perfected in the foreign jurisdiction (section 82(2)),
- (f) The security interest becomes unperfected at the end of the temporary perfection period and is taken never to have been perfected unless it is perfected within the temporary perfection time period (section 82(3)).

*Collateral moved to Australia where previously perfected*

4.41. If the security interest is perfected in a foreign jurisdiction, prior to relocation in Australia and perfected under this Bill, the security interest is taken to be continuously perfected from the time when it was perfected under the foreign jurisdiction (section 82).

## 5. ACQUIRING PERSONAL PROPERTY FREE OF SECURITY INTERESTS

5.1. Perfection of a security interest in personal property is normally sufficient to ensure that a secured party can enforce their security interest against third parties. Occasionally, however, reasonable commercial expectations require protection of the title acquired by a third party transferee. That protection is required regardless of whether the security interest is perfected or unperfected.

5.2. The provisions in this Part would establish the range of circumstances in which a person may acquire an interest in personal property free of a security interest. The circumstances generally involve the transfer of the collateral from the debtor to another person.

5.3. For the purposes of this document these provisions will be collectively referred to as ‘good interest provisions’.

5.4. An interest in personal property may be acquired free of a security interest because of the concurrent application of more than one rule to the same circumstances. The Part applies whether the security interest attaches to the personal property as original collateral or proceeds. However, the Part does not apply where the transferee’s interest is a security interest.

### *Acquiring an interest ‘free’ of a security interest*

5.5. A person would acquire an interest in personal property ‘free’ of a security interest in the circumstances outlined in the Part. The provisions do not use the word ‘extinguish’. One advantage of this language is that it reflects the intent that only the transferee’s interest is acquired free of the security interest. The Bill does not extinguish the security interest to the extent that it is attached to other collateral. Another advantage of using the concept of ‘acquiring an interest free of a security interest’ is that it is flexible enough to deal with the interest of a buyer and that of a lessee.

5.6. There may also be circumstances when property is returned to the seller. For example, goods would be returned to the lessor at the end of the lease, a buyer may return faulty goods or goods may be repossessed from a defaulting buyer. It may be necessary to determine whether a security interest automatically re-attaches when collateral is returned to a seller or lessor.

### *Knowledge*

5.7. The term ‘knowledge’ is central to the good interest provisions. In most cases, for a person to acquire an interest free of a security interest, a transferee could not have knowledge that the transaction constitutes a breach of the security agreement or knowledge of the security interest.

5.8. The definition of knowledge in section 56 applies to sections 88, 89, 90, 91, 92 and 93. Pursuant to 56(2), actual knowledge applies to sections 86 and 87.

5.9. The definition in section 56 is intended to capture those situations where a person is put on notice that an interest might exist in personal property that they propose to acquire, but they do not

make sufficient further inquires to find out more about that interest. A person would have knowledge of a circumstance where:

- (a) they have actual knowledge of the circumstance, or
- (b) the person would have had actual knowledge if they had made inquiries that ‘an honest and prudent person’ in their situation would have made.

5.10. The definition is intended to deter fraudulent transactions.

### ***Good faith***

5.11. In most jurisdictions that have already enacted personal property securities legislation, there is a requirement that a purchaser act in good faith to obtain a benefit under similar good interest provisions.

5.12. The Bill does not use the term ‘good faith’. A significant reason for the reform of personal property securities law in Australia is to create certainty in transactions. The term ‘good faith’ has no clear and settled meaning in Australian law. Its use may have decreased certainty in transactions leaving people unsure as to where they stand before entering into a transaction. The parties to a transaction need to know beforehand whether or not a good interest provision applies to the transaction.

5.13. To ensure that opportunities for fraudulent transactions are avoided, section 235 requires honesty in transactions. Honesty is intended to have both subjective and objective elements. A person would act honestly if their actions were honest according to the standards of ordinary people, and if they knew those actions were honest according to the standards of ordinary people.

### ***Value and new value***

5.14. In all circumstances, to acquire an interest in personal property free of a security interest, a person must provide either value or new value. In some cases, the notion of new value is used rather than value. The definition of ‘value’ includes the forgiving of an antecedent debt or liability. The concept of ‘new value’ is used in situations in which the forgiving of an antecedent debt or liability is not sufficient consideration, and something more is required to be given. The requirement for new value ensures that there would be something in the hands of the grantor that the secured party can pursue as proceeds if their interest is extinguished because of the good interest provisions.

### ***Non-constitutional security interests***

5.15. A referral of power from the States would be necessary if the Bill were to apply to all security interests. If a State does not refer power, or later chooses to discontinue their reference of power, the Bill would not apply to certain kinds of security interests. An example would be where an individual sells or leases personal property to another individual, and the secured party is also an individual.

5.16. A transferee would not acquire their interest free of a security interest because of a good interest provision if the Bill does not apply to the security interest (section 95).

***When a non-constitutional security interest becomes a constitutional security interest***

5.17. Where the Bill does not operate in relation to a security interest at a particular time, a transferee would take an interest in the property free of the security interest when the Bill begins to operate in respect of that security interest if:

- the Bill had operated in relation to the security interest at that time,
- the transferee would have acquired their interest free of a security interest because of the operation of a good interest provision, and
- the Bill begins to operate in relation to the security interest.

5.18. This rule deems that a person would acquire personal property free of a security interest in circumstances where a ‘non-constitutional security interest’ becomes a ‘constitutional security interest’. This would occur when:

- the original transaction involving the personal property would not have been covered by a State referral of power (and would be a non-constitutional security interest), and
- by virtue of a later transaction, the non-constitutional security interest becomes subject to the Bill and thereby becomes a constitutional security interest.

5.19. The provision would allow a constitutional corporation to deal with personal property without having to be concerned whether the Bill applies to the property: for example, whether the transaction concerns a referring State or not. A corporation would be able to ignore the fact that a State may not have referred its power to enact the Bill. The fact that a State has not referred power would only affect transactions involving individuals (see section 95 above).

***Unperfected security interests***

5.20. There are four ways in which a security interest can be perfected: by the secured party or its agent taking possession of the collateral; by registering the collateral; by taking control of the collateral (if the collateral is controllable property); or where the Act specifically confers temporary perfection.

5.21. A person who acquires personal property that is subject to an unperfected security interest would acquire it free of the security interest if they provide new value and are not a party to the transaction that provides for the security interest (section 85).

**Example**

GrantA obtains secured finance from BankA to purchase a lathe. BankA does not register the lathe on the PPS Register. GrantA sells the lathe to BuyA. BuyA’s search of the PPS Register does not disclose that BankA may have a security interest in the lathe. BuyA would acquire her interest in the lathe free of BankA’s security interest.

5.22. These arrangements provide an incentive for secured parties to register on the PPS Register to protect their security interest.

### ***Serially numbered personal property***

5.23. The Regulations would specify kinds of personal property that may or must be described by serial number on the PPS Register. It is expected that at least the following kinds of personal property would be specified as serial numbered personal property:

- motor vehicles (registered by vehicle identification number, chassis number, or a unique manufacturer's number),
- boats (registered by hull identification number), and
- aircraft (registered by manufacturers serial number).

5.24. For serial numbered property, registration by the serial number would be necessary to guarantee a prospective transferee's ability to rely on a search of the PPS Register, and to fully protect a security interest against an innocent acquisition.

5.25. Accordingly, a person would acquire an interest in serial numbered personal property—for example, a motor vehicle or a trade mark—free of a security interest if value is given, the transferee did not have actual knowledge of the security interest and a search of the PPS Register immediately beforehand by reference only to the serial number would not have disclosed the registered security interest. They would not receive the benefit of this provision however if they held the property as inventory (section 86). For example, a motor vehicle dealer would not acquire personal property free of a security interest because of section 86.

5.26. It would be possible for the financier of a motor vehicle dealer to perfect its security interest in the dealer's inventory by registering against vehicles generally, instead of against each individual vehicle. When the financier perfects its security interest in this way, a transferor (including a motor vehicle dealer) would not be able to take advantage of section 85.

#### **Example**

GrantA owns many motor vehicles. GrantA secures a loan from BankA against its motor vehicle fleet. BankA perfects their security interest in the fleet of vehicles by registering all of GrantA's motor vehicles. BankA does not register each motor vehicle by its individual serial number. GrantA sells a motor car to Terry. Terry's search of the PPS Register by reference to the motor vehicle's serial number does not disclose that BankA has registered the motor vehicle. Terry will take his interest in the motor vehicle free of BankA's security interest in the motor vehicle.

### ***Transactions in the ordinary course of business***

5.27. Generally, a person who acquires an interest in personal property in the ordinary course of the vendor's business of dealing with property of that kind would acquire the interest free of any security interest granted by the vendor, whether perfected or unperfected (section 87).

5.28. The section does not give the transferee protection from all security interests, only those security interests that have been granted by the transferor.

**Example**

BankA has a perfected security interest in GrantA's lathe. GrantA is not in the business of selling lathes. GrantA sells the lathe to DealA. DealA does not acquire the lathe free of the security interest because GrantA is not in the business of selling lathes.

DealA is in business of selling lathes. DealA grants a security interest in the lathe to BankB. DealA sells the lathe to BuyA in the ordinary course of DealA's business of selling lathes. BuyA will acquire the lathe free of BankB's security interest, but will acquire the lathe subject to BankA's security interest because BankA's security interest was not granted by DealA.

5.29. The fact that a transferee is aware of a security interest in the goods does not disqualify the transferee from the protection of the section. Many transferees are aware that the businesses that they deal with have given security interests in their inventory. However, the transferee would not get the protection of the section if they have actual knowledge that the transaction is a breach of the security agreement that creates the security interest.

5.30. Purchasers are only protected when they acquire their interest in the property 'in the ordinary course of the transferor's business of dealing with property of that kind'.

5.31. A determination of the ordinary course of business of the transferor would ultimately be a question of fact in all the circumstances of the case.

**Example**

GrantA is primarily in the business of leasing, repairing and rebuilding cranes. GrantA's practice is to sell a crane if it becomes obsolete, deteriorated beyond its useful life, or difficult to lease. GrantA sells one of its cranes to BuyA. The sale is the only sale that occurs that year. While the sale of the crane to BuyA would be in the ordinary course of GrantA's business, the sale would not be in the ordinary course of GrantA's business of dealing with property of that kind.

**Example**

GrantA is primarily in the business of raising and selling livestock. GrantA and BuyA regularly exchange livestock for feed. The exchange of the livestock for feed is in the ordinary course of GrantA's business of dealing in livestock. The sale would be in the ordinary course of business despite it being secondary to GrantA's primary business of raising finished cattle for sale at public market.

***Low value consumer property***

5.32. A person who acquires personal property that they intend to use predominantly for personal, domestic or household purposes (that is, consumer goods) would take it free of a security interest in that collateral provided certain conditions were met (section 88). These conditions are that:

- the person acquires their interest for new value,
- the person has no knowledge of the security interest,
- the market value of the personal property is not more than \$5,000, and
- the property must not be collateral that is required to be described by reference to a serial number.

5.33. This section allows purchasers of 'low value consumer goods' to purchase free of a security interest. It addresses the scenario where a consumer buys a low value good but not from a

transferor who is transferring the interest in the ordinary course of their business. For example, it would apply to purchases at a garage sale. Generally, it allows a consumer to purchase property without needing to search the PPS Register if the property does not have to be registered with a serial number and the market value of the personal property is less than \$5,000. For example, when a person buys a \$2,000 lathe at a garage sale with the intention to use in it their hobby workshop, and does not know of any security interest in the lathe, the lathe would be acquired free of any security interest.

5.34. A transferee would acquire property free of a security interest if the property had a market value of more than \$5,000, but they believed that it had a market value of less than \$5,000, and they paid less than \$5,000 for the property (provided the other conditions are satisfied).

5.35. Similarly, a transferee would acquire property free of a security interest if the property had a market value less than \$5,000, but they believed that it had a market value of more than \$5,000 and they paid less than \$5,000 for the property (provided the other conditions are satisfied).

5.36. For consumers, two important rules to remember are that, in order to gain the protection of this provision, the PPS Register should be searched when:

- the consumer intends to spend more than \$5,000 in acquiring an interest in personal property, or
- the consumer believes that the value of an interest in personal property is worth more than \$5,000 (even where they pay less than \$5,000).

### *Security interests in currency*

5.39. A transferee of currency would acquire their interest in the currency free of any security interests in that currency if either:

- at the time of acquiring the currency they had no knowledge of the security interest, or
- the transferee holds the currency for value.

5.40. When the transferee holds the currency for value, knowledge of the security interest would be irrelevant (section 89).

5.41. This rule recognises that, while it is important to preserve a secured party's security interest, the nature of currency is such that special consideration is required. Currency is the most basic medium of exchange in the economy. Its fungible nature also means that it would ordinarily be difficult to trace any security interest that has attached to the currency.

5.42. This consideration is of such weight that even knowledge of the security interest, or that the transaction is in breach of the security agreement, should not defeat the ability of a transferee to take the currency free of the security interest if value is provided.

5.43. Currency is any currency authorised as a medium of exchange by the laws of Australia or of any other country. It therefore includes coins and other currency of Australia (and other countries) that have a market value exceeding their face value.

### ***Security interests in investment instruments***

5.44. A person would acquire an investment instrument free of a security interest if they acquire their interest by a consensual transaction for value, they have no knowledge of the security interest, and they take possession or control of the investment instrument (section 90). The rules for determining whether a person has possession or control of an investment instrument are set out in section 45.

5.45. This provision gives those who deal in investment instruments certainty to undertake dealings within the timeframes demanded by the market.

### ***Security interests in investment entitlements***

5.44. A person would acquire an interest in an investment entitlement free of a security interest if their interest is acquired as a result of a credit to a financial account, they acquire their interest by a consensual transaction for value and they have no knowledge that crediting the investment entitlement to the account constitutes a breach of the security agreement.

### ***Special rules relating to motor vehicle purchases***

#### ***Incorrect or missing serial number***

5.46. A purchaser of a motor vehicle would acquire the vehicle free of a security interest if new value is given, the person acquiring the interest did not have knowledge of the security interest and a search of the PPS Register undertaken at any time on the day that the interest was acquired, or on the previous day, by reference to the serial number of the motor vehicle would not have disclosed a registered security interest (section 92).

5.47. This provision would only have effect in certain circumstances. In most cases, where personal property is required to be registered by serial number, and the serial number is incorrectly recorded on the PPS Register, the registration would be invalid and therefore the security interest would be unperfected. Accordingly, section 85 would apply and the transferee would take their interest free of the security interest. In cases where the serial number is missing, the registration would be invalid. However, section 85 would still apply.

5.48. This provision is the same as current section 7(1A) of the *Chattel Securities Act 1987* (Vic), which is known as the 'day and a half rule'. This section extinguishes security interests in particular goods in the following circumstances:



- (a) where a secured party has a registered security interest in goods but is not in possession of the goods,
- (b) a purchaser purchases the goods,
- (c) the sale is not in pursuance of a process of execution issued by or on behalf of a judgment creditor,
- (d) the sale is for value,
- (e) the sale is in good faith,
- (f) the transferee had no knowledge of the security interest when the purchase price is paid,
- (g) the sale is from a supplier being the debtor or another person in possession of the goods in circumstances where the debtor has lost the right to possession of the goods or is estopped from asserting an interest in the goods against the purchaser,
- (h) on the day of the purchase or on the preceding day a certificate was issued in respect of the goods, and
- (i) the certificate did not contain the particulars of an entry in the PPS Register relating to the goods.

5.49. This rule is also reflected in section 8(3)(b) of the *Registration of Interests in Goods Act 1986* (NSW).<sup>1</sup> Essentially, the existing provisions allow a purchaser to obtain a certificate showing that there are no registered security interests in the goods the day before they actually purchase the goods.

**Example**

BankA has an unregistered security interest in GrantA's car. GrantA agrees to sell the car to BuyA. BuyA's search of the PPS Register on Friday morning at 9:00am by reference to the serial number does not disclose that BankA has registered the car. BankA registers the car on the PPS Register at 2:00pm on Friday. BuyA pays GrantA the purchase price for the car on Saturday. BuyA will take her interest in the car free of BankA's security interest in the car.

5.50. If people adopt proper practices this provision would be avoided. This is due to the fact that the Bill would allow a secured party to register their interest in the goods prior to the security interest attaching to the goods. Further, a search of the PPS Register would be able to be undertaken immediately before purchase, for example, using a mobile phone including by text message.

5.51. Unlike the existing State provisions, the provision as drafted would not compel a transferee to actually undertake the search prior to purchase.

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<sup>1</sup> Section 8(3)(b) states that a person who obtains a certificate is 'not affected by notice of any information (other than the information in the certificate) relating to a registrable interest in those goods by reason only of a failure to make a further search in the Register before the end of the day that next succeeds the day of certification.

### *Acquisition from prescribed persons*

5.52. A transferee of an interest in a motor vehicle would ordinarily acquire it free of a security interest if it is acquired from a motor vehicle dealer (section 92(2)). The secured party must not have been in possession of the vehicle immediately before the transferee acquired their interest and the transferee cannot have acquired their interest at a sale held by or on behalf of an execution creditor. This provision is modelled on the *Chattel Securities Act 1987* (Vic).<sup>2</sup>

5.53. Some States and Territories have adopted a different approach. For example, in NSW, section 29A of the *Motor Dealers Act 1974* (NSW) states that a car market operator is liable for loss incurred by a purchaser of an encumbered vehicle. A Fidelity Fund has been established to cover claims made by purchasers against motor vehicle dealers. The establishment or continuance of such Fidelity Funds will be a matter for the States and Territories to consider in light of the provision.

5.54. A transferee would not gain the benefit of the provision if at the time of giving new value for their interest they have knowledge that the transaction breached a security agreement that provides for a security interest in the motor vehicle. Many transferees are aware that motor vehicle dealers they deal with would have given security interests in motor vehicles on their lot, for example, in a floor plan arrangement. The fact that a transferee is aware only of a security interest in the motor vehicle does not disqualify the transferee from the protection of the section. Nor would the provision apply if the transferee held the property as inventory.

#### **Example**

GrantA is a motor vehicle dealer. GrantA has cars in stock financed under floor plan arrangements with bailment company FinanciA. Under the floor plan arrangement FinanciA purchases the vehicles from ManufacturA and allows GrantA to retain them on its premises for sale. FinanciA registers its security interest in each vehicle.

BuyA wants to purchase a car from GrantA. BuyA needs to obtain finance from BankB for the purchase. Neither BuyA nor BankB need to search the PPS Register as the transferor (GrantA) is a motor vehicle dealer.

BuyA pays a deposit on the vehicle. BankB advances BuyA the balance of the funds required to purchase the car. BankB registers its interest in the motor vehicle. BuyA acquires its interest in the car free of BankA's security interest.

5.55. The policy behind the provision is that a transferee who acquires an interest in a motor vehicle from a motor vehicle dealer should not have to search the PPS Register prior to acquiring their interest. This extends to a person financing the acquisition.

5.56. Applying the wider definition of knowledge is intended to catch fraudulent transactions.

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<sup>2</sup> Section 7(1B)(2).

**Example**

GrantA is a motor vehicle dealer. BankA perfects their security interest in the fleet of vehicles by registering all of GrantA's motor vehicles. GrantA sells a motor vehicle to his friend BuyA for well under the market value of the vehicle. BuyA is aware that the motor vehicle is worth more and that his friend has arrangements with financiers in relation to the motor vehicles he sells. Buy A would not acquire its interest in the motor vehicle free of BankA's security interest.

***Temporarily perfected security interests***

5.57. A security interest would be perfected in a number of circumstances despite the secured party not having perfected it by registering the collateral, or taking possession or control of the collateral.

5.58. Transferees that acquire interests in collateral in which there is a temporarily perfected security interest under sections 70(2)(temporary perfection over proceeds of collateral) or 76(2) (tangible property returned to grantor) would acquire their interest free of the security interest where they provide new value and have no knowledge of the security interest (section 93).

5.59. This outcome provides protection for an innocent transferee who acquires collateral that is subject to a temporarily perfected security interest. The reason for this is that an innocent transferee could have searched the PPS Register and not found a perfected security interest. The temporary perfection of the security interest would protect the secured party against the grantor's insolvency.

**Example**

BankA has perfected its security interest in tangible property by arranging for a bailee to possess the property on their behalf. The property is returned to GrantA for sale. The security interest will be temporarily perfected for a further five business days.

If GrantA becomes insolvent during those five days, BankA's security interest will not be void because it has not been perfected.

However, if GrantA sells the property to a third party during the five days, the transferee will take the collateral free of BankA's security interest, despite the secured party's interest being temporarily perfected.

However, if GrantA does not sell the collateral during the five days, BankA will be able to achieve continuous perfection of its security interest by registering the collateral or resuming perfection by possession. This would allow BankA to retain its priority over the security interest despite having surrendered possession for a few days.

## 6. PRIORITY BETWEEN SECURITY INTERESTS

An item of personal property may secure payments or obligations owed to more than one secured party.

6.2. The priority rules in Part 2.4 of the Bill determine which of the secured parties is entitled to seize the collateral when more than one of them becomes entitled to do so in accordance with their security agreement. The rules would also determine whether a secured party is entitled to take over an enforcement process initiated by another secured party.

6.3. Before applying the priority rules, it is important to determine whether the relevant security interests are attached to the collateral. The priority rules would not apply if a person has earlier acquired the collateral free of one of the competing security interest (section 106).

### **Example**

GrantA grants a security interest in its lathe to BankA and later grants a security interest in the same lathe to BankB. BankB registers the lathe, while BankA does not. GrantA transfers the lathe to BuyA for new value. BuyA acquires the lathe free of the BankA's unperfected security interest (section 85). It is not necessary to consider whether the priority rules accord a higher priority to the security interest granted to BankA or BankB, because BankA's security interest has been extinguished.

6.4. The Bill includes general priority rules (sections 100 to 106) and specific priority rules that apply:

- to advances (section 107),
- to purchase money security interests (sections 108 to 112),
- when the collateral is transferred to another person (section 113 to 115),
- to creditors, purchasers of negotiable instruments, chattel paper and negotiable documents of title (sections 116 to 119),
- between security interests and certain other interests (section 120), and
- to execution creditors, ADI accounts and returned tangible property (section 121 to 123).

### ***Default priority rule***

6.5. The default priority rules apply only if the Bill does not establish any other way for determining the priority between competing security interests in the same collateral (section 100(1)).

### ***Priority between unperfected security interests***

6.6. The order in which the security interests attach to the collateral is relevant only if both interests are unperfected, in which case priority is determined by the order of attachment (section 100(8)).

*Priority between perfected and unperfected security interest*

6.7. A perfected security interest would have priority over an unperfected security interest in the same collateral (section 100(2)).

**Example**

GrantA grants a security interest in its lathe to BankA, and later grants a security interest in the same lathe to BankB. BankB registers the lathe, while BankA does not. The security interest held by BankB will have a higher priority than the security interest granted by BankA, despite GrantA having granted the first security interest to BankA.

*Priority of security interests perfected by control*

6.8. A security interest that is perfected by control would have priority over a security interest that is perfected by any other means (section 100(3)).

**Example**

GrantA borrows \$10,000 from BankA, and grants BankA a security interest in shares issued by XYZ Ltd. BankA perfects its security interest by registering the shares on the PPS Register. GrantA later borrows \$15,000 from BankB and grants BankB a security interest in the same shares issued by XYZ. BankB perfects its security interest by taking control of the shares. BankB's security interest would have priority over BankA's security interest because BankB has perfected its security interest through control while BankA has perfected its security interest through registration.

6.9. Only controllable property can be perfected by control (although controllable property may be perfected otherwise than by control). A security interest would be perfected by control when the secured party, or another person on behalf of the secured party, has control of the collateral (section 64(1) and 64(2)(b)).

6.10. The following kinds of property are controllable property:

- an investment instrument,
- an ADI account,
- a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation,
- an investment entitlement,
- a negotiable instrument that is not evidenced by a certificate (section 26, definition of 'controllable property').

6.11. A security interest perfected by control will have priority over a security interest that is not perfected by control even when the secured party knows that the grant of the security interest was made in breach of a pre-existing security interest. This makes it unnecessary to consider whether a person with control had knowledge of another security interest or the terms of the other security interest. The advantage of this is that determining whether a person has knowledge can be difficult and expensive, especially when large companies are involved.

6.12. Secured parties should therefore protect their security interests by perfecting their interests appropriately. As perfection by registration alone would be insufficient to guarantee priority against a competing security interest perfected by control, a secured party with a security interest in controllable property who is concerned that the grantor might transfer the collateral to another person, should consider taking control of the property.

6.13. Where all the security interests are perfected by control, the first in time principle will apply and priority will be determined by the order in which the secured parties took control of the collateral (provided that perfection by control has been continuous)(section 100(4)).

6.14. Perfection by control by an ADI of a security interest in an ADI account held with the ADI is an exception to the rule that the first in time to perfect by control has priority (section 122)). A security interest held by an ADI would be subordinate to a security interest held by another secured party who has control and is able to direct the disposition of funds from the ADI account without the consent of the grantor. An ADI who is concerned about this may choose to require that the account only permit the account holder to direct the disposition of funds from the account.

### ***Letter of credit***

6.15. The Bill does not specify when a secured party would have control of the rights contained in a letter of credit. However, a secured party would only have control of the rights contained in a letter of credit when the issuer has agreed to assign the proceeds of the letter of credit to the secured party (section 47).

### ***Investment instruments***

6.16. Because investment instruments may be traded in high volumes and with great frequency, taking control of the collateral is standard commercial practice. The Bill therefore allows security interests in investment instruments to be perfected by control because requiring the perfection of security interests in investment instruments by registration on the PPS register would be impractical.

6.17. A person (including a secured party) has control of a certificated or uncertificated investment instrument while they are registered by the issuer as the registered owner (section 45(1)).

6.18. A person has control of a certificated investment instrument if they have possession of the instrument and have the power to transfer or otherwise deal with it (section 45(2)).

6.19. A person has control of an uncertificated investment instrument if the grantor and the person have agreed that the person is able to initiate a transfer or dealing in the instrument (section 45(3) and (4)).

### ***Priority between security interests not perfected by control***

#### *Priority time*

6.20. Priority between perfected security interests not perfected by control would be determined by their priority time. The security interest with the earliest priority time would have the highest priority.

6.21. A time will be the priority time for a security interest only if two conditions are satisfied.

6.22. First, the security interest must be continuously perfected since the priority time (section 100(7)).

6.23. Secondly, the period of continuous perfection must begin:

- (a) where the security interest was perfected by registration—from the registration time for the relevant registration
- (b) where the security interest was perfected by possession or control—from the time when the secured party, or another person on behalf of the secured party, first took possession or control of the collateral
- (c) where the security interest is perfected by force of a temporary perfection provision, or in accordance with sections 69 or 74—from the time when the security interest was perfected (sections 100(5) and (6)).

#### **Example**

GrantA has an agreement with FinanciA for a loan to be secured by GrantA's lathe. FinanciA registers against GrantA in relation to lathes and later lends money to GrantA secured against the lathes. GrantA later borrows further funds from FinanciB secured against the lathes. FinanciB also registers against GrantA in relation to the lathes. The security interest held by FinanciA would have priority over that held by FinanciB because FinanciA's registration was registered first.

6.24. When a security interest has been perfected only by registration, the priority time is the registration time (section 100(6)(a)).

6.25. When a security interest has been perfected only by possession or control, the priority time would be the time that the secured party, or another person on behalf of the secured party, took possession or control of the collateral (section 100(6)(b)).

6.26. When a security interest has been perfected only by temporary perfection or in accordance with sections 69 or 74, the priority time is the time when the security interest is temporarily perfected or perfected in accordance with sections 69 or 74 (section 100(6)(c)).

6.27. The temporary perfection provisions would perfect, for a limited period, security interests:

- in collateral, after it is moved to Australia (section 81),
- in proceeds that are not covered by a registration (section 70),

- in collateral, after it is transferred to another person (assuming that the person does not take the collateral free of the security interest)(section 73),
- in tangible property, before the secured party perfects the security interest by taking possession of a negotiable document of title from a bailee (section 75),
- in collateral, after the grantor is given possession by a bailee in order to deal in it (sections 76),
- in collateral, after it is returned to the grantor in order to deal in it (section 77),
- in collateral, after it is returned to the vendor, or comes into possession of the secured party, when the contract for sale of the collateral comes to an end (section 79), or
- after the commencement of the Bill (section 290).

6.28. A security interest in proceeds that are currency or the right to an insurance payment (including any other payment as indemnity or compensation for loss or damage to the collateral) would be perfected when the collateral gives rise to proceeds (section 69(3)).

6.29. A security interest will be perfected in accordance with section 74 when it has attached to tangible property in the possession of a bailee and:

- (a) the security interest is perfected by registration, or
- (b) the security interest is perfected by possession on behalf of the secured party, or
- (c) the bailee issues a document of title in the name of the secured party, or
- (d) the bailee issues a negotiable document of title, in which the secured party has a perfected security interest.

### ***Priority time—changes in perfection methods***

6.30. Over a period of time, a secured party might perfect a security interest by more than one method. For example, the security interest might initially be perfected by possession and then perfected later by registration. In this case, provided that the security interest has been continuously perfected, the priority time would be the earliest priority time (section 100(6)).

#### **Example**

On 1 July 2020, GrantA grants FinanciA a security interest in a lathe. FinanciA takes possession of the lathe from 1 July 2020 until 30 August 2025. On 1 August 2025, FinanciA registers against GrantA in relation to the lathe with an end date of 31 October 2030. On 1 October 2030, FinanciA again takes possession of the lathe until 31 December 2035. At 31 December 2035, FinanciA's security interest in the lathe will have been continuously perfected since 1 July 2020—initially by possession, subsequently through registration and later by possession. The priority time for the security interest will be 1 July 2020.

6.31. The priority time for the security interest, first perfected by control, would be when the collateral was first perfected by control. A secured party who has control of the collateral and who wishes to surrender control while retaining a perfected security interest, should satisfy themselves beforehand that the security interest will remain perfected despite the loss of control (section 100(7)).



*Priority of intervening security interests*

6.32. If a security interest has priority over a second security interest and that second security interest has priority over a third security interest, then the first security interest would have priority over the third security interest (section 101). It would not matter whether the second security interest exists.

*Priority of proceeds*

6.33. Proceeds are the personal property that derive directly or indirectly from a dealing with the collateral and include rights to an insurance payment or other compensation arising from loss or damage to the collateral, payments made in discharge of chattel paper, intangible property, investment property or negotiable instruments or rights arising from investment instruments or investment entitlements (section 42, definition of ‘proceeds’).

6.34. A security interest in collateral attaches to proceeds of the collateral unless the security agreement provides otherwise (section 68(2)).

6.35. At the time the proceeds of collateral arise, a security interest in the proceeds has the same priority as the security interest in the collateral (section 102(1)(a)).

6.36. Thereafter, the registration in the collateral will be effective to perfect the security interest in the proceeds if the registration includes a description of the proceeds and the proceeds are of a class that is covered by the registered description of the collateral (section 69(2)).

6.37. Alternatively, the proceeds will be perfected if the proceeds are in the form of currency or consist of a right to an insurance payment or any other payment or indemnity or compensation for loss or damage to the collateral or proceeds (section 69(3)).

6.38. When the security interest in the collateral was perfected by registration and the registration is not effective to perfect the security interest in the proceeds, the security interest in the proceeds will be temporarily perfected for a further 5 business days. During those 5 business days, the priority time for the security interest in the proceeds would be when the registration in the collateral became effective and would continue if the security interest in the proceeds is perfected by another means before the end of the five business days (section 70).

6.39. When the secured party had possession or control of the collateral and later acquires possession or control of the proceeds, the priority time for the security interest in the proceeds would be when the secured party first took possession or control of the collateral (section 102(1)(c)).

*Priority between constitutional and non-constitutional security interests*

6.40. The priority of a constitutional security interest over a non-constitutional security interest is relevant where a State does not refer the power to enact the Bill to the Commonwealth. Some security interests would be within the constitutional power of the Commonwealth (sections 7(2) and (3) and sections 10 to 13), but others would not be. For example, the Bill would operate in relation to a security interest when the secured party is a constitutional corporation and the grantor is an

individual (section 12(1)(b)). However, the Bill would not operate when both the secured party and the grantor are individuals and the constitution does not apply to the collateral (section 13).

6.41. A security interest that is within the constitutional power of the Commonwealth would have priority over the security interest that is not within the constitutional power of the Commonwealth (section 103). Accordingly, a security interest granted by an individual over non-constitutional property to a constitutional corporation would have priority over a security interest in the same property granted to an individual.

**Example**

StateA is a State that has not referred the power to enact the Bill to the Commonwealth. GrantB is an individual, and has granted a security interest in his or her personal property to FinanciB, another individual. The security agreement is entered into in StateA. GrantB later grants a security interest in the same personal property to BankA. The security interest held by BankA, as a security interest arising from the Commonwealth's banking power, would have priority over the security interest held by FinanciB.

*Transfer of security interests*

6.42. When a security interest is transferred to another party, the transferred part of the security interest would have the same priority after the transfer that it had immediately before the transfer (section 104).

*Subordination agreements*

6.43. A secured party can subordinate their security interest to any other interest (whether or not a security interest) in the same collateral (section 105(1)). A subordination agreement is effective according to its terms between the parties (section 105(2)(a)).

6.44. The secured party, who is to benefit from the subordination agreement, can enforce the subordination agreement without being a party to the agreement (section 105(2)(b)).

**Example**

GrantA has granted a security interest over all of its present and after acquired property to BankA, which registers against GrantA. GrantA seeks further finance from FinanciB, secured against a lathe. GrantA and BankA enter into a subordination agreement that subordinates BankA's security interest to any security interest that FinanciB may have in the lathe. FinanciB's security interest in GrantA's lathe will have a higher priority than BankA's security interest in the lathe.

6.45. A security interest would not be created by an agreement or undertaking to postpone or subordinate the right of a person to performance of all or any part of an obligation to the right of another person to the performance of all or any part of another obligation of the same debtor.

6.46. It will be possible to include details of the subordination agreement on the PPS Register (section 191).

### ***Relationship with other parts of the Bill***

6.47. The priority rules will apply only when there are competing interests in the same collateral. There would not be a competing interest in the collateral if another person subsequently acquires the property free of the security interest (section 106).

### ***Future advances***

6.48. The existing law on the priority of future advances is very complex and can depend on whether the grantor is incorporated and where the advance is made.

6.49. Under the Bill, a security agreement may secure future advances (section 60, definition of 'future advance').

6.50. A security interest provided for by a security agreement will confer the same priority on all advances (including future advances and obligations) made under the agreement (section 107). This means that if a security interest has priority, the priority will apply to all advances, future advances and obligations made under the security agreement without limitation on the amounts advanced or obligations made.

### ***Purchase money security interests***

6.51. A security interest is a purchase money security interest when:

- (a) the security interest secures an obligation to the seller to pay the purchase price (section 32(1)(a)), or
- (b) the secured party has provided the finance required by the grantor to acquire the collateral or provided the collateral itself (section 32(1)(b)), or
- (c) a lessor or bailor has an interest under a PPS lease (section 32(1)(c)) (a PPS lease is a lease or bailment of tangible property for more than one year (or 90 days in the case of serial numbered goods); an indefinite term; a term of up to one year that is automatically renewable or renewable at the option of the parties; or a term of up to one year where the possession extends beyond a year but only once the possession begins to extend beyond one year (section 31), or
- (d) a consignor has an interest under a commercial consignment (section 32(1)(d)).

#### **Example**

BankB has a security interest in all of GrantA's present and after acquired property that is perfected by registration. GrantA later leases a lathe from FinanciA under a lease for a term of more than one year. FinanciA's lease is a purchase money security interest that would have priority over BankB's security interest.

### ***Priority of purchase money security interests***

6.52. A secured party who has a purchase money security interest would have priority over a perfected security interest in the same collateral, granted by the same grantor, provided that:

- (a) the collateral is inventory,
- (b) the perfection requirement is satisfied,
- (c) when the grantor holds the collateral as inventory—the notice requirements have been satisfied,
- (d) when the competing security interest is also a purchase money security interest—the priority interest is held by a seller, lessor or consignee of the collateral (sections 111 and 112).

**Example**

GrantA owes \$5,000 to BankA, but the loan is unsecured. GrantA borrows a further \$10,000 from BankA to allow GrantA to purchase a lathe. All of the \$10,000 is applied by GrantA towards purchasing the lathe. BankA secures both the \$10,000 and the earlier \$5,000 against the lathe. The security interest in the lathe would be a purchase money security interest only to the extent that it secures the \$10,000 advanced by BankA to allow GrantA to purchase the lathe.

6.53. Although the Bill is not concerned with legal title, by conferring purchase money security interest status on retention of title holders, long term lessors and commercial consignors, it protects the legal owner of the collateral.

6.54. A security interest is a purchase money security interest only to the extent that it secures purchase money security obligations and not to the extent that it does not secure purchase money security obligations (section 32(3)).

**Example**

GrantA borrows \$10,000 from BankA. GrantA uses \$6,000 of the loan to purchase a lathe and \$4,000 to discharge an existing loan secured against a compressor. BankA has a security interest in both the lathe and compressor. BankA has a purchase money security interest in the lathe, but not in the compressor.

6.55. If a security interest is granted in purchase money security collateral and collateral that is not purchase money security collateral, the security interest is a purchase money security interest only to the extent that it secures the purchase money collateral (section 32(4)).

**Example**

GrantA borrows \$10,000 from DealerA to purchase a lathe from DealerA. GrantA uses the \$10,000 to purchase the lathe. DealerA secures the loan against the lathe and also a compressor which GrantA owns. The security interest in the lathe and the compressor would be a purchase money security interest only in relation to the lathe.

6.56. A purchase money security interest would continue to be a purchase money security interest despite the secured obligation being renewed, refinanced, consolidated or restructured (section 32(5)).

**Example**

BankA gives GrantA a \$5,000 unsecured loan and BankA also has a \$10,000 purchase money security interest secured against GrantA's lathe. GrantA and BankA agree to consolidate the loans, to extend the period over which BankA must be repaid and to secure the loan against the original lathe and also a compressor owned by GrantA. The consolidated loan would be a purchase money security interest, but only to the extent of \$10,000 of the \$15,000 consolidated loan and to the extent that it is secured against the lathe.

6.57. When an obligation secures both purchase money security interests and other security interests, the parties may agree on a method of apportioning payments. If the parties don't agree, the payments would be apportioned as intended by the grantor, alternatively in the following order:

- (a) to unsecured obligations,
- (b) to secured obligations,
- (c) to obligations secured by purchase money security interests (section 32(6)).

***Purchase money security interest—perfection requirement***

6.58. When the grantor holds the collateral as inventory, the secured party must have perfected the security interest:

- for tangible property—by the time the grantor takes possession of the collateral, or
- for intangible property—by the time the security interest attaches to the collateral (section 109(1)(b)).

6.59. A financier would be able to register a description of the inventory that will provide purchase money priority status for later security interests.

**Example**

FinanciA and GrantA have an arrangement under which FinanciA provides the finance for motor vehicles purchased by GrantA. GrantA is able to draw down on a facility provided by FinanciA for the sole purpose of purchasing motor vehicle. FinanceA registers against GrantA in relation to all motor vehicles held by GrantA. This registration protects the priority of its purchase money security interest. Later, once it becomes aware of the serial numbers, it makes new registrations that include the serial numbers.

6.60. When the grantor does not hold the collateral as inventory, the secured party has a further five business days to perfect the purchase money security interest after either:

- (a) for tangible property—the day the grantor obtains possession of the collateral,
- (b) for intangible property—the day the security interest attaches to the collateral (section 110(b)).

***Purchase money security interest—notice requirements***

6.61. Purchase money security interests attached to inventory will have priority over other security interests attached to the same inventory, granted by the same grantor, provided that notice has been given to secured parties who had previously perfected their interests by registration (section 109(1)(c)). It is only necessary to give notice when the grantor holds the collateral as inventory.

6.62. The notice must describe the inventory, state that the secured party (inventory financier) intends to acquire a purchase money security interest in the inventory and that the purchase money security interest will be perfected once the grantor obtains possession or the security interest attaches to the inventory provided notice has been given prior to that time (section 100).

6.63. When the person holding the purchase money security interest supplies inventory to the same grantor on a number of different occasions, it would only be necessary to give one notice describing the inventory.

6.64. A purchase money security interest will confer priority on the secured party (the inventory financier) over a secured party (general financier) that has a security interest in all of the grantor's all present and after acquired property. While the general financier will have priority for advances made under the security agreement in respect of all present property (pre-purchase money security interest property) and non-purchase money security after acquired property, the inventory financier will have priority over the purchase money security inventory.

6.65. Because a general financier would not ordinarily make checks of the PPS Register to confirm that they have maintained their priority for all future advances, the requirement for the inventory financier to give notice to the general financier ensures that the general financier becomes aware that they lack priority over newly acquired inventory.

**Example**

GrantA is a wholesaler of lathes. GrantA purchases lathes from ManufacturA financed by BankB. BankB has secured its interest against Grant A's all present and after acquired property but does not have a purchase money security interest. GrantA decides to take up ManufacturA's offer to supply the lathes on a retention of title basis. ManufacturA would have a purchase money security interest in the lathes supplied after this time. ManufacturA gives BankB notice before supplying the lathes under the new arrangement. BankB is on notice that its security interest does not have first priority over lathes supplied by ManufacturA after the notice is given.

***Purchase money security interests—accounts to which section 111 applies***

6.66. The priority held by an inventory financier in a purchase money security interest may extend to proceeds arising from a dealing by the grantor in the collateral (sections 68(2)(b), 69 to 70). But

when those proceeds are in the form of an account (other than an ADI account), the grantor may assign the account to another person for new value.

6.67. The question then arises whether the inventory financier or the transferee (accounts financier) has higher priority to the account due to the grantor (section 111).

*Priority over purchase money security interest perfected later*

6.68. The accounts financier will have priority provided it registers its security interest against the grantor, before the earlier of:

- the perfection of the purchase money security interest, or
- the registration time of the purchase money security interest (section 111(2)).

*Priority over purchase money security interest perfected earlier*

6.69. Alternatively, the accounts financier will have priority if it gives notice to each secured party holding a registered purchase money security interest in the inventory at least five business days before the earlier of the day when:

- (a) it registers its security interest against the grantor, or
- (b) the priority interest attaches to the account (section 111(3)).

6.70. The requirement that five business days notice be given to the inventory financier is intended to give the inventory financier time to take appropriate action. It would probably want to alter the terms of trade for future inventory finance that would now be subordinate to the priority interest.

6.71. If the purchase money security interest is subordinate to another interest, the purchase money security interest will continue in either the proceeds of the inventory or the new value received by the grantor (sections 33(1) and 33(2)(a)). This security interest in the new value is taken to be perfected by the registration that perfected the purchase money security interest in the proceeds (section 33(2)(b)).

**Example**

GrantA regularly transfers the proceeds of its inventory (which are in the form of accounts) to DiscountA for new value. DiscountA has registered its security interest in the transferred accounts. ManufacturA begins to supply inventory to GrantA on a purchase money security interest basis. DiscountA has priority over ManufacturA in relation to the accounts, but ManufacturA would have a purchase money priority over the new value it has received on the transfer of the accounts to DiscountA (section 111(2)).

**Example**

ManufacturA supplies inventory to GrantA on a purchase money security interest basis. ManufacturA has registered against GrantA in relation to the inventory. GrantA would like to begin transferring the proceeds of its inventory (which are in the form of accounts) to DiscountA for new value. DiscountA gives 5 business days notice to ManufacturA of its intention to begin buying accounts from GrantA. DiscountA has registered its security interest in the transferred accounts. At the end of the 5 business days, DiscountA begins buying the accounts from GrantA. DiscountA has priority over ManufacturA in relation to the accounts, but ManufacturA would have a purchase money priority over the new value GrantA has received on the transfer of the accounts to DiscountA (section 111(3)).

***Purchase money security interests—competing purchase money security interests***

6.72. More than one purchase money security interest can attach to the same collateral, for example when a grantor acquires collateral that is financed partly by the seller, lessor or consignor of the collateral and partly by another financier.

6.73. A purchase money security interest held by a seller, lessor or consignor will have priority over any other purchase money security interest granted by the same grantor, if the purchase money security interest is perfected:

- (a) for collateral that is inventory and tangible property—at the time the grantor obtains possession,
- (b) for collateral that is inventory and intangible property—at the time the priority interest attaches to the collateral, and
- (c) in any other case, before the end of 5 business days after the grantor obtains possession of the collateral (section 112(1)).

**Example**

GrantA acquires a lathe from ManufacturA on a retention of title basis, under which GrantA is obliged to pay 25% on possession and the balance in regular instalments over six months. ManufacturA has a purchase money security interest in the lathe that secures the 75% balance owing on the lathe. GrantA finances the initial 25% of the purchase price of the lathe through a loan from BankB secured against the lathe also on a purchase money security interest basis. ManufacturA's purchase money security interest will have priority over BankB's purchase money security interest.

6.74. When neither of the purchase money security interests is held by a seller, lessor or consignor, priority would be determined in accordance with the default priority rules, that is, on the basis of the earliest priority time or earliest attachment if neither is perfected (section 100).



**Example**

BankA grants GrantA a loan to purchase equipment for its business. BankA takes a security interest in all GrantA's all present and after acquired property (including proceeds) to secure the loan. GrantA then acquires a lathe from ManufacturA, on a retention of title basis and ManufacturA registers its purchase money security interest in the lathe. GrantA finances the initial down payment on the lathe through a loan from BankB also secured against the lathe (and proceeds) on a purchase money security interest basis. GrantA sells the lathe and acquires proceeds in the form of an account. GrantA sells the account to DiscountA and keeps the new value provided by DiscountA. DiscountA gives notice to ManufacturA one day before it registers its security interest in the transferred account (section 104). DiscountA has priority over ManufacturA in the proceeds that were transferred to it (section 102) As the seller of the lathe, ManufacturA will have priority over BankB's purchase money security interest in the proceeds from the lathe but BankB will have priority over BankA which does not have a purchase money security interest in the proceeds from the lathe.

***Transferred collateral***

6.75. A grantor may transfer the collateral to another person in circumstances that do not extinguish the security interest. If the transferee grants a security interest in the collateral to another secured party, it becomes necessary to determine which security interest has priority.

***Current Law***

6.76. The current law is uncertain whether a transferor-granted interest or a transferee-granted interest will have priority. The law is contained within statutes, common law and equity and the outcome will depend on a number of factors including whether the parties are corporations, the nature of the security interests, the form of the transaction, the secured property and whether the transferee has notice of the interest.

6.77. The law needs to balance the competing interests of two innocent parties:

- the secured creditor who provided finance to the transferor and who did not consent to and is unaware of the transfer (the transferor's secured party), and
- the secured creditor who provided finance to the transferee and who was not aware of the earlier security interest (the transferee's secured party).

6.78. Where the transferor-granted security interest or the transferee-granted security interest is a purchase money security interest, the interest would not have super-priority, because purchase money security interest super-priority only applies when the competing security interests have been granted by the same grantor (section 108).

***Serial numbered collateral***

6.79. When the collateral is personal property that may be registered with a serial number, the transferee will take the property free of the transferor-granted interest unless the collateral is registered with its serial number (section 86).

6.80. When both security interests are perfected by a registration with a serial number, the default priority rule would apply and the security interest with the earliest priority time would have priority.

This will ordinarily be the security interest granted by the transferor's secured party, as this registration would be made before the transfer.

6.81. However, if the transferor's registration ceases to be effective, the transferee's secured party registers with a serial number, and the transferor re-registers with a serial number, then the transferor would have priority (section 114(1)). During the period before the transferor granted interest is re-perfected, the transferee's secured party has priority.

### ***Non- Serial numbered collateral***

6.82. Where it is not possible to include a serial number in the registration, the policy considerations are different.

6.83. The transferor-granted interest has priority if it was perfected immediately before the transfer and:

- (a) has been continuously perfected since the transfer (section 115(2)),
- (b) has not been continuously perfected, but is later re-perfected and notice is given to all other registered secured parties (section 115(3)) In this case, an innocent transferee granted security interest will have priority during the period that the transferor-granted interest was not perfected (section 115(4)).

### **Example**

BankA has a registered security interest against GrantA in relation to 'lathes' that has an end time of 30 June 2027. On 1 July 2027, GrantA transfers the lathe to GrantB, who is unaware that the transfer is a breach of GrantA's security agreement with BankA. GrantB does not acquire the lathe free of the security interest. GrantB grants BankB a security interest in the lathe. BankB perfects its purchase money security interest in the lathe. Subsequently, BankA reperfects its security interest in the lathe. BankB's security interest in the lathe would have priority over BankA's security interest to the extent of any advances made or obligations incurred before BankA reperfected its security interest with notice to BankB.

6.84. A transferor-granted security interest would be continuously perfected until the earliest of:

- the end time for the registration against the transferor,
- the end of the month that is 24 months after the transfer,
- if the transferor's secured party consented to the transfer—the end of five business days after the transfer, or
- if the transferor's secured party did not consent to the transfer—the end of five business days after the secured party had knowledge of the transfer (section 73(2)).

### **Example**

BankA has a registered security interest against GrantA in relation to 'lathes' that has an end time of 31 December 2027. On 1 July 2024, GrantA transfers the lathe (without BankA's consent) to GrantB, who grants a purchase money security interest in the lathe to BankB. GrantB does not acquire the lathe free of BankA's security interest. BankA becomes aware of the transfer on 31 January 2027. The security interest is not continuously perfected because more than two years have passed since the transfer on 1 July 2024. However, there are no registrations against GrantB in relation to lathes. BankA registers against GrantB in relation to 'lathes'. BankA's security interest in the lathe would have priority over any other security interests granted by GrantB in relation to lathes because of the default priority rules.

### **Example**

BankA has a registered security interest against GrantA in relation to 'lathes' that has an end time of 31 December 2027. On 1 July 2024, GrantA transfers the lathe without BankA's consent to GrantB, who grants a security interest in the lathe to BankB. GrantB does not acquire the lathe free of BankA's security interest. BankA becomes aware of the transfer on 31 January 2027. The security interest is not continuously perfected because more than two years have passed since the transfer on 1 July 2024. BankA searches the PPS Register and discovers that BankB has registered against GrantB in relation to lathes. On 1 February 2027, BankA gives section 115(3)(e) notice to BankB and then registers against GrantB in relation to lathes. However, GrantB received an advance of \$10,000 from BankB while GrantA's security interest was perfected (before 31 July 2026) and a further \$15,000 while GrantA's security interest in the lathe was not perfected (between 31 July 2026 and 31 January 2027). BankA's security interest in the lathe will have priority over BankB's security interest in the lathe, except to the extent of the \$15,000 advance and present liability incurred while GrantA's security interest was not perfected between 31 July 2026 and 31 January 2027.

## ***Priority of creditors and purchasers of negotiable instruments, chattel paper and negotiable documents of title***

### *Payment of debt*

6.85. A creditor who is paid money by a debtor through a debtor initiated payment would have priority over any security interest in the funds paid, the intangible that was the source of the payment or the negotiable instrument used to effect the payment. However, the creditor must not have had actual knowledge that the payment was a breach of the security agreement that provided for the security interest (section 116).

### *Negotiable instruments*

6.86. Parties that acquire negotiable instruments in consensual transactions would have priority over pre-existing security interests provided:

- (a) the transferee provided value and took possession or control of the instrument, and
- (b) the acquisition was in the ordinary course of a person's business of acquiring instruments of that kind, and
- (c) the acquisition took place without actual knowledge that it was contrary to the security agreement (section 117).

6.87. This provides certainty to those who regularly deal in negotiable instruments within the timeframes demanded by the market.

6.88. When the acquisition is not in the ordinary course of the person's business of acquiring instruments of that kind, they will only take it free of the security interest if they do not have knowledge of the security interest.

6.89. Secured parties could avoid losing priority by retaining possession of the specific instrument in which they have the security interest (section 117(2)(c)).

#### *Chattel paper*

6.90. The interest of a person who acquires chattel paper for new value in a consensual transaction in the ordinary course of their business of acquiring chattel paper of that kind would have priority over the following interests:

- a perfected security interest if the person does not have knowledge of the security interest, and
- a security interest that has attached to proceeds of inventory as original collateral (section 118(2)).

6.91. This priority is intended to promote the development of a market for chattel paper.

#### *Negotiable document of title*

6.92. The interest of a holder of a negotiable document of title would have priority over a perfected security interest in the document if the holder gives new value for the document and:

- it was acquired without knowledge that the acquisition was a breach of the security interest (where the holder acquired the document in the ordinary course of their business of dealing in documents), or
- it was acquired without knowledge of the security interest (in other cases)(section 119).

#### *Priority between security interests and other interests*

6.93. A security interest will be subordinate to interests in personal property:

- (a) that arise under a law of the Commonwealth, State or Territory or the general law, and
- (b) the interests arise in relation to the provision of goods in the ordinary course of business, and
- (c) the person who holds the priority interest provided the goods, and
- (d) no law of the Commonwealth, a State or a Territory provides for the priority between the priority interest and the security interest, and
- (e) the holder of the priority interest acquired the interest without actual knowledge that the acquisition is a breach of the security agreement (section 120(1)).

6.94. A security interest may also be subordinate to a priority interest where:

- (a) the priority interest arises under a law of the Commonwealth (as provided by legislative instrument) or a law of a State or Territory, and
- (b) a law of the Commonwealth, a State or a Territory provides that a specific kind of priority interest will have priority over a security interest, and the priority interest is of that kind, and
- (c) the priority interest arises after the priority law is made, and
- (d) the person who holds the priority interest acquired it without knowledge that the acquisition was a breach of the security agreement (section 120(2)).

**Example**

BankA has a security interest in FarmerA's grain. FarmerA then enters into an agreement with WarehousemanA for the storage of the grain. FarmerA fails to pay the storage costs. Under the relevant State legislation, WarehousemanA acquires a lien over the grain to cover his storage costs and the lien takes priority over BankA's security interest.

*Priority of execution creditor*

6.95. A security interest would be subordinate to the interest of an execution creditor provided the security interest is not perfected at the time of execution (section 121).

*Priority of security interests in returned tangible property*

6.96. A perfected security interest in returned tangible property that has re-attached to property under section 78(2) has priority over a security interest that is granted under section 79(2) to the transferee of an account (section 123(1)).

6.97. A security interest in tangible property granted under section 79(2) to the transferee of chattel paper has priority over:

- (a) a perfected security interest granted under section 79(2) to a transferee of an account,
- (b) a perfected security interest that has re-attached (if the transferee takes possession of the chattel paper in the ordinary course of business and for new value), or
- (c) a perfected security interest in after-acquired property that attaches when the property comes into the possession of the grantor or transferee (section 123(2)).

**Example**

FinanceA grants a loan to DealerA and secures a security interest in all DealerA's motor vehicles. LessorA leases a motor vehicle from DealerA. The lease creates chattel paper which DealerA transfers to FinanceB. LessorA makes the required payments under the lease to FinanceB. LessorA then terminates the lease and returns the motor vehicle to DealerA. FinanceA's pre-existing security interest re-attaches to the motor vehicle but this security interest is subordinate to FinanceB's security interest as the transferee of the chattel paper.

6.98. A security interest in tangible property that is granted by a person who acquires an interest in the property has priority over a security interest that re-attaches under section 78, or is granted under section 79, if:

- (a) the attachment occurred while the person possesses the property, and
- (b) immediately before the possession time, the priority interest was perfected (section 123(3)).

## 7. TRANSFER AND ASSIGNMENT OF RIGHTS IN COLLATERAL

### *Transfer of collateral*

The Bill confirms that the grant of a security interest does not, of itself, affect the effectiveness of a transfer of the collateral to another person, even if the transfer is made in breach of the security agreement. When the rights of a grantor in collateral *are able to be transferred*, but for a provision in the security agreement prohibiting the transfer or declaring the transfer to be a default, the grantor's rights may be transferred (section 124). That the transfer is effective would not affect the right of a secured party to treat the prohibited transfer as an act of default (section 124(3)).

7.2. The transferee would acquire the collateral subject to the security interest, unless the transfer is subject to an extinguishment provision (or another rule of law operates to allow the transfer to take the property free of the security interest).

### *Rights of transferee of account or chattel paper not improved*

7.3. The rights held by a transferee of an account or chattel paper would not be any better relative to the account debtor than those of the transferor of the account or chattel paper. The rights of the transferee remain subject to the terms of the contract between the account debtor and the transferor and any defence, remedy or claim available to the account debtor (section 125(1)), unless the account debtor agreed not to assert any contractual defences (section 125(2)).

### *Modification of contract*

7.4. An account debtor and the transferor of the account may agree to modify the contract giving rise to the account. The modification would be effective against the transferee provided that:

- (a) the account debtor and the transferor acted honestly in modifying the contract, and
- (b) the modification was made in a commercially reasonable way, and
- (c) the modification does not have a materially adverse effect on the transferee's rights or the transferor's ability to perform under the contract.

7.5. On transfer, the transferor may agree with the transferee that it would not modify the contract giving rise to the account (section 125(6)). A transferor would then not be acting honestly if they agreed to modify the contract giving rise to the account in a manner contrary to their agreement with the transferee.

7.6. An account debtor would be unaffected by an assignment of a debt until notice of the assignment is given directing the account debtor to pay the transferee (sections 125(7) and (8)).

### *Restrictions on the right to transfer accounts or chattel paper*

7.7. A term in a contract which prohibits the transfer of:

- (a) an account which is proceeds of inventory, or
- (b) an account which arises from granting right/services in the ordinary course of business, or
- (c) chattel paper;

is binding on the transferor only to the extent of making the transferor liable in damages for breach of contract and is unenforceable against third parties (section 126(2)).

7.8. Breach of such a clause would give rise to an action in damages against the assignor by the account debtor. This provision does not affect any remedies the account debtor may have against the transferee in tort.

7.9. This provision recognises that it is impractical for transferees of accounts and chattel paper to examine each contract for anti-assignment clauses and is included to promote the development of markets in accounts and chattel paper.

### *Security interests in intellectual property licences*

7.10. A security interest in an intellectual property licence or sub-licence, where the intellectual property or intellectual property license is transferred, continues in the license or sub-license and binds every successor-in-title to the licensor to the same extent as the security agreement was binding on the licensor (section 127(1)).

#### **Example**

LicensA is the owner of copyright, and has licensed GrantA to exercise certain rights comprised in the copyright. GrantA has granted a security interest in the licensed rights to BankA. LicensA transfers the copyright to LicensB. LicensB will be bound by the security interest granted by GrantA to BankA to the same extent that LicensA was bound by the security interest.



## 8. AGRICULTURAL INTERESTS, ACCESSIONS AND COMMINGLED GOODS

Chapter 3 of the Bill would contain specific priority, extinguishment and enforcement rules for security interests in agricultural products, accessions and commingled goods. These rules should be read in conjunction with the provisions on transferred collateral (Chapter 2, Part 2.2), extinguishment (Chapter 2, Part 2.3) and enforcement (Chapter 4).

### *Security interests in agricultural products*

8.1. Part 3.1 outlines the circumstances in which a security interest in crops or in livestock would have priority over other security interests in those agricultural products.

8.2. This Part establishes what might be termed an ‘agricultural PMSI’ (purchase money security interest), which would allow farmers to source additional finance using crops and livestock as collateral on a PMSI-like basis. These rules recognise the importance of agriculture to the Australian economy.

8.3. The ‘agricultural PMSI’ provisions are additional to the Bill’s general provisions relating to security interests. It is important to recognise that current financing arrangements used for the agricultural sector would be accommodated under the general provisions of the Bill. The ‘agricultural PMSI’ is an additional feature to provide additional short-term finance if required by a farmer.

### *Security interest in crops*

8.4. Where a party provides finance for a debtor to produce a crop in return for a security interest in a crop, the Bill provides that the security interest would have (section 130). However, the security interest in the crop would only have priority over other security interests if it is perfected and if the security agreement was granted for value and made not more than six months before the crop was planted or while it is growing.

8.5. The Bill would provide that a security interest in a crop would be a security interest for the purposes of the Bill while the crop is growing and after it is harvested. In the case of a harvested crop, a security interest would continue whether or not the crop is stored on the land on which it is grown (section 128).

### **Example**

GrantA, a farmer, borrows money from BankA and provides BankA with a security interest in his crops that is not a PMSI interest. GrantA then borrows money from BankB to enable GrantA to buy fertiliser to help the crops grow. BankB’s agricultural PMSI has priority over BankA’s security interest in those crops.

8.6. While operating to provide protection to secured parties with an interest in a crop, the Bill would also operate to provide protection for lessors and mortgagees of real property on which the crops are growing. Where a lessor or mortgagee’s interest existed at the time the security interest in the crop was created and the lessor or mortgagee had not consented to the creation of the security

interest the Bill would ensure that the security interest in the crop does not prejudicially affect the rights of the lessor or mortgagee (section 129).

8.7. Conversely, a dealing with the land would not prejudicially affect a security interest in the crops (section 129), provided that the security interest in the crop is perfected. This provision reflects similar protections provided in State and Territory legislation.<sup>3</sup>

#### *Security interest in livestock*

8.8. Where a secured party provides finance for a debtor to feed or develop livestock, that security interest would have priority over any other security interest in the same livestock granted by the same grantor (section 129). However, the security interest must be perfected and the livestock must be held by the grantor when the security agreement is made or be acquired within 6 months thereafter. Section 131 (section 131), would apply to a wide variety of livestock. ‘Livestock’ is defined as including sheep, goats, cattle, horses, swine, poultry, alpacas, llamas, ostriches fish or other animals and the unborn young of livestock (section 26).

#### *Accessions*

8.9. Tangible personal property is sometimes made up of separate components that may require replacement as they wear out or become obsolete. As well, the value or utility of such property may sometimes be enhanced by the addition of new components—a roof rack or trailer hitch on a car. These substituted or added goods are ‘accessions’ for the purposes of the Bill.

8.10. An accession to tangible property (the improved property) means other tangible property that is installed in, or affixed to, the improved property, but only if the separate identities of the improved property and the other tangible property are lost at the time the other tangible property is installed in, or affixed to, the improved property (section 34). For example, an aircraft engine that is routinely moved between aircraft frames is not an accession to a particular aircraft frame, because the engine does not lose its separate identity when it is affixed to an aircraft frame.

8.11. The Bill establishes a priority regime concerning rights between security interests in an accession and interests in the improved property. The purpose of these rules is to resolve priority between a person with a security interest in an accession and a person with an interest in the improved property.

8.12. Accessions also raise particular enforcement issues, which are dealt with in Part 3.4 of the Bill.

#### *Continuation and priority of security interest in accessions*

8.13. As a starting point, the Bill contains two general rules that would apply when a security interest has attached to an item of personal property that is an accession. Firstly, a security interest in an accession would continue in the accession despite being affixed or installed (section 132). This is to say that the security interest would not cease (or be extinguished) at the moment it becomes part of the improved property.

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<sup>3</sup>For example, see section 62 of the *Instruments Act 1958* (Vic).

8.14. Secondly, a security interest in an accession would have priority over an interest in the improved property unless the interest in the improved property would have priority under one of the exceptions contained in Division 2 of Part 3.2 (section 134).

*Interest in accession perfected—protection against later acquired interests in improved property*

8.15. The Bill provides that an unperfected security interest in an accession would not have priority over a later interest in the improved property acquired by an innocent purchaser for value. If the later interest is a security interest, it must be perfected immediately after it attaches to the property (section 135). The result is that an unperfected security interest in an accession would be vulnerable to a later innocent acquisition.

**Example**

GrantA borrows money from FinanciB to buy a new motor for its pump, which is placed into the pump. Before FinanciB registers its security interest in the motor, GrantA offers the pump as security for a loan from BankA, which advances the money and perfects its security interest in the pump through registration.

BankA has priority over FinanciB to the motor because BankA acquired for value an interest in the improved property (the pump) before the security interest in the accession (the motor) was perfected.

*Subordination of interest in improved property—protection against earlier interests in improved property*

8.16. The Bill provides that an interest in the improved property (including a security interest) would have priority over a security interest that attaches to the accession after it becomes an accession unless the party who holds the interest in the improved property has agreed to subordinate its interest (section 136). The result is that a security interest that is attached to an accession before it is affixed would have priority over an existing security interest in the improved property.

**Example**

GrantA owns a pump. BankA has a registered security interest in GrantA's pump, including any accessions to the pump. GrantA orders a replacement motor from SupplierA to be installed in the pump. SupplierA supplies the motor to GrantA on terms requiring GrantA to pay for the motor within 30 days of the installation and that title to the motor stays with SupplierA until GrantA has paid for the motor. GrantA takes delivery of the motor and installs it in the pump. SupplierA's security interest in the motor has priority over BankA security interest in the pump because its security interest in the motor existed before the motor was affixed to the pump.

**Example**

GrantA owns a pump. BankA has a registered security interest in GrantA's pump, including any accessions to the pump. GrantA orders a replacement motor from SupplierA to be installed in the pump. GrantA takes delivery of the motor and installs it in the pump. GrantA borrows money from BankB secured against the motor. BankA's security interest in the pump has priority over BankB's security interest in the motor because BankB's security interest only arose after the motor was affixed to the pump.

8.17. It is also important to note that the generally applicable extinguishment rules in the Bill (Part 2.3) would apply to security interests in accessions where there is an acquisition of the accession separate from the improved property.

**Example**

GrantA is a motor vehicle dealer. SupplierA has a security interest in GrantA's floor stock. CustomerA agrees to buy a vehicle provided it is fitted with an improved sound system. GrantA purchases a sound system from SupplierB on a retention of title basis, and installs the sound system in the vehicle. Immediately after the installation, SupplierB's security interest in the sound system has priority over SupplierA's security interest in the vehicle. GrantA sells the vehicle to CustomerA. CustomerA acquires the car free of the security interest in the both the vehicle and the sound system (section 86).

***Commingled goods***

8.18. Goods may be manufactured, processed, assembled or commingled so that they become part of a product or mass. A security interest may have been attached to the goods before they became part of the product or mass. It then becomes necessary to decide whether the security interest continues in the goods. When the value of the product or mass (or the value of its proceeds) is less than the aggregate value of the security interests, it also becomes necessary to allocate that value among the security interests. The Bill contains rules that deal with this issue (Part 3.3).

8.19. The Bill provides that tangible property that is commingled includes tangible property that is mixed with tangible property of the same kind (section 26).

8.20. Commingled goods also raise particular enforcement issues, which are dealt with in Part 3.4 of the Bill.

***Continuation of security interests in commingled tangible property***

8.21. The Bill provides that a security interest that exists in tangible property carries over into the new product or mass when the manufacturing, processing, assembling or commingling results in the tangible property losing its identity in the new product or mass (section 138). To assist in determining whether the identity of an item of tangible property is lost in a product or mass, the Bill provides that identity would, amongst other circumstances, be lost if it is not commercially practical to restore the property to its original (section 138(2)).

8.22. Commingling may involve the mixing of like tangible property, such as the mixing of grains in a silo. Commingling may also involve the mixing of dissimilar tangible property: such as the mixing of cement, sand, gravel and crushed stone.

8.23. Section 138 would apply when only one component is used in a manufacturing process: such as when lumber is converted into a plank. In this example, the plank is part of the product (despite its also being the entire product).

8.24. The Bill contains provisions which ensure that when a security interest continues in commingled goods, the matters that relate to its priority are preserved (section 139). For example, the time a security interest in tangible property that continues in the mass or product attaches would be deemed to be the time the security interest in the tangible property attaches (section 139(1)(b)).

8.25. For the purposes of the default priority rule in the Bill, a security interest that continues in a product or mass would be taken to have been granted in the same collateral as a security interest that is granted in the product or mass (section 139(3)). This would result in a priority contest between the product or mass itself and a component good in the product or mass being determined under the default priority rule.

*Limit on value of the obligation secured by component goods*

8.26. The value of the obligation secured by a security interest in tangible property that continues in a product or mass does not exceed the lesser of the value of the obligation at the time in question or the market value of the tangible property immediately before the tangible property's identity is lost in the product or mass (section 140).

**Example**

GrantA is a furniture-maker. FinanciA has a registered security interest of \$1000 in glue supplied to GrantA. The market value of the glue used for each table is \$50 but the tables are valued at \$1000 each, being for the timber, glue, labour and skill of the furniture maker.

On enforcement of its security interest, FinanciA could recover no more than \$50 per table.

*Enforcement of security interests in accessions and commingled goods*

8.27. The Bill contains specific enforcement provisions to deal with the special nature of accessions and commingled tangible property (Part 3.4).

8.28. Where two or more security interests of the same kind continue in commingled tangible property, and at least two of them were originally granted in different components of that property, they would each have the same priority as each other (section 141(2)). These rules reflect the fact that the competing security interests were most likely taken without knowledge of each other, making it unreasonable if one security interest were to have priority over the other.

8.29. Where there are insufficient proceeds to satisfy all security interests of the same kind in commingled tangible property, the proceeds would be distributed proportionally, by reference to the proportion that the market value of the relevant property is to the total market value of all the relevant property in relation to all equal security interests (section 143(2)).

## 9. ENFORCEMENT OF SECURITY INTERESTS

### *Overview*

9.1. Chapter 4 of the Bill would detail the rights and obligations of parties in the event that a debtor defaults in meeting its obligations under a security agreement. It would establish the remedies available and the process to be followed when enforcement action is taken against collateral.

9.2. Currently, enforcement remedies are defined according to the contractual arrangements between the parties and any existing relevant law (which may vary between jurisdictions). Different remedies may be applied depending upon the particular security device utilised. The enforcement sections in the Bill provide simple and comprehensive remedies for all security transactions regardless of the nature or form of the transaction.

9.3. The Bill does not attempt to codify the rights, duties and obligations of the parties. It recognises that parties to security agreements are best placed at making judgements about their enforcement terms. Accordingly, the enforcement sections do not establish the definitive rights in relation to enforcement and parties generally remain at liberty to contract as to their respective rights and responsibilities in relation to enforcement.

9.4. Any secured party would, regardless of its priority ranking, be able to commence enforcement action under the Bill. This would enable secured parties to negotiate between themselves and come to an agreement about enforcement. Higher ranked secured parties would, however, be able to protect their interests by seeking possession of collateral from a lower ranked enforcing party.

9.5. The Bill would require all parties to exercise their rights, duties and obligations that arise under the security agreement or the Bill honestly and in a commercially reasonable manner (section 235). This would also apply to parties exercising their rights of enforcement against collateral under the security agreement or the Bill. The duty would apply in conjunction with the specific duties imposed in the enforcement sections.

9.6. Chapter 4 provide remedies in relation to security agreements generally. Additional rules apply in relation to enforcement against a debtor where the security interest is in an accession or commingled good.

9.7. The secured party's statutory rights and remedies become operative on default by the debtor of the payment or obligation that is secured by the collateral under the security agreement (section 161). The Bill does not place any constraints on the obligations that may be secured by the collateral.

9.8. Enforcement under the Bill would not require secured parties to obtain judgment against a debtor before being entitled to exercise rights against the secured assets.

9.9. The enforcement sections have been drafted with a view to protecting the interests of parties who may potentially be affected by enforcement action. Given the risk that enforcement would result in alienation of collateral, the impact of enforcement is most likely to affect the grantor of the

security interest. As a result the rights provided for in the Bill are directed primarily at the grantor and other secured parties.

9.10. The rights of the enforcing secured party, the grantor and other persons that may be affected by enforcement action are detailed in Table 9.1.

### ***Exclusions***

#### *Deemed and possessory security interests*

9.11. The enforcement sections would not apply where:

- the transaction is deemed to be a security interest because of section 28(3), or
- a party has perfected its security interest in an investment instrument by taking possession or control (section 149(2)).

9.12. A transaction that does not secure payment or performance of an obligation does not create a security interest (section 158) and therefore should not be subject to enforcement remedies relating to security interest. An example of such a transaction is a lease for a term of more than one year that does not secure payment or the performance of an obligation.

9.13. When the secured party has perfected their security interest in an investment instrument by possession or control they would be able to sell, transfer, use or otherwise deal with the collateral in the manner and to the extent provided in the security agreement. This would allow a secured party to take timely advantage of movements in the market without having to abide by the procedures and time limits that would be imposed by the Bill.

#### *Collateral used for consumer purposes*

9.14. The Bill distinguishes between transactions securing inventory and equipment and those securing consumer goods, particularly in relation to the extent to which parties may contract out of the enforcement sections. In describing consumer transactions the enforcement sections refer to the phrase ‘goods used predominantly for personal, domestic or household purposes’, rather than the term ‘consumer property’. The term ‘consumer property’ is defined in the Bill as property used exclusively for a non-ABN activity (section 26). This would mean that even if collateral was used for a negligible period of the time for non-consumer purposes they would not be classified as consumer property. Section 26 defines personal property as used predominantly for personal, domestic or household purposes if it is used only for those purposes or is intended to be used mostly for those purposes and is not acquired as an investment.

9.15. The use of the phrase ‘predominantly for personal, domestic or household purpose’ enables sections providing consumer protection to apply to all transactions that are consumer in nature. The use of the wider definition is consistent with the Consumer Credit Code (the Code) and would ensure that the consumer protections in the Code and the Bill would apply in broadly the same set of circumstances.

9.16. Certain remedies would not be available where the collateral is used predominantly for personal, domestic or household purposes. The remedies that fall into this category are:

- remedies available under applied provisions of the State and Territory land law (section 156 and 157),
- the collection and application of liquid collateral (section 159),
- disposal of collateral by lease to a third party (section 166(2)(b),
- disposal by sale where the collateral is acquired by the enforcing secured party (section 167), and
- retention of the collateral by the enforcing secured party (section 172).

### ***Interaction with general law and other proceedings***

9.20. As previously noted, the enforcement sections are intended to operate in conjunction with other laws providing remedial and enforcement rights. The enforcement sections are not meant as a 'code', establishing all rights, remedies and obligations in relation to enforcement. Parties would continue to have the rights and remedies provided for by the security agreement, any Commonwealth, State and/or Territory law and any rule of law or equity (section 150). Accordingly, the rights and remedies available to parties may be a combination of right and remedies provided in the Bill, contractual provisions and other legislation.

9.21. The Bill would provide that in exercising rights and remedies under Part 4.1 the secured party would only be able to deal with collateral to the same extent as the grantor would be entitled to deal with it. Exception to this general rule would apply where the secured party had title to the collateral before commencing enforcement, was a deemed security agreement that does not secure payment or performance of an obligation or if the security agreement would otherwise prevent the dealing (section 151).

### ***Contracting out***

9.22. The parties would continue to have freedom of contract in relation to their respective rights and responsibilities in enforcement.

9.23. Parties would also be able to contract out of specific sections of the enforcement provisions. The rights of parties to contract out would not impact on the rights and remedies affecting third parties who are not a party to the contract.

9.24. The extent to which parties would be able to contract out would depend on whether the collateral secured was used predominantly as a consumer good.

9.25. A practical illustration of a secured party's requirements where collateral is predominantly used as a consumer good is given below.



**Example**

GrantA obtains a loan from BankA to finance the purchase of business assets secured against her car.

GrantA uses the car 90% of the time for personal use. For 10% of the time GrantA uses the car for business purposes.

GrantA defaults on the loan and BankA initiates enforcement action.

As a result of GrantA's use of the car predominantly for personal, household or domestic purposes, BankA is unable to vary or contract out of most of the enforcement provisions. For example, BankA is not able to contract out of the requirement to serve GrantA notice of disposal under section 168 or contract out of any information requirements in the statement of account (section 170).

9.26. Where collateral is not used predominantly for personal, domestic or household purposes, parties would be able to contract out of most of the enforcement provisions (section 154.)

9.27. This is intended to allow the parties freedom to tailor the rights and obligations upon default to meet their circumstances and needs.

9.28. Where collateral is used for personal, domestic or household use, parties would be able to contract out of the right of a secured party to gain apparent possession in certain circumstances (section 154).

9.29. Extensive contracting out for collateral used for personal, domestic and household use would, in any event, be of limited use as parties would still have to meet the requirements in the Code.

**Table 9.1: Rights of secured party, grantor and others in enforcement action**

<i>Secured Party</i>	<i>Grantor/Debtor</i>	<i>Other parties with an interest in the collateral</i>
<p><b>section 155</b> Right to appoint a receiver pursuant to a security agreement in relation to specific property not covered by the <i>Corporations Act 2001</i></p>	<p><b>section 157(6)(b) and (c)</b> Right of other secured parties to have standing in proceedings under section 156. Right of secured party to apply to a court for the conduct of a judicially supervised sale of the personal property</p>	<p><b>section 157(6)(b) and (c)</b> Right of other secured parties to have standing in proceedings under section 156. Right of other secured parties to apply to a court for the conduct of a judicially supervised sale of the personal property</p>
<p><b>section 156</b> Right to enforce against personal property using the remedies and rights available in relation to land to the highest-ranking secured party</p>	<p><b>section 160(4) and (5)</b> Right of grantor to a notice</p>	<p><b>section 160(1) and (2)</b> Right of higher ranking secured parties to get notice section 160(3) Right of a higher ranking secured party to provide notice advising that it intends to take action to collect and apply liquid collateral under section 159, thereby preventing a lower ranking secured party from doing so</p>
<p><b>section 159</b> A secured party is entitled to collect and apply liquid collateral</p>		<p><b>section 165</b> A higher ranking secured party has the right to seize collateral from a lower secured party</p>
<p><b>section 161</b> A secured party is entitled to seize collateral</p>	<p><b>section 163</b> Right to ensure that seized collateral is disposed of by sale, lease or purchase (unless contracted out of)</p>	
<p><b>section 166</b> Right to dispose of collateral after seizure</p>		
<p><b>section 164</b> Right to apparent possession in specified circumstances</p>		
<p><b>section 166</b> Entitled to dispose of collateral by sale or if security agreement provides by lease</p>	<p><b>section 175</b> Entitled to object to purchase of collateral by a secured party in which case the secured party must sell or lease to a third party</p>	

<i>Secured Party</i>	<i>Grantor/Debtor</i>	<i>Other parties with an interest in the collateral</i>
<p><b>section 167</b> Secured party may purchase the collateral if the collateral is not used as a consumer good</p>	<p><b>section 168</b> Entitled to receive notice prior to disposal</p> <p><b>section 169</b> Duty of secured party to obtain at least the market value or, where there is no market value, the best price reasonably obtainable</p> <p><b>section 170</b> Right to statement of account once collateral has been disposed of</p> <p><b>section 171</b> Right to have security interest in collateral preserved if the secured party has a higher priority ranking than the enforcing secured party</p>	<p><b>section 173</b> Right to receive notice if a secured party seeks to retain collateral</p> <p><b>section 175</b> Right to object to secured party's proposal to retain collateral</p>
<p><b>section 172</b> Secured party is able to propose to retain the collateral</p>	<p><b>section 177</b> Right to any surplus remaining after distribution</p> <p><b>section 180</b> Right to redeem the collateral</p> <p><b>section 181</b> Right to reinstate the security agreement by paying the amount in arrears and enforcement costs or expenditure</p>	

***Interaction between enforcement sections and other remedies***

*Corporations Act*

9.30. Chapter 4 would not apply to property that is subject to a receiver, a receiver and manager or a controller ('receivers and other controllers') appointed under Part 5.2 of the *Corporations Act 2001*. The fact that the enforcement provisions do not apply in relation to property while a person is a receiver, a receiver and manager or a controller of the property (section 155) should confine the operation of the provisions to cases when a secured party is enforcing the security agreement themselves.

9.31. Maintaining the operation of Part 5.2 provides continuity to financiers and their clients and avoids major alterations to the operation of the *Corporations Act 2001*.

### *Land laws*

9.32. Security agreements in relation to commercial transactions often use both personal property and land to secure the same obligation. Currently, a secured party must initiate separate enforcement proceedings against the land and the personal property to meet any outstanding debt secured by both. This is costly and can lead to prolonged enforcement proceedings.

9.33. To allow for efficacy in the enforcement process, to reduce costs and to ensure expeditious resolution of enforcement, the Bill would allow a secured party who has a security interest in relation to both kinds of collateral to apply the land law to the personal property as if the personal property were land (section 156 and section 157).

9.34. Applying land law in this way would give the secured party access to the same rights, remedies, and obligations provided for in the State/Territory land laws. A secured party relying on these provisions in the Bill would be relying on the State/Territory land law in relation to any enforcement action it took against the land and on the Bill in relation to any enforcement action it took against the personal property.

9.35. Applying the land law to the personal property would not involve any expansion or derogation of State/Territory jurisdiction. State/Territory land laws would remain unaffected in their existing application to land.

9.36. The incorporation of the land laws would not require a secured party having an interest in both land and personal property to initiate enforcement action under land laws. The inclusion of these provisions is simply to give a secured party the choice to do so. A secured party could, alternatively, take separate proceedings against the land under the land law and against the personal property under the law relating to personal property

9.37. Where a secured party decides to proceed under land law, the land law of the State or Territory in which the land is situated would apply.

9.38. An election to proceed under the incorporated land provisions releases the secured party from compliance with requirements in Chapter 4, other than the distribution rules in section 177. The rights of other secured parties are still preserved (section 157(6)(a)). The secured party must, for instance, observe a higher ranking party's right to seize the personal property. To ensure that their interests are adequately respected and protected, secured parties are given standing in any proceedings taken to enforce the security under real property law and are entitled to apply to the Court for the conduct of a judicially supervised sale (sections 157(6)(b) and (c)).

### *Consumer Credit Code*

9.39. Where collateral is used for consumer purposes, the Bill and the Code may operate concurrently and, in these circumstances, a secured party would have to comply with both the requirements in the Bill and in the Code.

9.40. Whether the Code applies depends on the purpose of the credit. The Code establishes the rights and obligations of parties where credit has been provided or is intended to be provided wholly or predominantly for personal, domestic, or household purposes.

9.41. There would be overlap between the Bill and the Code when the credit is provided or is intended to be provided wholly or predominantly for personal, domestic, or household purposes; and the collateral is secured against property that is used wholly or predominantly for personal, domestic, or household purposes. The Code would not apply where the credit was intended for business purposes, even if the credit is secured against personal property that is used wholly or predominantly for personal, domestic or household purposes.

9.42. The Bill would not exclude or limit the operation of the Code, to the extent that it is able to operate concurrently (section 15(1)).

9.43. The Code and the Bill contain similar requirements for enforcement. The Code and Bill do contain rights and requirements on which the other is silent. The Code and Bill would also have a number of requirements that correspond. Where both the Code and the Bill contain similar obligations, regulations under the Bill would provide that a secured party who has complied with the relevant provision of the Code would be deemed to have complied with corresponding obligations in the Bill (section 158).

9.44. The concurrent operation of the Bill means that:

- where there are requirements or rights in the Code on which the Bill is silent the secured party must comply with the requirements in the Code,
- where there are requirements or rights in the Bill on which the Code is silent: a secured party must comply with the requirements in the Bill, and
- where there are corresponding requirements in relation to the same party/s in both the Code and the Bill, the requirements in the Bill may be deemed to be satisfied by a secured party undertaking the requirements in the Code.

9.45. To understand how the concurrent application of the legislation would work in practice a list of the differing requirements and rights in the Code and the Bill are detailed in table 9.2.

**Table 9.2: Interaction between the Code and the Bill**

<i>The Code</i>	<i>The Bill</i>
<p><b>section 80</b> After default the credit provider must send a notice to the debtor specifying the action required to remedy the default. The credit provider must wait at least 30 days before taking enforcement action</p>	<p>The Bill is silent on pre-seizure requirements. That is, the Bill would not prevent the operation of section 80 of the Code. Accordingly, a secured party enforcing against collateral used as a consumer good would have to send a notice prior to seizure as required in the Code</p>
<p><b>section 82</b> A secured party cannot enforce a security interest against a guarantor, that is, a person who is a grantor but not the debtor unless the following conditions exist: (i) judgment has been obtained against the guarantor and the judgement has remained unsatisfied; (ii) the court has satisfied the credit provider from obtaining judgment against the debtor; (iii) the debtor cannot be located; or (iv) the debtor is insolvent</p>	<p>The Bill does not provide any pre-seizure conditions where the grantor is not the debtor. Accordingly, the conditions in section 82 of the Code would apply where the collateral is used as a consumer good</p>
<p><b>section 83</b> A secured party must seek the consent of a court to seize goods where the amount outstanding is less than 25% of the credit provided or \$10,000 whichever is the lesser amount</p>	<p>The Bill does not contain any minimum amount that must be outstanding before enforcement action can take place. There is nothing preventing the restrictions in section 83 of the Code from applying</p>
<p><b>sections 84 and 85</b> An acceleration clause in a contract or mortgage may only be applied in certain circumstances</p>	<p>The Bill does not provide any restrictions or qualifications on the operation of an acceleration clause. Accordingly, where a mortgage document relating to a consumer good contains an acceleration clause the provisions of the Code would apply in relation to the acceleration clause</p>
<p><b>sections 86, 87, 88 and 89</b> Postponement of enforcement action either negotiated between the parties or ordered by a court</p>	<p>The Bill is silent on the issue of postponement of enforcement action. As such, the provisions in the Code relating to postponement would apply</p>
<p><b>section 90</b> A secured party may seek details of the whereabouts of collateral from a debtor</p>	<p>The Bill is silent on this issue and therefore there is nothing to prevent a secured party from seeking information about the whereabouts of collateral from a debtor under section 90 of the Code</p>
<p>The concurrent application of the Code and the Bill means that a secured party may, under the Bill seize collateral used predominantly for personal, domestic or household purposes if any applicable preconditions in the Code have been complied with</p>	<p><b>section 161</b> A secured party may seize collateral if the debtor is in default</p>
	<p><b>section 162</b> A secured party with possession or control can be said to have seized the collateral</p>
	<p><b>section 165</b> A secured party with a higher ranking may seize the collateral from the possession of a lower ranking party</p>

*The Code***sections 91, 92 and 93**

A secured party cannot enter residential premises to take possession of collateral without the permission of the occupier or an order from court. A court may order entry. The Code is silent on the issue of apparent possession and accordingly parties could seize by apparent possession under section 164 of the Bill unless this provision has been contracted out of

**section 94**

Within 14 days of taking possession a secured party must provide a notice to the debtor and must not sell the goods within 21 days of providing the notice

*The regulations could provide that section 168 of the Bill would be taken to have been complied with if a notice to the debtor is provided as required under section 94 of the Code*

**section 95**

A debtor may nominate a person who is prepared to purchase the goods

**section 96**

If the outstanding obligation has not been paid within 21 days the debtor must sell the goods for the best price reasonably obtainable

**section 96(3)**

After the sale a secured party must give the debtor a notice stating the gross amount realised, the net proceeds of the sale, the amount required to pay out the credit contract, any further action the secured party intends on taking and matters required under regulations

*The regulations could provide that section 170 of the Bill would be taken to have been complied with if a notice to the debtor is provided as required under section 96(3) of the Code*

**section 97**

A secured party is entitled to deduct the following amounts from the money received from the sale: (i) the amount outstanding and any reasonable enforcement expenses incurred by the secured party; and (ii) all outstanding obligations owed to other secured parties

*The regulations could provide that section 177 of the Bill would be taken to have been complied with if a notice to the funds are distributed as required under section 97 of the Code*

*The Bill***sections 161(1) and 164**

The Bill provides that a secured party may seek seize the collateral by any method permitted by law. As a result, a secured party would have to comply with Code provisions regulating seizure. If collateral cannot be readily moved from a grantor's premises or adequate storage facilities are not available a secured party may seize the collateral by taking apparent possession of the collateral

**section 168**

A secured party must give a notice prior to disposal at least 5 business days prior to the day the collateral is to be disposed

The Bill does not prevent the application of section 95 of the Code. A debtor is free to nominate a person interested in purchasing the collateral

**sections 163, 166 and 169**

Secured party after seizing collateral section must sell or retain the collateral. A secured party must obtain market value or if the collateral does not have a market value the best price reasonably obtainable

**section 170**

A secured party must give the debtor and other interested persons a notice outlining the total amount received from sale, the amount of enforcement expenses, any amounts paid to interested parties and the balance owing to the owner or by the debtor to the secured party

**section 177**

A secured party is required to distribute funds received on disposal in the following order:

- (a) obligations to persons holding interests or security interests that have a higher priority;
- (b) the costs of enforcement;
- (c) the outstanding obligations to the secured party;
- (d) obligations to persons holding interests or security interests in the collateral that have a lower priority;
- (e) obligations to the grantor

**Example**

BankA has a security interest in GrantA's stereo set. GrantA uses the stereo at home. When GrantA defaults on her loan with BankA, BankA decides to take enforcement action against GrantA's stereo. As GrantA uses the stereo predominantly for consumer use BankA must comply with all the obligations in the Consumer Credit Code as well as the requirements in the Bill.

As required by the Consumer Credit Code, BankA provides a pre-possession notice to GrantA and gives her 30 days to remedy the default. Pursuant to the Consumer Credit Code, BankA obtains a court order allowing it to enter GrantA's residence and take possession of the stereo. As required by both the Consumer Credit Code and the Bill, after gaining possession, BankA provides a notice advising GrantA that it intends to dispose of the stereo.

The Consumer Credit Code prevents BankA from selling the stereo until 21 days has elapsed after the giving of the notice. The Bill requires only a period of 10 days to have elapsed before BankA can dispose of the stereo. The regulations would provide, however, that if BankA complies with the requirements in the Consumer Credit Code they are deemed to comply with the Bill.

Accordingly, BankA gives GrantA the pre-disposal notice and waits until 21 days have elapsed before it sells the stereo. By doing this BankA has complied with the Consumer Credit Code and is deemed to have complied with the Bill.

***Enforcement rights where there are multiple secured parties***

9.46. Any secured party would, regardless of its priority ranking, be able to commence enforcement action under the Bill. To ensure no prejudice to the interests of higher ranking secured parties the Bill would provide that a higher-ranking secured party may require a lower ranking enforcing secured party to give it possession of the collateral. This right of higher-ranking parties exists regardless of whether a lower-ranking secured party is collecting and applying liquid collateral (section 159) or whether a lower ranking secured party has seized tangible or intangible collateral (section 161).

9.47. This protects the property and enforcement rights of higher ranking parties, who have a superior property right in respect of competing interests and a superior enforcement right against other secured parties.

***Enforcement of liquid assets***

9.48. The Bill would address the enforcement rights of secured parties where the collateral consists of payments owing to the grantor by a third party. Collateral in this category can take the form of an account, chattel paper, an investment instrument in the form of a debt obligation or a negotiable instrument. These forms of collateral are the equivalent of cash and are practically self-liquidating. A separate enforcement process is provided to ensure that the secured party does not have to go through a two-step process of seizure and sale, but realise the collateral by collection directly from the third party owing the funds to the grantor (section 159 and section 160).

9.49. When liquid assets are collected in accordance with this Part, the enforcing secured party must apply the assets to discharge the obligation secured by the security interest and distribute any amounts/surplus in accordance with the Bill (section 177(3)).



**Example**

GrantA owes FinanciA \$30,000. To secure the loan FinanciA has taken a security interest in the bank account GrantA has with BankA. FinanciA is the only secured party. On 1 January 2028, GrantA defaults on her loan repayments to FinanciA. On 6 January 2028, FinanciA gives a written notice to BankA requiring it to pay \$30,000 from GrantA's bank account (section 159). On 8 January 2008, BankA pays FinanciA \$30,000 from GrantA's bank account, that is, within 5 days of receiving the notice (section 159(3)). FinanciA applies the money received from BankA (\$30,000) towards discharging the obligation GrantA owes it (section 159(4)).

9.50. The secured party must give a written notice to higher ranking secured parties within 10 business days before the day on which third party notice is given or control of the asset is taken (whichever applies)(section 160). This would allow the higher ranking creditor to take enforcement action in its own right (section 160(3)). The enforcing secured party would also have to notify the grantor within 5 business days after the day on which action is taken (section 160(5)).

9.51. When liquid assets are collected in accordance with this Part, the enforcing secured party must apply the assets to discharge the obligation secured by the security interest and distribute the balance in accordance with the Bill (sections 159(4) and (5)).

***Seizure of collateral***

9.52. The secured party may need to seize the collateral on default as a preliminary step in the exercise of further remedies. If the contract failed to provide a contractual right to seize, this would not be determinative, as the Bill would provide for this remedy. The enforcement sections provide for seizure of both tangible as well as intangible collateral.

9.53. A secured party would be able to seize the collateral by any method permitted by law where the debtor is in default under the security agreement (section 161). This would enable parties to determine the method of seizure that is most appropriate to the collateral and to their circumstances.

9.54. Where the collateral is an intangible, the secured party cannot physically possess the collateral. The Bill would deem seizure to have occurred if a secured party takes steps to gain control over an intangible. If the collateral is a licence, the secured party can effect seizure by giving notice of possession to the licensor and either the grantor or the grantor's successor (section 162(2)). If the collateral is any other type of intangible (for example, an investment instrument) a secured party can seize the collateral after giving notice to the grantor (section 162(2)).

9.55. A secured party who has perfected the security interest by possession or control is taken to have seized the collateral under section 162.

***Apparent possession***

9.56. Taking possession of the collateral implies removing it from the grantor's premises to the secured party's premises or control. In general, this is something secured parties wish to do. But physical removal may not always be practicable. A secured party may take 'apparent possession' of collateral where it cannot be readily moved from a grantor's or their agents' premises or where adequate storage facilities are not readily available (section 164(1)).

9.57. Without allowance for apparent possession, secured parties would be forced to remove collateral that is not easily moveable or to continue their search for adequate storage facilities. The section should facilitate expedient seizure and subsequent disposal of the collateral.

9.58. Constructive seizure or apparent possession provides a marker of the movement of the collateral from the grantor to the secured party. Once a secured party has gained apparent possession any interference with this possession would be an interference with the secured party's rights.

9.59. A secured party who takes apparent possession may dispose of the collateral on the grantor's property. To ensure that this section does not work unfairly against grantors, the Bill would provide that secured party must not cause the grantor any greater cost or inconvenience than is necessarily incidental to the disposal (section 164(2)(1)).

**Example**

BankA has decided to enforce its security interest in GrantA's grain which is located in a silo on her property. BankA is unable to find adequate storage facilities in the vicinity of her property and, after meeting the notice requirements under the Bill, advertises the GrantA's grain for public sale by auction despite not having actual possession of the grain.

BankA decides to conduct the auction on GrantA's property, and to run a small market at the auction on GrantA's property. The market stalls are not 'necessarily incidental' to the sale. BankA does not have the right to operate the market stalls. As the stalls will be on GrantA's property, she can prevent BankA from conducting the market stalls.

*Seizure by parties with a higher priority*

9.60. At any time where a secured party has taken possession of collateral, a higher ranking secured party may require that secured party to give it possession of the collateral (section 165). To seize collateral from a lower ranking party, a higher ranking party must provide it with a written notice requiring possession. A lower ranked enforcing secured party must comply with the notice within 5 business days of receiving it or within a reasonable period given the circumstances.

9.61. A higher ranked party that has gained possession of the collateral must pay the enforcement costs of the lower ranked party within 5 business days of obtaining possession. If not paid, the outstanding enforcement costs become a debt due by the higher party and the lower ranked party can initiate court action to recover these costs.

9.62. A higher party who has seized the collateral from a lower ranked party is required to dispose of or retain the collateral as would be required in the Bill.

**Example**

FinanciB decided to commence enforcement action against Dina who was in default of a security agreement over a small aircraft. FinanciB's security interest was second in priority to that of BankA. FinanciB took possession of the aircraft and gave notice to BankA. BankA gave written notice to FinanciB to give possession of the aircraft to BankA. FinanciB must comply. BankA takes over enforcement action.

9.63. By enabling any secured party to seize and enforce against the collateral, the rights of junior secured parties would be protected, in that, they would not be waiting for a higher-ranking party to take action. Conversely, the right of a higher ranking party to seize would enable a higher-ranked party with the opportunity to act to protect its own interests.

## *Disposal*

9.64. Secured parties who seize collateral under the Bill are required to dispose of collateral (section 166) or retain the collateral (section 172).

9.65. The term disposal relates to three different types of remedies:

- sale to a third party,
- sale where the collateral is purchased by the enforcing secured party, and
- lease or licence.

9.66. The disposal provisions apply to all collateral including intangibles such as licences. A secured party may dispose of collateral by sale or lease to a third party (section 166). Any proceeds arising from the disposal must be distributed in accordance with the Bill (sections 166(7) and 177).

9.67. The Bill does not require immediate disposal after seizure. Instead it recognises that there may be circumstances in which a higher price could be realised if disposal was delayed or alternatively disposal needs to be delayed for other reasons. The secured party would be able to delay disposal or retention in whole or part. They would only be able to do so if the delay is reasonable in the circumstances or is in accordance with the security agreement (section 163(2)). Parties may contract out of this provision.

### *Disposal by sale*

9.68. The Bill provides the secured party considerable latitude in choosing the method of sale. A secured party may dispose of collateral by private or public sale (including auction or closed tender).

9.69. Collateral may be disposed of as a whole or in commercial units or parts (section 166(2) and (5)). Enabling disposal in parts allows parties to dispose of collateral components as individual marketable items where they are having difficulty in disposing of collateral in its entirety. Disposal of collateral components may result in different components being sold at different times.

9.70. Disposal of licences must be in accordance with the terms and conditions of the licence (section 166(4)).

9.71. The secured party generally has an incentive to obtain the highest price to limit the need for separate proceedings to recover deficiencies. There are, however, a number of duties or rules that provide some protection interested parties. Firstly, the secured party must provide notice of the disposal which includes the method of sale and the details of when the sale is to be conducted, thus allowing the sale to be 'policed'. Secondly, enforcing secured parties are bound by specific duties when disposing of collateral as well as the more general duty to act honestly and in a commercially reasonable manner.

### *Disposal by lease*

9.72. A disposal by lease may only occur if expressly provided for by the security agreement (section 166(2)(b)). If collateral is disposed by lease, the disposal would occur at the time the lease

is entered into (section 166(3)). The terms of a lease would be determined by the security agreement. Disposal by lease allows for flexibility in disposal.

### **Example**

ManufacturA sells new and leases new and used office furniture. Almost all of its business is aimed at providing office furniture for small to medium sized businesses. GrantA has entered into a conditional sale agreement to buy office furniture from ManufacturA. Under the agreement, GrantA will pay the purchase price of the office furniture over a period of 9 months.

The sale agreement provides that the office furniture will continue to be owned by ManufacturA until the last instalment has been paid. The sale agreement also provides that if GrantA defaults on the sale agreement, ManufacturA is able to dispose of the office furniture either through sale or through a lease arrangement. If the office furniture is leased it must be leased for a minimum of 3 months.

GrantA defaults on its sale agreement. ManufacturA seizes the desks and chairs under the Bill and leases them according to the terms in the sale agreement.

### *Purchase of collateral by secured party*

9.73. A secured party who seizes collateral that is commercial property (and not used for consumer purposes) for the purposes of the Bill may dispose of the collateral by purchasing it (section 167).

9.74. A significant concern of interested parties is that a secured party who purchases collateral may purchase it for less than its market value. To prevent this happening, the Bill sets out a process by which notice of intention to purchase must be given to the grantor and other interested parties, who then may object to the purchase. A secured party may only purchase the collateral if an objection to the purchase is not received (section 167(2)).

9.75. A secured party may only purchase collateral by public sale (including auction or closed tender) for a price that bears a reasonable relationship to the market value of the collateral (section 167(3)).

9.76. Regardless of how it intends to dispose of the collateral, a secured party who has seized the collateral would be required to provide notice of its intention to dispose (section 168). The purpose of the notice is to advise interested parties that the secured party intends to take the final step in enforcing against the collateral. Interested parties are then free to either seek to redeem or reinstate the collateral. Notice recipients may also seek to police the disposal to ensure that it is conducted in a commercially reasonable manner.

### *Pre-disposal notice*

9.77. A secured party is required to notify the grantor, a person with a registration covering the collateral and certain persons with an interest or claimed interest in the property. This notice must be given at least 5 business days before the day on which the collateral is to be intended to be disposed of (section 168(2)).

9.78. The secured party would not be required to give notice in certain circumstances including:

- where the secured party, after making reasonable attempts to locate the person, has failed to do so (section 182),
- where financial damage may be suffered if collateral is not immediately disposed of,

- where the collateral is perishable, and
- where the secured party reasonably believes that the value of the collateral is prone to substantially decline if not disposed of immediately (section 168).

9.79. These exemptions ensure that the notice provisions do not prejudice the interests of all parties in obtaining the maximum value that could be gained from the collateral being sold at its peak. By providing these exemptions, the Bill allows for parties to act immediately to dispose of goods with a limited shelf life.

*Duties owed by a secured party when disposing of collateral*

9.80. When disposing of collateral to third parties the secured party would owe a duty to exercise reasonable care to obtain at least the market value for the collateral or, if there is no market value, to obtain the best price that is reasonably obtainable, having regard to the circumstances that exist at the time (section 169). This is the same duty on sale as that required of a controller of property of a corporation under section 420A of the *Corporations Act 2001*.

9.81. Breach of this provision does not depend on an actual failure to achieve either the market price or the best price reasonably obtainable. The issue to be determined is whether the process that was followed was one where all reasonable care was taken to sell the property for its market value, or alternatively for the best price reasonably obtainable.

9.82. The provision requires that the collateral be marketed in a manner appropriate for sale of collateral of that type. Accordingly, much would depend upon the circumstances of each sale. The secured party exercising a sale would be expected to, where appropriate, obtain proper valuations, advertise appropriately, maintain the collateral in good condition pending sale and choose an appropriate venue for the sale.

9.83. This section enshrines the right of interested persons to ensure that the enforcing secured party works to obtain the best achievable price, rather than obtain a price that would meet its own interests. This duty operates in conjunction with the requirement for secured parties to exercise their rights honestly and in accordance with ordinary commercial practice (section 235).

9.84. This provision is critical to the debtor because the grantor is liable to make good the deficiency between the sale price and outstanding obligations. The debtor would also receive any outstanding surplus after others have been paid the value of their interest. Other secured parties also have a critical interest to ensure that the maximum is achieved. If secured parties do not receive the amount of the outstanding obligation owed they would be required to take separate legal action against the debtor.

9.85. If reasonable steps are not taken to achieve this outcome, interested parties would be able to claim that a statutory breach had occurred. They would be able to take legal steps to either ensure that adequate steps are taken. Alternatively, they would be able to claim for damages suffered as a result of the statutory breach.

***Statement of account***

9.86. Where a secured party has disposed of collateral or exercised its collection rights, those with an interest in any surplus should be entitled to find out the basic financial and logistical details.

9.87. A secured party who disposes of collateral must give a written statement of account to all interested parties on request (section 170). This statement must be given within 20 business days following the request or such further period as is reasonable in the circumstances (section 170(2)).

9.88. The notice is the means by which enforcing secured parties account to interested parties as to how much was received from the disposal and how these funds were distributed. The statement would help interested parties ensure that the proceeds of the disposal are properly accounted for.

***Acquirer taking free of security interest***

9.89. A person acquiring collateral after disposal would do so free of a number of interests on the collateral (section 171), namely:

- the interests of the grantor of the collateral,
- the security interest of the enforcing secured party, and
- all security interests that are lower in priority to the interest of the enforcing secured party.

9.90. The Bill would not discharge higher ranking security interests. An acquirer would acquire the collateral subject to the security interests of higher ranked parties. However, the higher ranking security interest may be discharged in accordance with the terms of the security agreement if the enforcing secured party realises sufficient funds to achieve this.

9.91. The rules relating to an acquirer taking free of security interests need to be read in conjunction with the distribution rules (section 186), which require payment to the higher secured party ahead of amounts owed to the enforcing secured party.

9.92. Secured parties who take a lower-ranked security interest would take that interest in the knowledge of their priority placing and on the basis that their subordinate status would have consequences in enforcement.

***Retaining collateral***

9.93. The Bill would also allow a secured party to enforce their security interest by retaining collateral (section 172) they have seized. However, the collateral may not be retained if it is collateral that is used predominantly for personal domestic or household purposes (section 149(4)).

9.94. There may be scenarios where it is commercially advantageous for a secured party to retain collateral rather than sell it and the Bill would allow them to do so. The capacity to retain collateral corresponds to a creditor's existing right to seize and retain collateral on default under a retention of title arrangement. However, retention is not an absolute right and the Bill provides a process for ensuring that the interests of all interested parties are considered in the event that a secured party seeks to retain collateral. This is particularly important, given that the remedy of retention, as established in the Bill, does not require a secured party to compensate other interested parties for

the loss of their interest in the collateral. The process of notice and objection established would play an important role in balancing the interests of all interested parties.

9.95. Before a secured party can retain property it would be required to follow the processes outlined in sections 172 to 176 of the Bill.

9.96. If a secured party wishes to retain collateral it must give notice of its intention to the grantor, debtor, other secured parties and others with an interest in the collateral (section 173). Persons given this notice may object to the secured party's proposal of retention (section 175(2)). The objector must give notice to the secured party within 10 business days after the day on which the objector received the secured party's notice (section 175(2)).

9.97. If the secured party is given an objection notice, the secured party must sell or lease the collateral rather than retain or purchase it as had been proposed (section 175(3)).

9.98. After receiving an objection a secured party is entitled to seek proof of the objector's interest in the collateral. If such proof is not provided within 10 business days of the request, the notice of objection would be taken not to have been given (section 176).

9.99. If a secured party gives the required notice concerning the retention of collateral and receives no objections by the end of 10 business days after the day the last notice is given, the secured party would be taken to have irrevocably elected to acquire the collateral in satisfaction of the obligation secured by it (section 174(1)). Following this the secured party becomes the unencumbered owner of the property and may deal with it as they wish.

9.100. A secured party may, however, need to take steps to ensure that legal title to the property passes to them as this would not occur by operation of law.

9.101. Once the remedy of retention is exercised, the enforcing secured party would have no right to obtain any of the outstanding obligation from the grantor. It is likely that a secured party would negotiate acceptable terms of compensation with other secured parties.

9.102. A secured party who has a higher ranking priority may gain possession of the collateral with a view to retaining it themselves. However, it would still be required to provide notices and would only be able to retain the collateral if objections to its proposal were not received. Alternatively, they may object to the party retaining the collateral and thereby force a sale or lease of the collateral.

9.103. Similarly, secured parties who are subordinate to the retaining secured party and the grantor(s) may also object to the retention of the collateral. This is especially important as the subdivision does not provide for subordinate parties or the grantor to receive anything if the value of the retained collateral is greater than the amount owed to the retaining secured party

9.104. The Bill would provide that a secured party who has acquired title to the collateral acquires the collateral free of the interests of both the grantor and subordinate security interests (section 174(2)).

### ***Common rules relating to enforcement***

9.105. Any proceeds received from the collateral either through enforcement against liquid collateral (section 159) or by disposal (section 166) must be applied to meet outstanding obligations of the enforcing secured party and subordinate interest holders (section 177).

9.106. Distribution of proceeds must be paid towards satisfying the following outstanding amounts:

- obligations to persons holding interests or security interests that have a higher priority,
- the costs of enforcement,
- the outstanding obligations to the secured party,
- obligations to persons holding interests or security interests in the collateral that have a lower priority, and
- obligations to the grantor.

9.107. This distribution order may mean that, where there are insufficient funds, parties lower in the order may not recover the amount owed to them. This section applies in relation to a security interest even if it is extinguished under section 171.

9.108. Where a secured party has taken enforcement action and, as a result, the security interest of subordinate secured parties has been extinguished, the interest of higher ranking secured parties would be preserved (section 186(5)).

9.109. The order of payment outlined above is based on the order of priority of interests in the collateral.

9.110. Where a secured party does not receive funds from the distribution or there is a shortfall in the amount received, the secured party is able to initiate legal action against the debtor personally for the outstanding obligation.

9.111. Where a secured party is unable to determine the order in which proceeds should be applied, the secured party would pay the proceeds to the Commonwealth (section 178). The Commonwealth would pay all or part of the proceeds to a person only if a court has ordered the whole or the part to be paid to the person, all parties with an interest in the collateral have consented in writing to the payment, or the PPS Registrar believes on reasonable grounds that a court would make that order and it is not commercially practicable or reasonable for the person to make an application (section 178(3)(c)).

### ***Redemption***

9.112. The right of redemption is the right to cure the default and redeem the collateral at any time before the collateral is irrevocably disposed of by sale or foreclosure.

9.113. The Bill provides the debtor, and higher ranking secured parties, the right to redeem the collateral (sections 180(1)).

9.114. A debtor's right to redeem the collateral would have priority over the right of any other party the higher ranking secured party's right to redeem the collateral (section 180(3)).



9.115. Redemption would be given effect when the redeemer pays the amount required to discharge the obligation secured by the collateral and the amount of any reasonable expenses incurred by the secured party relating to taking possession, holding, storing, repairing, maintaining, valuing and preparing the collateral for disposal or retention. A person redeeming the collateral would have to pay the entire amount required to discharge all obligations, not just the amounts secured by the collateral. If the obligation secured by the collateral exceeds the value of the collateral, the redeemer would nonetheless be required to pay the higher amount.

9.116. Parties to a non-consumer transaction may contract out of the right of redemption (section 154).

9.117. Once retention has occurred, section 171 guarantees title to collateral free of the interests of the grantor, the enforcing secured party and lower ranking secured parties.

### ***Reinstatement of the security agreement***

9.118. A grantor, debtor or other person entitled to receive the notice of disposal may reinstate the security agreement before the collateral is disposed of or is retained. The right of reinstatement is meant to protect grantors and debtors from overreaching creditors where their default is minor, temporary and aberrational. It is not meant to encourage chronic tardiness in payment.

9.119. The Bill would establish several safeguards against the risk of debtor abuse of the remedy. The person seeking reinstatement must not only pay the amount in actual arrears but also cure any other default and reimburse the secured party's enforcement expenses (section 190(1)).

## 10. PERSONAL PROPERTY SECURITIES REGISTER

10.1. Chapter 5 would establish a single national online Personal Property Securities Register (the PPS Register) under which personal property that is or may be subject to a security interest can be registered.

10.2. The main object of the PPS Register would be to provide a real-time online noticeboard of personal property over which a security interest has been, or may be, taken. The PPS Register would replace an array of existing electronic and paper-based registers. It would be a voluntary registration scheme, allowing secured parties to weigh up the costs and benefits of registering their security interests.

10.3. The PPS Register would contain information about security interests. All security interests in personal property would be registrable regardless of the form of the security interest, the legal personality of the grantor of the interest, the nature of the collateral or the jurisdiction in which the property or the parties are located. Registration of security interests will be voluntary. However, parties should be aware that failure to register a security interest on the PPS Register may result in a loss of priority to a third person or unenforceability against a liquidator, administrator, trustee in bankruptcy or the Official Receiver.

10.4. It is anticipated that registration would be the most commonly used method of perfecting a security interest for the purpose of establishing priority in enforcement and effectiveness on insolvency. A person would also be able to search the PPS Register to determine whether a prior registered interest exists in personal property when deciding whether to purchase that property or to lend money in relation to it.

10.5. A simple targeted electronic 'registration' would provide notice to the world of any actual or prospective security interests without the need to sift through complex documentary material as occurs in many of the schemes to be replaced by the PPS Register. This approach makes advance registration of security interests possible; that is, property may be registered on the PPS Register before a security agreement is made or the security interest attaches to it.

10.6. While the PPS Register would primarily be accessed using a web browser, it would also be supported by a business to government interface, a physical document lodgement service, a contact centre and SMS message connectivity. PPS Register information would be transmitted using secure, encrypted methods of communication.

### **Example**

GrantA applied for a loan with FinanciA using its business assets to secure the loan. FinanciA registered the business assets on the PPS Register before approving the loan.

### ***Establishment of the PPS Register***

10.7. The PPS Register would be established and maintained by a Registrar of Personal Property Securities (section 186(1)). While the Registrar may keep the register in any form that he or she considers appropriate, the Government proposes to implement a fully electronic register from 1 May 2010.

10.8. The PPS Register would be maintained and operated at all times (section 186(3)). This means that it would be available day and night, as well as on weekends and public holidays when large numbers of secured transactions take place. The Registrar would be able to refuse access to, or suspend the operation of, the PPS Register, in whole or in part, where it is not practical to provide access (section 186(4)). If this occurs, the Registrar must publish notice of the suspension or refusal in a way prescribed by the regulations and, if not prescribed, by Gazette (section 186(5)).

**Example**

The Registrar may consider that it is not practical to maintain the PPS Register when upgrading the IT system or during an IT failure that closed down part of the register.

10.9. The PPS Register could contain a range of information about personal property in which a security interest is or may be taken, including an audio or video file, a photograph or a manuscript (section 187(a) and (b)). This would allow buyers and financiers to readily identify property that is subject to an actual or potential security interest. The PPS Register would not, however, operate as a de facto method of obtaining material subject to copyright protection as such access would not be authorised by the legislation.

10.10. There would also be scope to register property subject to other kinds of interests: such as those that arise in vehicles impounded by State and Territory police because of their use in unlawful activities ('hoon liens')(section 187(c)). Any such interests could be included on the PPS Register by regulation with the provisions in Chapter 5 being applied with necessary or desirable modifications (section 188). This policy initiative is designed to help prospective purchasers and lenders to obtain the most-up-to-date information about the status of personal property. The list of interests to be recorded on the PPS Register is still to be settled.

***Registration: application and contents***

10.11. A person may apply to the Registrar to make a 'registration' of personal property on the PPS Register under section 189(1). However, a person must not apply for a registration of personal property as collateral unless the person believes on reasonable grounds that a security interest in the property is, or will be held by a person stated in the application as a secured party (section 190). Where a person registers without such a belief they will be taken to have contravened an obligation owed to any person with an interest in the personal property. This will not affect the validity or effectiveness of the registration, but may give rise to a right to claim damages under section 236.

10.12. The Registrar must give effect to a registration where:

- the application is in a form approved by the Registrar,
- the registration fee has been paid or an arrangement for payment has been made,
- the Registrar is not satisfied that the application is frivolous or vexatious or made in circumstances in which the registrant does not believe on reasonable grounds that it holds or will hold a security interest in the property stated in the application, and
- the registration is not prohibited by the regulations (section 189(2)).

10.13. If a person applies to register personal property and does not hold a reasonable belief that she or he holds or will hold a security interest in the property, the registration will nonetheless be effective in the absence of any invalidating defect.

10.14. While applications for registration must be in writing, they would predominantly be lodged electronically through a web browser or through a business to government interface. The *Electronic Transactions Act 1999* would have the effect that any applications made in accordance with the Bill could be made by electronic transmission of words or data or the display or representation of words or data by any form of communication.

10.15. Registration fees would be payable on a ‘pay as you go’ basis or by arrangement with the Registrar (in accordance with arrangements determined by the Minister under section 230). This capacity to make arrangements with the Registrar has been included to facilitate commerce and to reduce business costs and inconvenience.

**Example**

FinanciA projected that it would undertake about 1,000 transactions on the PPS Register each month. To overcome the inefficiency of multiple small ‘as you go’ transactions, FinanciA enters an arrangement with the Registrar of Personal Property Securities for the invoicing and payment of fees on a monthly basis.

*Contents of the PPS Register*

10.16. In making a registration, a person—being a secured party or its agent—would be required or authorised to enter a range of information including:

- details about the secured party and related information such as an address for giving notices to the secured party (section 191, table items 1 and 3),
- details about the grantor except where the collateral is consumer property and required by the regulations to be described by a serial number (section 191, table item 2)(in such cases, the serial number will be sufficient to allow a search of the register to disclose a registration over the collateral without grantor details),
- a description of the collateral and proceeds (including as prescribed by the regulations (section 191, table item 4) involving:
  - description as either ‘consumer property’ or ‘commercial property’,
  - a serial number where required by the regulations,
  - allocation to a single class as prescribed by the regulations, and
  - where proceeds are claimed, a description of proceeds in accordance with the regulations,
- the end time of the registration (optional)(section 191, table item 6 and section 192(2)),
- details of any subordination agreements (optional)(section 191, table item 7), and
- any other matter prescribed by the Act or regulations (section 191, table item 9 and section 192(4)).

10.17. For the purposes of the registration provisions, the ‘grantor’ and ‘secured party’ include a person who is named as such in a registration regardless of whether they have granted an interest in, or are a secured party in respect of, registered personal property (see section 26, definitions of ‘grantor’ and ‘secured party’).

10.18. The PPS Register would contain other information such as the ‘initial registration time’, being the time that the registration first became available for search on the PPS Register

(section 191, table item 5 and section 193). This information would be recorded by the PPS Register system.

*Multiple grantors and secured parties*

10.19. Reflecting commercial realities, a collateral description may include multiple secured parties and/or multiple grantors (section 192(1)). This would be important where people hold or propose to hold the property jointly, or as tenants in common when jointly accessing credit. There may also be occasions where credit is offered by multiple secured parties, such as on a joint venture basis.

*Names and other information to identify grantors and secured parties*

10.20. The details to be included on the PPS Register about a secured party or grantor would be prescribed by regulation. It is anticipated that individuals would be identified by their name and date of birth. Other persons would be identified by the Australian Company Number (ACN) issued under the *Corporations Act 2001* at registration; the Australian Registered Body Number (ARBN) issued to a 'registrable body' under that Act; the Australian Registered Scheme Number (ARSN); and for those that do not have an ACN, ARBN or ARSN, their name as it appears in its constitution or other prescribed method (for example, for trusts, partnerships and bodies politic).

10.21. Further information about the details proposed to be recorded on the PPS Register in relation to secured parties and grantors is set out in a Discussion Paper on the Regulations to be made under the Personal Property Securities Act which can be found at:

[http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews\\_personalpropertysecuritiesreform\\_PPSSDownloads](http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_personalpropertysecuritiesreform_PPSSDownloads)

10.22. The incorrect entry of the name of an individual grantor would be a registration error that would result in a registration being ineffective (and therefore invalid). Sometimes, this may occur because of simple inadvertence but, more often, because people are known by a name that differs from the name that appears on the relevant identification document/s. To promote certainty, the regulations would stipulate the sources of identification from which names and dates of birth would be drawn and the format that data is to be entered on the PPS Register. The PPS Register system may adopt rules that ignore the use of accents, hyphens and non-alphabetic symbols.

10.23. Secured parties would be wholly responsible for the accuracy of all details contained in their registrations. However, to assist users to maintain the accuracy of registrations, the PPS Register system could perform validity checks against other databases (such as the National Names Index or the Australian Business Register administered, respectively, by the Australian Securities and Investment Commission and the Australian Taxation Office). This application of IT technology would help to promote the integrity of information recorded on the PPS Register.

*Other secured party information*

10.24. Secured parties would also be able to enter a unique number (or identifier) devised by them in relation to particular registrations (section 191, table item 3(b)). This would also assist in channelling requests for information pertaining to the property and/or security agreement to the appropriate person engaged by the secured party (section 251).

10.25. As some repeat customers may engage agents to apply for PPS Register registrations and amendments, search the PPS Register and perform related tasks, other persons can be nominated by

the secured party as having authority to act on its behalf in relation to the registration (section 191, table item 1(b)).

### *Collateral descriptions*

10.26. A focal part of each registration would be the ‘collateral description’ which would describe key attributes of the property that is the subject of the registration (section 191, table item 4).

10.27. Personal property must be described on the PPS Register as ‘consumer property’ or ‘commercial property’ (section 191, table item 4(a)). This distinction is important because the Bill contains special consumer safeguards to ensure that consumers are not subject to the full range of rules designed for commercial transactions. By way of example, there would be a special rule to ensure that registrations over consumer property are ended as soon as the underlying property ceases to secure any obligation to the secured party.

### *Allocation of a single class and other descriptors prescribed by regulation*

10.28. All of the collateral described in a particular registration would have to be allocated a single class as prescribed by the regulations (section 191, table item 4(c)). The classes are yet to be settled, but are likely to include motor vehicles, boats, aircraft, other goods, crops or livestock, a transfer of chattel paper or accounts, current assets (other than inventory) and so on. The list of classes is set out in the Discussion Paper on the Regulations to be made under the Personal Property Securities Act, which can be found at:

[http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews\\_personalpropertysecuritiesreform\\_PPSTDownloads](http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_personalpropertysecuritiesreform_PPSTDownloads).

10.29. Reflecting current practices in relation to general company charges, it is proposed that the prescribed classes would include ‘present and after-acquired property’ and ‘present and after acquired property except specified property’ (with a capacity to describe the exception in a free text field).

10.30. It is anticipated that the regulations would allow secured parties to enter free text into a separate data field in the registration in order to provide further particulars of the property (section 191, table item 9 and section 192(4)). This would make it easier for third parties searching the PPS Register to accurately identify the property.

#### **Example**

FinanciA made a registration against GrantA’s wheat crop. It described the collateral as ‘crops’, and entered the description of ‘wheat’ in the free text field.

#### **Example**

FinanciA made a registration against GrantA’s present and after acquired property apart from scuba equipment. It allocated the class of ‘all present and after acquired property except’, ‘other goods’ and placed ‘scuba equipment’ in the free text field.

10.31. It is also proposed that the regulations would allow a person to enter other data on the PPS Register (section 192(4)). The regulations would supplement section 187(b)(which deals with the contents of the PPS Register) and allow the parties to attach documents to their collateral

descriptions such as audio or video files, photographs or manuscripts. Again, this would assist the ready identification of personal property.

**Example**

PurchasA wants to buy a painting from GrantA. PurchasA searched the PPS Register and discovered that it was already registered by BankA. PurchasA was able to identify the painting on the PPS Register by the photograph that BankA had attached to its registration against GrantA.

*Serial numbered goods—motor vehicles and other goods*

10.32. It is proposed that the PPS Register would take the place of existing State and Territory schemes for registering encumbrances over motor vehicles (such as the REVS and VSR schemes), and would extend to other property assigned a serial number in accordance with recognised standards.

10.33. In circumstances prescribed by the regulations, such as when the collateral is consumer property, it would be mandatory to describe property registered on the PPS Register by its serial number: such as the vehicle identification number (VIN) or chassis number applied to motor vehicles (section 191, table item 4(b)). This would help PPS Register users to readily identify property. It would also promote privacy protection as such property would be identifiable on the PPS Register by the serial number, rather than by the grantor's name.

10.34. Where serial numbered goods are registered as 'commercial property', it would be optional for the secured party to record serial numbers (section 191, table item 9 and section 192(4)). This approach is taken to avoid the inconvenience of requiring secured parties to continually update the PPS Register in relation to car-lot inventory and the like.

10.35. This would allow the PPS Register to link with other databases such as the National Exchange of Vehicle and Driver Information System (NEVDIS). NEVDIS would return information about whether the vehicle has been reported as written off or stolen. Including this information in the search result would give consumers greater confidence that they are buying property that is not subject to a security interest or other restriction.

**Example**

When PurchasA decided to buy Sella's car, it searched PPS Register for possible registrations. Using the SMS service, PurchasA texted the VIN to the PPS Register. Shortly afterwards, a reply SMS message was received from the PPS Register indicating that the vehicle was clear of any registrations and had not been reported as written off or stolen. The message also contained a search code that would allow the PurchasA to access a written copy of the PPS Register search result.

*Proceeds*

10.36. A secured party would be able to describe the collateral as including any proceeds arising from the sale of the property (section 191, table items 4(d) and 9). This is important because it means that the proceeds can be perfected in the same way as the original collateral thereby allowing priority and enforceability against third parties. Where proceeds are to be specifically claimed, the secured party must indicate this in the registration in order to obtain perfection. The way in which proceeds can be claimed will be prescribed by the regulations.

*Subordination agreements*

10.37. A secured party would be able to record the details of any subordination agreements that postpone the secured party's interest to that of another person on the relevant registration or registrations (section 191, table items 7 and 9). Disclosure of subordination agreements would be optional because the subordination would only affect the priority position of those people bound by it. The details of information to be recorded would be set out in the regulations.

*Registration times*

10.38. The PPS Register system would assign some of the required information to registrations such as the time that the registration becomes available for search in relation (the 'initial registration time')(section 191, table item 5). This would assist people with an interest in property to determine when that property was first registered on the PPS Register. This information would be important when determining the priority of competing interests in property that are to be enforced. Where a registration is amended to add collateral, the added collateral would have its own registration time (although this would be described on the PPS Register as an 'amendment time'—see section 191, table item 8, section 193 and section 205(2)).

10.39. The allocation of registration and amendment times by the PPS Register system is important for ensuring that the data recorded on the PPS Register is accurate and consistent across registrations. Accuracy would be imperative where, for example, two parties have competing PPS Register registrations over collateral and are seeking to enforce their respective interests. Such disputes would be more easily resolved using the results of a printed search result generated by the PPS Register system.

**Example**

FinanciA registered GrantA's painting on the PPS Register. Immediately after the registration was transmitted to the PPS Register, it became available for search. This moment is the 'registration time'. When FinanciA lent more money to GrantA to buy a second painting, it amended its registration to include the new painting. When the amendment was transmitted to the PPS Register, it became available for search. This moment would be the 'registration time' for the second painting, but would be recorded as the 'amendment time' for the registration.

*End times, default end times and renewal of registrations*

10.40. Registrations would have a period of registration that commences from the 'initial registration time' and ends at the moment that the registration ceases to be available for a real-time search on the PPS Register (the 'end time')(sections 191, table items 5 and 6, 192 (2) and (3), 193, 196 and 200). Secured parties could renew a registration by amending the registered 'end time'. The purpose of requiring renewal is to protect people from being subject to stale registrations on the public record that do not reflect their current circumstances and which may impede their capacity to obtain finance.

10.41. When making a registration, a secured party would have the option of specifying an 'end time' for the registration. Where an end time is not specified or does not comply with the rules for default registration periods, the PPS Register system would assign a 'default end time' according to the type of property and 'default registration period' (see section 191, table item 6 and sections 192(2) and (3)).



10.42. For consumer property and other property described in a registration by a serial number, the default registration period would be no later than the end of the day seven years after the registration became available for search on PPS Register (noting that the registration would be extendable by increments of up to seven years)(section 191, table item 6(b)). Commercial property, such as inventory or equipment, would be registrable for a period of up to 25 years after the end of the day the collateral became available for search or on an indefinite basis (section 191, table item 6(a)). Registrations over commercial property could be extended by increments of up to 25 years or by amending the registration to continue on an indefinite basis.

10.43. Where a secured party has specified an end time that occurs before the initial registration time or that ends at a date beyond the relevant default registration period, the PPS Register system would assign an end time based on the relevant default registration period (that is, of 7 and 25 years as appropriate).

**Example**

FinanciA registers GrantA's car on 1 January 2020. It does not enter an end time for the registration so that the PPS Register system assigns a default end time of 1 January 2027 in accordance with the rules for the 'default registration period' for consumer goods.

On 1 January 2021, FinanciA lends GrantA more money against the car and tries to extend the registration by entering an end date of 1 January 2034. Under the 'default registration period' rules, the PPS Register assigns a default end time of 1 January 2028.

*Regulations*

10.44. The regulations would allow for matters relating to the contents of a registration to be prescribed (section 191, table item 9 and section 192(4)). It is envisaged that most matters that would be prescribed by regulation would concern, but not be limited to, grantor and secured party details and collateral descriptions. Further information about the details to be recorded on the PPS Register in respect of secured parties and grantors is set out in a Discussion Paper entitled Regulations to be made under the Personal Property Securities Act which can be found at: [http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews\\_personalpropertysecuritiesreform\\_PPSTDownloads](http://www.ag.gov.au/www/agd/agd.nsf/Page/Consultationsreformsandreviews_personalpropertysecuritiesreform_PPSTDownloads).

***Registration: timing***

10.45. The PPS Register would be based on notice filing rather than document filing. Personal property would be registrable before or after a security agreement is made describing the property (section 194). This makes it possible for secured parties to register their collateral descriptions before the security interest attaches to the property. A registration would be effective even though no security agreement has been made and/or no security interest has attached to the property. There would be no requirement for the person offering the property as security to sign any documents prior to registration.

10.46. Advance registration would allow secured parties to know their order of registration (and potentially their order of priority) while still negotiating the transaction. This would enhance certainty in commercial arrangements as parties would have a greater awareness of their relative priority over personal property. Improved certainty in this area should contribute to lower finance costs for individual borrowers as well as the general public.

10.47. The general rule would be that a registration commences from the moment that the collateral description becomes available for search on the PPS Register in relation to a particular secured party (section 193(1)). This moment would coincide with the time that the registration is entered into the PPS Register.

**Example**

On 1 January 2020, FinanciA registered GrantA's wheat crop on the PPS Register in anticipation of entering a loan agreement. The collateral was registered from the moment it became available for search on the PPS Register even though the security interest only attached to the crop from 1 March 2020 when FinanciA lent money to GrantA.

10.48. When property is added to a registration, the added property (and any proceeds as described) would only be registered from the moment that the new collateral description becomes available for search on the PPS Register (section 193(2)). That is, registration of that added property would not be taken to have commenced at the initial registration time (being the registration of the earlier registered property).

**Example**

GrantA applied for a loan extension with FinanciA using its barley crop as further security. On 1 July 2022, FinanciA added GrantA's barley crop to its PPS Register registration. The wheat crop registration commenced on 1 January 2020, while the barley crop registration commenced on 1 July 2022.

10.49. Consistent with the 'noticeboard' concept, the PPS Register would allow a registration to reflect the transfer of a security interest or of the collateral before or after the transfer (section 195).

10.50. Where a security interest in property is transferred to another secured party, the secured party could add the prospective secured party to the registration as a new secured party and, in effect, transfer the registration to them by later arranging for the removal of their name. The 'registration time' for the property would not be affected. Alternatively, the prospective secured party could apply for a new registration. Here, the registration time would, by operation of law, be the registration time for the original collateral provided that the property had been continuously perfected since the initial registration time (that is, there is no gap in time between the omission the property from the old registration and the new registration of that property).

**Example**

FinanciA sold its security interest in GrantA's crops to BankA. The transfer could be reflected in PPS Register in one of two ways. FinanciA could add BankA as a secured party to its registration and, after the transfer, BankA would remove FinanciA as a secured party.

Alternatively, BankA could register GrantA's crops in a new registration. FinanciA would have to end its effective registration against GrantA's crops after the transfer is complete. BankA would take a subordination agreement from FinanciA in case FinanciA did not end its registration.

***Effective registration***

10.51. The Bill would use a concept of 'effective registration'. This would describe when a person has a notice recorded on the PPS Register that is valid. This would be important for the purposes of

establishing, in the context of a priority dispute or a grantor's insolvency, that the person is a secured party with a security interest in personal property that is perfected by registration.

10.52. In the absence of any disqualifying defects, a registration of particular collateral would be effective from the 'registration time' of the relevant collateral until the earliest of the following times: the registration reaches the end time for the registration; the collateral is omitted from the registration; or the description of the collateral otherwise ceases to be available for search (for example, where the Registrar has removed the data because it is frivolous or vexatious) (section 196).

10.53. An effective registration could also be brought to an end by the Registrar pursuant to section 197 for failure to pay a maintenance fee. This section would only apply where the Minister has determined that a fee is payable to maintain a registration (under section 230(1)(b)) and the Registrar has issued a notice requiring the secured party to pay the fee. The notice must specify a time by which the fee must be paid and include<sup>4</sup> a statement of the effect of a failure to pay the determined fee. This provision is included to ensure parity of fees between the different types of registrations, particularly as between those relating to consumer property and serial numbered goods (which are subject to a default registration period of 7 years) and those that have an indefinite duration. It could be used to remove registrations when the secured party declines to pay the maintenance fee.

#### *Defects in registrations*

10.54. It is the secured party's responsibility to ensure that the information registered on the PPS Register is accurate and complete. A registration would be ineffective in certain circumstances (section 198). Specifically, the registration may contain a seriously misleading defect in any data relating to the registration or another defect that is specifically mentioned in the Bill as rendering a registration ineffective. A defect includes an irregularity, omission or error in the registration (see the definition of 'defect' in section 26).

10.55. A registration would be ineffective where there is a seriously misleading defect in any data relating to the property (section 198(2)(a)). This policy approach has been adopted to promote the reliability of PPS Register data. This rule would not necessarily make a registration defective on the basis of a simple mistake, such as a typographical error in a free text field. Nor would it be likely to capture errors of a more substantive kind that do not seriously mislead a person. For example, the omission of the name of one secured party in a consortium would not be seriously misleading whereas an incomplete or inaccurate collateral description would be likely to be so.

10.56. In order to establish that a defect is seriously misleading, it would not be necessary to prove that any person was actually misled by the registration (section 198(3)). This means that parties would need to objectively consider whether certain errors are seriously misleading. This would promote the integrity and reliability of the PPS Register system and minimise recourse to litigation.

10.57. For the same reasons, the Bill would establish specific circumstances in which a registration would be ineffective (section 199). These are:

- where the collateral is described by a serial number in the PPS Register—no search of the PPS Register by reference only to the serial number is capable of disclosing the registration (this rule will apply to registrations covering either consumer property or commercial property)
- where the collateral is described by a serial number in the PPS Register and the regulations also require the grantor's details to be provided—no search of the PPS Register by reference only to

the grantor's details is capable of disclosing the registration (this rule will only apply to commercial property by virtue of section 191, table item 2

- in any other case—no search of the PPS Register by reference to the grantor's details is capable of disclosing the registration, and
- a defect in the data related to the registration that is prescribed by the regulations.

**Example**

FinanciA made a number of errors when entering data into the PPS Register. For example, it registered: GrantA's car using an incorrect serial number (12344 instead of 12345); and GrantB's name using the incorrect ACN. Either of these errors is sufficient to render the registration ineffective.

10.58. One exception to the general rule regarding registration defects arises in relation to the description of particular collateral that forms only part of the property subject to the registration. Specifically, the registration of certain collateral would not be ineffective for the sole reason that the registration of other collateral in the same registration is ineffective (section 198(4)). This means that a registration may be partly effective and partly ineffective.

**Example**

After FinanciA registered GrantA's wheat crop, it added GrantA's barley crop. In the free text description, FinanciA mistakenly entered the phrase 'and canola' (rather than 'and barley'). The misdescription of the barley crop did not affect the registration of the wheat crop, which continued to be effective.

*Registration continues despite certain defects*

10.59. Registrations would continue to be effective despite certain defects arising over time. This might occur, for example, where the grantor's name becomes seriously misleading because of a name change following marriage. In such cases, the registration would remain effective until the earliest of:

- the end time for the registration as registered immediately before the change,
- the end of the month that is 60 months (5 years) after the change, and
- the end of 5 business days after the day that the secured party acquires the knowledge of the defect (section 200), or as extended where approved by a court (section 257).

10.60. A secured party would have the knowledge required to correct a defect if the secured party has actual knowledge of the defect or would have had such knowledge had they made enquiries that would be made by an honest and prudent person (sections 201 and 56(2)). Finance providers should not be subject to unduly onerous requirements to update the PPS Register, but could be expected to undertake periodic reviews of their customer loans. Where such reviews reveal a change of circumstances, registrations made by the secured party should be amended to include updated information. This would ensure continuing priority in the property, but is also desirable to assist other PPS Register users.

10.61. This rule is not intended to give secured parties the opportunity to correct defects of their own creation, but to allow a grace period to correct registrations for events beyond their control that have introduced a defect into a previously effective registration.

10.62. It is important to note that the ineffectiveness of a registration does not affect the validity of the underlying security agreement, but may result in a loss of priority where a competing interest is registered on the PPS Register.

**Example**

When Gina changed her name to Gina O'Grady by deed poll, she forgot to tell BankA. When BankA reviewed Gina's loans some eighteen months later, it discovered Gina's name change and amended its registration to correct the defect within 5 business days. BankA's registrations remained effective throughout the whole period.

10.63. Prospective secured parties would be well advised to ask prospective borrowers whether they have changed their name or are known by other names. Similarly, prospective purchasers of personal property should ask vendors about name changes and aliases, and tailor their PPS Register searches accordingly.

***Amendment of registration***

10.64. Change is a feature of day-to-day commerce. As an example, debts may be repaid early or forgiven, security interests may be subordinated, additional property may be given as security, property may be destroyed and companies may be wound up. Similarly, a registration may be about to expire, but the parties agree that the security interest in the property should continue. To accommodate these kinds of changes, a person who is registered as a secured party may apply to the Registrar to amend a registration (section 202(1)). The Registrar is empowered to amend registrations upon the application of a secured party, but also following an amendment demand and related administrative or judicial processes, or to correct an error or omission made by the Registrar or her or his delegates (section 201).

10.65. For secured parties, the amendment process would be similar to the application process in terms of requirements that the application be in an approved form, that any determined fee be paid or an arrangement be made for the payment of fees, and that any prohibitions regarding the data be observed (sections 202(2)(d) and (e) and 203 relating to applications that are frivolous or vexatious, prohibited by the regulations or made in circumstances in which the registrant does not believe on reasonable grounds that it holds or will hold a security interest in the collateral). The amendment must also be authorised by sections 204 and 205.

10.66. The kinds of amendments that would be authorised are set out in a table in section 204. These include:

- adding, omitting or changing the details of a secured party and/or grantor (including details about a secured party's agent, how notices are to be given to secured parties and in relation to any unique identifiers for such notices)(section 204, table items 1, 2 and 3),
- adding, omitting collateral or proceeds or otherwise changing the collateral description and/or description of proceeds (noting that no change could be made to the prescribed class of personal property to which the collateral was assigned)(section 204, table item 4),
- substituting a new end time that would bring the effective registration to an end (section 204, table item 5),
- adding, omitting or changing the details of any subordination agreement (section 204, table item 6), or
- making any amendments as authorised by the Act or the regulations (section 204, table item 7).

10.67. When a registration is amended, the amendment takes effect as soon as it becomes available for search on the PPS Register. This moment is known as the ‘amendment time’ (section 208(2)).

10.68. A registration would be renewable by amending the registered ‘end time’ to a later time. If a registration were to lapse, the security interest would remain valid and enforceable against the grantor. However, as against third parties, the perfected status of the security interest may be lost. Where the personal property covered by a registration no longer secures any obligation, the appropriate course would be for the secured party to amend the end time of the registration to bring the entire registration to an end.

10.69. The scope of personal property covered by a registration may be extended or reduced, or the entire registration may be brought to an end by amendment. For example, a registration against a person’s ‘present and after-acquired property except cattle’ could be extended by removing the cattle exception. Or the scope of a registration against ‘paintings photographed in the attachments’ could be reduced by omitting a photograph. Where personal property is omitted from a registration, the omitted property would cease to be available for a real-time PPS Register search, but the registration covering any remaining personal property would continue to be effective and searchable.

**Example**

GrantA completes its loan obligations in respect of his wheat crop but not his barley crop. FinanciA amended its registration against GrantA to omit the wheat crop from the collateral description. The amendment time signals the time that the wheat crop is omitted from the PPS Register and has ceased to be available for search.

10.70. An amendment to a registration would be effective from the time the amended registration becomes available for search on the PPS Register until it ceases to be searchable, for example, due to expiry or removal of the collateral registration (sections 205(2) and 193). Where a secured party amends a registration to correct seriously misleading data, the effectiveness of the registration can only be established from the time of the amendment and not from the initial registration time (other than where the registration is taken to be effective under section 200 which concerns certain registration defects beyond the secured party’s control).

**Example**

When FinanciA registered GrantA’s car, it incorrectly entered GrantA’s last name as ‘Grantor’. When FinanciA noticed the error, it immediately applied to correct it by amendment. The registration would be effective from the time the correction became available for search on the PPS Register (being the amendment time).

***Requirement to end the registration of certain property***

10.71. To ensure that individuals are not prejudiced by outdated registrations, a secured party would be under a statutory obligation to omit collateral or end the effective registration of collateral that is a consumer good or serial numbered property and the security interest that is perfected by registration would become unperfected. The secured party would have to end the registration within 5 business days of the ‘unperfection time’ (section 206) or extended time as approved by a court (section 257). Non-compliance would expose the secured party to liability for statutory damages under section 236 and entitle the grantor to seek to bring the registration to an end using administrative or judicial processes. This is important because secured consumer credit transactions

tend to be one-off dealings between the parties where there is no reason for the secured party to obtain the benefit of continuing priority status at the expense of the consumer.

10.72. In all other cases, there is no statutory obligation on the secured party to end a registration. This is because commercial financing is typically a medium to long term arrangement, often involving a fluctuating line of credit rather than a lump sum loan, and a series of security agreements rather than a one-time loan or credit transaction. In many commercial arrangements, it would be contrary to the interests and intentions of both parties to require the secured party to end a registration every time there was a short break in their financing relationship.

10.73. That said, most financing arrangements do come to an end at some point and there is a possibility that negotiations might fall apart after a registration is made and when no security agreement is executed. Similarly, many consumers would not want to pursue damages claims or would have suffered no loss or insufficient loss to warrant court action but would still want old registrations ended. Hence, the Bill would include an amendment demand process aimed at ensuring that all parties can obtain rectification of the PPS Register in certain circumstances.

### ***Amendment demands***

10.74. Ideally, secured parties and people with an interest in registered personal property would resolve any difficulties with the registration between themselves. However, in the event that a secured party is unwilling or neglects to omit property from, or end, a registration, a person with an interest in the collateral (other than a security interest) could demand, in writing, that the registration be amended (section 207). This statutory demand will be known as an ‘amendment demand’. An interested person could demand that the secured party omit the collateral from the registration or end the effective registration of the collateral. The amendment demand process is important as a mere registration could limit the person’s ability to deal with the registered property.

10.75. Where a dispute remains unresolved, the person seeking amendment could obtain rectification of the registration through either an administrative or judicial process. The administrative process is intended to reduce the cost and inconvenience of having to take court action over what may be a relatively straightforward matter.

10.76. To commence the amendment process, a person with an interest in property described in a registration would have to give a written demand to the secured party for amendment of the registration under section 207. The *Electronic Transactions Act 1999* authorises the giving of a demand by electronic means.

#### **Example**

GrantA became aware that FinanciA had registered against all of its present and after acquired paintings rather than the particular painting he offered as security for the loan. GrantA sends an email to FinanciA demanding that it amend the registration to apply only to the particular painting.

10.77. Where the secured party fails to amend the PPS Register in line with the demand by the end of 5 business days after the day of the demand (or such later period as approved by the court under section 257), the person would generally have a choice of pursuing an administrative process or judicial process to obtain an amendment of the PPS Register. However, if the security agreement that provides for the security interest in the collateral is a security trust instrument, only the judicial process will be available (section 208(1)(c) and (3)).

*Administrative process to demand amendment of a registration*

10.78. The Australian PPS Register system would only allow secured parties, their agents and the Registrar (including subject to court order) to amend a registration. This means that secured parties could expect that registrations would not generally be subject to accidental or surreptitious amendment by inadvertent or maleficent third party users.

10.79. The administrative process would be available where a person has given a written demand to a secured party to amend the registration and the secured party has failed to apply for the amendment before the end of 5 business days or a period as extended by the court. However, the process would not be available where:

- the security agreement (if any) creating the security interest in respect of the collateral is a security trust instrument, or
- proceedings are before a court in relation to an application concerning the demand (section 208).

10.80. The reason for the exception in relation to security trust instruments is to minimise the scope for inadvertent, fraudulent or negligent changes to a registration being initiated as a result of a trustee's act or omission. In cases involving security trust instruments, the beneficiaries of the trust rather than the trustee would suffer the direct loss where a security interest loses priority due to, say, negligent or fraudulent action that brings a registration to an end.

10.81. The administrative process would cease to be available where the registration is subsequently amended in accordance with the demand or proceedings come before a court relating to the amendment demanded (section 208). This is to allow the person seeking the demand to choose their forum for obtaining rectification, but also reflects the fact that there is limited value in allowing both remedies to be simultaneously pursued.

10.82. To commence the administrative process, a person must give a written statement to the Registrar setting out the nature of their demand and anything else prescribed by the regulations (section 209(3)). As soon as practicable after the statement is given to the Registrar, the Registrar must give an amendment notice to the secured party unless the Registrar has already done so while acting under her or his own initiative (section 209(4)). In this regard, the Registrar may give an amendment notice to a secured party where the Registrar suspects on reasonable grounds that the amendment demanded is authorised (section 209(2)), that is, where the underlying obligation has ceased. It is important to allow the Registrar to act swiftly if she or he becomes aware of registrations that should not have been made or should have been ended earlier.

10.83. An amendment notice must be in the approved form or state the amendment demanded, and invite the secured party to submit a response before the end of 5 business days after the day of the Registrar's notice or an extended period approved by the Registrar. The Registrar must describe the 'show cause' procedure in the amendment notice. Where the Registrar acts other than on her or his own initiative, the amendment notice must include a copy of the written statement of the person who demanded the amendment (section 209(4) and(5)).

**Example**

FinanciA failed to comply with GrantA's request to amend the registration over GrantA's painting. GrantA wrote to the Registrar setting out the terms of his demand and other required information. The Registrar gave FinanciA written notice of GrantA's statement and invited FinanciA to show cause why the registration should not be amended.



10.84. The ‘show cause’ process requires the Registrar to amend a registration in accordance with the demand described in the amendment notice unless the Registrar suspects on reasonable grounds that the amendment is not authorised under the Act (section 210(2)). In deciding whether to amend or refuse to amend the registration, the Registrar must consider the response (if any) of the secured party as well as any other relevant information (section 210(5)). It is noted that the provision of false or misleading information in any response to the Registrar’s invitation may be an offence against Part 7.4 of the Criminal Code.

10.85. A secured party must be notified of the Registrar’s decision by verification statement under section 221. The Registrar’s decision would be reviewable by the Administrative Appeals Tribunal (the AAT).

#### *Judicial process to obtain amendment of a registration*

10.86. Consistent with the approach taken in all other PPS jurisdictions, the Bill would provide a judicial process for interested persons who are affected by a PPS Register registration to obtain an amendment to a registration that concerns their interests. These parties would not be required to undergo the administrative process prior to applying to a court.

10.87. In Australia, the judicial process would be available where a written demand for amendment has been made and the secured party has not complied with the demand within 5 business days after being given notice of the demand or a period extended by a court under section 257. As in other jurisdictions, the judicial process would be available in all cases, including those where a security trust instrument is involved (section 211).

10.88. The secured party or the person who gave the demand (usually the grantor) can apply to a court for an order relating to the registration (section 212(1)). This option is provided because a party may consider that their interest in particular property is of such import to warrant court involvement. Any person with an interest (including a security interest) in the collateral would have the right to appear before the court (section 215(2)). The Registrar also has the right to appear in proceedings (section 270). This right is important because other administrative processes relevant to the cause of action may be underway.

10.89. Where a party has applied to a court in relation to an amendment demand, the court could make orders to amend the registration or, if the court did not consider the demand was authorised, to restrain the Registrar from amending the registration (section 213(1)). The court could also impose any conditions that it considered proper to give effect to such orders and give any other orders it considers to be proper (section 213(2) and (3)). The Registrar must comply with a court order as soon as practicable after receiving it (section 213(4)).

10.90. A secured party would not be able to require payment for compliance with a demand for amendment except where the demand related to property described as commercial property, and the person who made the demand agreed in writing to pay the fee (section 214). Consumers are thereby protected against the imposition of hidden loan fees.

#### *Removal of data and correction of registration errors*

10.91. Consistent with the Registrar’s role of establishing and maintaining the PPS Register, the Registrar would be empowered to amend registrations; to correct errors and omissions made by the

Registrar and registry staff; to remove, restore and archive data; and to implement court orders as authorised.

10.92. The Registrar would be empowered to remove data (including an entire registration) from the PPS Register in two circumstances. First, where the data is frivolous or vexatious and, secondly, where registration of the data is prohibited by the regulations (section 215). The circumstances in which material may be prohibited are yet to be settled, but it is likely that the regulations would prohibit the registration of data that the Registrar considers, in all the circumstances, would be inappropriate for registration on a public register. Examples may include data that would cause offence, is defamatory or is otherwise unlawful.

10.93. Regulations would only be made to remove such material from the PPS Register where there are strong public interest grounds for doing so. However, where data is removed the Registrar must give a verification statement to each secured party to allow them to appeal the decision if they consider that the decision is wrong.

**Example**

IndividualA applied for a registration against IndividualB in which the collateral was described as 'IndividualB'. As IndividualA could not take a security interest in a person, the registration would be frivolous or vexatious and the Registrar could remove it.

10.94. The Registrar would also have the capacity to remove from the PPS Register data that is old, that is, data that has been ineffective for 7 years or more after its registered end date (section 216). This power would improve the searchability of the PPS Register and help to maintain individual privacy by limiting access to personal data that is no longer relevant.

10.95. The Registrar would be able to restore data (including an entire registration) to the PPS Register where that data was incorrectly removed (section 217). This power would be conferred in discretionary rather than mandatory terms because circumstances might arise where incorrectly removed data would have been removed in any case such as where the data was frivolous or vexatious.

10.96. To ensure that removed data is not lost, the Registrar would be able to keep a record of any removed data (section 218). This would allow the archiving of old and removed records and prevent the PPS Register from becoming unduly cluttered by old and ineffective registrations. The parties would be able to gain access to archived records under the *Freedom of Information Act 1982*.

10.97. The Registrar would be empowered to amend a registration to correct an error or omission made by the Registrar (section 219). This is an important incident of maintaining a public register, particularly where registry staff is responsible for data entry and removal.

**Example**

FinanciA applied to register property against GrantA by facsimile. A transcription error occurred during registration. FinanciA noticed the error in its verification statement and amended the registration. A new verification statement was sent to FinanciA confirming the correction.

10.98. The Registrar's discretionary decisions about removing data and correcting an error or omission in data would be subject to AAT review.

### *Verification of register events*

10.99. Given the importance of registration as a means of perfecting security interests in personal property, the PPS Register scheme must be underpinned by robust notification procedures. All people named in the PPS Register, particularly individuals, must have every opportunity to know about information that might affect their capacity to sell personal property and/or secure finance.

10.100. To help parties manage their registrations, the Bill would establish a system for verifying data when it is recorded on the PPS Register. Registrations, amendments to registrations (including registry corrections and the ending of an effective registration), the removal and restoration of data in a registration, and the inclusion of any data approved by the Registrar are termed ‘verifiable events’ (section 220). The verification statement could include data about the event, a secured party, a grantor and/or the collateral. The statement would be in an approved form.

10.101. Where a verifiable event occurs, the Registrar would be required to give a verification statement to each person who is or was registered as a secured party immediately after or before the time of the verifiable event (sections 221(1) and (2)). A verification statement would give secured parties a documentary basis upon which they could check the accuracy of any data added, altered or removed from the PPS Register by them, their agent or the Registrar. The statement must be given as soon as practicable after the time of the verifiable event or the latest verifiable event where more than one event is notified. A single verification statement could be given in relation to two or more verifiable events in certain circumstances (section 224(4)). This will simplify notification procedures and ensure that secured parties are not overrun by unnecessary paperwork.

10.102. Where a verifiable event involves an amendment to the address for giving notices, the Registrar must ensure that the notice is sent to the secured party at the old and amended addresses. Similarly, where a registration has been removed, the Registrar would be able to send the verification statement to the address that had been registered for the giving of notices to the secured party prior to its removal from the PPS Register (section 221 and 222).

10.103. The *Electronic Transactions Act 1999* would operate alongside the Bill to allow the Registrar to provide verification statements and other notices given under the Bill by electronic means. In such cases, that Act would require that the person consented to the information being given by electronic communication. However, consent may be inferred from the person’s conduct. For example, the Registrar would be able to infer consent where a secured party has nominated an email address as the address for giving notices in relation to the registration.

10.104. Recipients of a verification statement must ensure that a notice of the statement is given as soon as practicable to each person who is registered as a grantor immediately before and/or immediately after the verifiable event (sections 223(2) and (5)). The statement must be given in an approved form and as soon as practicable after the relevant verifiable event. The approved form may authorise specified data in the verification statement not be included in the notice in case the notice contains confidential information such as passwords (section 223(4)). There may be scope for the PPS Register system to send statements to grantors upon request by a secured party, even though the secured party would retain the responsibility for ensuring that the notice is actually sent.

10.105. Where the collateral is described as commercial property, the grantor may waive the right to receive a copy of a verification statement in relation to certain verifiable events (section 223(6)). For consumer protection purposes, consumer grantors would not be able to waive this requirement.

10.106. If a verifiable event occurs which affects a number of persons registered as secured parties (whether before or after the events) and the Registrar considers that it would be inconvenient for verification statements to be sent to each interested person, the Registrar may publish a single

verification statement in relation to all verifiable events. Where this occurs, the requirement for individual verification statements no longer applies (section 224). This process may be used, for example, in relation to data migration occurring during the transition to the new system.

10.107. A failure to send a verification statement to the grantor would not alter the effectiveness of a registration, but may give rise to a claim for damages against the secured party under section 236.

### *Searching the register*

10.108. The availability of reliable, low-cost, fast and accessible search facilities would be a central feature of the PPS Register. This is important because prospective lenders might wish to know whether particular property is subject to a current or prospective security interest, while prospective purchasers may want to learn whether property they are about to buy is subject to an encumbrance or other restriction. In addition, secured parties may want to search the PPS Register to verify the validity and history of their own registrations, while grantors might like to monitor registrations made against them.

10.109. As with all registrations and amendments, the PPS Register would be accessible for search purposes by direct online access 24 hours a day, 7 days per week or by making a written application lodged with the Registrar. This could be done through a web browser, through a business to government interface, via SMS message, or by written application. A search result could provide real-time and historic point-in-time information. A person could enlist the services of an agent to perform the searches on her or his behalf. This would mean that all people would be able to access the PPS Register for search and other purposes even where they are located in remote areas.

10.110. To this end, the Bill would provide that a person can apply to search the PPS Register for data and to obtain a written search result in relation to that data (sections 225(1) and (2)). Users would not have to be registered to undertake a PPS Register search. Search access must be authorised by the Act and not prohibited by the regulations, and a search fee must be paid or an arrangement for the payment of fees made in accordance with a determination made by the Minister. Further, an application for search must be in the approved form (section 227(3)).

10.111. The Bill would provide that a person may search the PPS Register by reference to specified criteria, namely:

- a secured party's details,
- a grantor's details,
- a serial number by which collateral may (or must) be described, or
- any other criteria prescribed by the regulations (section 226).

10.112. For serial numbered goods (such as motor vehicles used for consumer purposes), users would be able to search the PPS Register by the serial number only. This is in line with the current practice on the REVS and VRS registers, which do not record grantor details.

10.113. While the search criteria to be prescribed by regulation are not yet settled, it is proposed that a person would be able to search the PPS Register by reference to the unique identifier of the registration. This will make searching more efficient as searchers will not have to examine multiple registrations involving material that is irrelevant to their requirements.

10.114. In most other cases, PPS Register searches would generally be undertaken against the grantor's details—usually their name (as recorded according to the regulations) and, for grantors

who are natural persons, their date of birth. PPS Register users should satisfy themselves that they have knowledge of, and make search queries using, accurate information about each grantor's details, including any former or alternate names. This would help to ensure that they obtain accurate search results from the PPS Register.

10.115. To improve business efficacy and minimise inconvenience and time wastage, the PPS Register search function would allow users to refine their searches according to their needs. Thus, while a user may search against a particular grantor's name, they may refine their search to a particular class of collateral or other descriptor. It is anticipated that these descriptors might include information, for example, that identifies whether the property is a purchase money security interest.

10.116. Similarly, a searcher may be able to refine their searches by examining registrations made after a particular time, for example, within the last 12 months. This functionality would ensure that PPS Register searches deliver meaningful results and that users avoid the need to examine multiple registrations involving material that is irrelevant to their requirements. The search request could retrieve either real-time or historic data.

#### **Example**

BankA searches the PPS Register for dairy cattle registered against GrantA, a company that is recorded as the grantor in several PPS Register registrations. BankA enters the GrantA's ACN and indicates in the search request that he is searching for livestock registrations. The search returns two registrations against that ACN—one for dairy cattle against FinanciA and another for goats against BankB.

10.117. The Registrar must ensure that the way in which the results of a search are worked out in response to a search application is determined in accordance with any regulations made for such purposes (section 226(2)). This provision would allow the regulations to determine rules for applying technological solutions for working out search results. It is proposed that the PPS Register would apply an exact match search method, with a correction table for frequently used substitutes (such as Ltd and Limited).

10.118. A person would be able to search the PPS Register for an authorised purpose only. The authorised search purposes are set out in the table in section 227. These purposes are varied and allow a broad spectrum of searches without compromising individual or commercial privacy. While the PPS Register will not provide unfettered access to company information, or any capacity to access charge documents, legitimate commercial reasons to access data contained in registrations will be authorised. When entering security agreements, parties might consider whether they will require a grantor's consent to access a registration at any time and whether this should be made a term of the security agreement.

#### **Example**

VendA is selling a large commercial shopping complex. VendA made it a condition of its leases that tenants not enter into any general security interests. PurchasA would like to search the PPS Register to establish whether the tenants have complied with the lease terms. PurchasA will not be able to search the PPS Register for this purpose. As VendA made it a condition of the lease agreement that it could search the PPS Register for this purpose, VendA will be able to undertake the searches and warrant compliance to PurchasA.

#### *Interference with privacy*

10.119. To deter people from making unauthorised searches, the Bill would provide that a person must not, otherwise than for an authorised purpose, search the PPS Register or use data obtained as

a result of searching the register unless the data has been lawfully obtained from another source (section 227(2)). This means that there will be limits on the extent to which PPS Register search data can be used, including by information brokers. A person who suffers loss or damage as a result of unauthorised searching or information use would be able to make a claim for damages under section 236. This is achieved by making compliance with section 227(2) an obligation owed to the secured party or the grantor (as the case may be), and providing that a contravention is taken to be a failure to discharge that obligation (section 227(3)).

10.120. Given the public nature of the PPS Register, protecting the privacy of individuals is a paramount concern. The Bill would provide that an unauthorised search or use of the personal information obtained in a search by an ‘agency’ or ‘organisation’ (within the meaning of the *Privacy Act 1988*) would constitute an act or practice interfering with the privacy of an individual (section 228(2)). The Privacy Act presently defines an ‘organisation’ means an individual, body corporate, partnership, other unincorporated association or a trust—being one that is not a small business operator, a registered political party, a State or Territory authority or a prescribed instrumentality of a State or Territory. The term ‘agency’ is defined to cover various Commonwealth public sector organisations.

10.121. Under the Bill, an individual or the Registrar could complain to the Privacy Commissioner if she or he believes that a search of the PPS Register or use of the personal information obtained by an agency or organisation constitutes interference with an individual’s privacy. Where a complaint is lodged, the Privacy Act would apply as though the complaint were a complaint involving a breach of the information privacy principles under section 36 of that Act.

#### **Example**

IndividualA received a phone call from FinanciA offering her cheap finance because she had no registrations on the PPS Register. IndividualA complained to the Federal Privacy Commissioner that FinanciA had made unauthorised searches of the PPS Register. The Federal Privacy Commissioner investigated IndividualA’s complaint and found that the searches constituted a breach of IndividualA’s privacy. FinanciA agreed to the Federal Privacy Commissioner’s recommendations, which included an apology. The Federal Privacy Commissioner reported its decision against FinanciA on its website and in its annual report.

10.122. An individual would be able to access his or her personal records in accordance with information privacy principle 6 of the *Privacy Act 1988* and under the *Freedom of Information Act 1982*. This would enable any person whose personal information appears on the PPS Register to obtain information about them and require any correction where appropriate.

#### *Written search results and evidence*

10.123. Obtaining accurate and reliable written search results could be expected to become an important part of entering a secured transaction. While a clear PPS Register search result would provide prospective purchasers and lenders with some comfort that the transaction they are about to enter would not be undermined by other registered interests, it would be another matter to prove the status of a registration at a later time, particularly if a priority dispute were litigated.

10.124. To this end, a person who makes an electronic search of the PPS Register could elect to obtain a written search result documenting the search (section 225(2)(b)). The written search result would be admissible as evidence in a court or tribunal and, in the absence of evidence to the contrary, proof of matters stated in the search result (section 229(1)). Where competing interests are in dispute, a party may need a written search result covering two or more competing registrations which could be obtained consistent with section 229(2)(c).

**Example**

FinanciA and BankB both registered GrantA's present and after acquired property on the same day. However, FinanciA's registration was the first to become available for search on the PPS Register. A later written search result issued by the Registrar provided prima facie written evidence that FinanciA was the first to register. This occurred because it was BankB's practice to make all of its registrations at the end each business day, while FinanciA made its registrations as they occurred throughout the day.

10.125. A written search result would be provided in the appropriate form, including being issued by the Registrar in the approved form or by Commonwealth, State or Territory officers determined by the Registrar or other prescribed persons. The Registrar must perform any approval of officers, agencies and data by legislative instrument (section 229(7)).

***Fees, administrative review and annual reports******Registration and search fees***

10.126. The Minister would be able, by legislative instrument, to determine the amount of fees for the purpose of: applying for, amending and maintaining registrations; applying to search the PPS Register; and determining arrangements for the payment of fees (sections 230(1) and (2)). Any fees imposed by the Bill would be set on a cost recovery basis, and must not be such as to amount to taxation (section 232(4)). Consistent with section 55 of the Commonwealth Constitution, this requirement is important for the validity of any fee determination made under the Bill.

10.127. The amount of any fee, other than a fee to maintain a registration, would be a debt due to the Commonwealth, and may be recovered by the Commonwealth by application to a court (section 230(5)). The fee to maintain a registration would not be a debt to the Commonwealth because the sanction imposed for non-payment would be the ending of the effective registration of the property.

***Review of decisions***

10.128. To improve the reliability of the PPS Register and to overcome the cost and inconvenience of court action, provision is made to allow review by the Administrative Appeals Tribunal (the AAT) of certain administrative decisions made by the Registrar (section 233).

10.129. A person may apply to the AAT for review of any of the following decisions by the Registrar:

- to refuse to give effect to an application for a registration under section 189(2),
- to end the effective registration of collateral due to a failure to pay a maintenance fee under section 197(6),
- to refuse to amend a registration in response to an application by a secured party under section 202(2),
- to amend or refuse to amend a registration following an amendment demand under section 210(2),
- to remove data from the PPS Register under section 215,

- to amend a registration to correct an error or omission made by the Registrar under section 219, or
- to refuse to give a person access to the PPS Register to search for data under section 225.

10.130. Under the *Administrative Appeals Tribunal Act 1975*, a party to AAT proceedings may appeal a decision by the tribunal to the Federal Court of Australia on a question of law.

#### *Annual reports*

10.131. Consistent with the approach adopted in many schemes established under Commonwealth legislation, the Registrar must prepare an annual report at the end of each financial year for tabling by the Minister in the Parliament. The report must address the operation of the Act during the relevant financial year. It must provide details of each occasion on which access to the Register was refused or otherwise suspended during the relevant year, and any information necessary to demonstrate that the fees determined by the Minister do not amount to taxation (section 232).



## 11. MISCELLANEOUS PROVISIONS

### *Rights, duties and obligations*

#### *Rights and duties to be exercised in an honest and commercially reasonable manner*

The Bill would provide a general standard of conduct applicable to the exercise of rights and duties arising under a security agreement or the Bill. The applicable standard would be that rights and duties be exercised ‘honestly’ and in a ‘commercial reasonable manner’ (section 235).

11.1. A breach of this provision would confer on the affected party a right to claim damages under section 236.

#### *Entitlement to damage for breach of duties or obligations*

11.2. The Bill would provide a general right for a person affected by another person’s failure to discharge an obligation of the Bill to recover compensation from that person for any damage suffered that was reasonably foreseeable (section 236).

11.3. This right to recover damages for loss would be limited to persons to whom the duty or obligation was owed and persons who would reasonably have expected to rely on the performance of the duty or obligation.

11.4. Examples of situations in which the provision could be relied upon include:

- a breach by a secured party of the duty to obtain market value on disposal under section 169 while undertaking enforcement,
- a breach by a secured party of the duty not to damage property while removing an accession under section 147 while undertaking enforcement,
- a breach by a person to meet the standard set out in section 235, and
- failure to discharge a registration under section 206.

11.5. This right would co-exist with other remedies in the Bill or elsewhere.

11.6. Damages for loss would not be recoverable from certain persons acting honestly under a power conferred upon them by the Bill or its regulations. These persons include the Minister responsible for oversight of the PPS Register, the Registrar and their delegates (section 237).

11.7. A person that was affected by an error made by any of these people would have recourse against the Commonwealth’s Compensation for Detriment caused by Defective Administration scheme.

### *Information to be provided by secured party*

11.8. The Bill would allow certain people to request information from a secured party who would be required to respond to the request (section 238).

11.9. The information that could be requested would include:

- a copy of the security agreement,
- a statement in writing setting out:
  - the amount or the obligation that is secured by the security interest,
  - the terms of payment or performance of the obligation as at the day specified in the request,
  - confirmation of an itemised list of property over which the security interest is granted, and
  - the amount owing under the security agreement (section 238(1)).

11.10. Persons entitled to request this information would include the grantor, a person with another security interest in the collateral, a execution creditor with an interest in the collateral, and an authorised representative of any of these (section 238(9)). A person considering an application to provide finance might ask the applicant for an authority to obtain this information.

11.11. The secured party would be required to provide the information within 10 days of receiving the request (section 240).

11.12. The secured party would not be required to respond to a request for information if they had agreed not to do so in writing with either the debtor (section 238(6)(a)). This agreement would have to be made prior to the request for information being made (section 238(7)(a)).

11.13. The secured party would not be required to provide information if they had already done so under another legal obligation (section 238(5)) or if providing the information would contravene a legal obligation (section 238(6)(b) and (c)).

11.14. The Bill would allow recipients of information provided by the secured party to rely on that information (section 246).

11.15. The Bill would allow secured parties to recover their costs of responding to a request for information (section 242). The fee charged could not exceed the 'reasonable marginal costs' of providing the information (section 242(2)). This means that the charge for providing the information can not contain a profit component and should only reflect the additional cost to the secured party associated with providing the information.

11.16. The secured party would not be required to provide the information if the fee was not paid (section 242(5)). However a grantor would be entitled to receive the information free of charge once every 6 months or otherwise if there has been a material change in the information since it was last provided (section 242(3)).

11.17. If a person who is no longer a secured party receives a request for information they will be required to advise the requesting party the latest successor in interest, if known (section 239) This would ensure that the person making the request would be able to determine who the secured party was.

11.18. The court would be able to make the following orders:

- exempting secured parties from the requirement to respond to a request for information in whole or in part if it would be unreasonable for the person to respond to the request (sections 241(1)(a) and (2)),

- extending the time for responding to the request (section 241(1)(b)) if it would be unreasonable for the secured party to respond to the request within the time allowed. (section 241(3)),
- requiring the secured party to provide information where:
  - the 10 day period to respond has lapsed (section 243(1)(a)),
  - an incomplete or incorrect response has been provided (section 243(1)(b)),
  - determining whether a claim by a secured party that information cannot be disclosed under law or is subject to a duty of confidence is valid (section 243(1)(c)),
  - the charge sought for providing information exceeds reasonable marginal costs (section 244(1)(b)(i)), or
  - if the interested person is a debtor, whether the information has been provided within the previous 6 months or there has been a material change in the information since last provided (sections 244((1)(b)(ii) and (iii)).

11.19. When a person fails to comply with a court order under sections 243 or 244, the court would have the power to make an order extinguishing the security interest and directing the Registrar to amend the registration accordingly (section 245).

### *Giving of notices*

11.20. The Bill would include provisions about the form that notices required to be provided under the Bill should take, and the manner in which they be given. These provisions do not apply to notices required to be served in court proceeding (section 247).

11.21. The Bill would require that a notice or other document it required to be given under the Bill be provided in writing (section 248, section 26, definition of ‘writing’).

11.22. The Bill includes provisions setting out how a notice must be served on a secured party for the purposes of the Bill. A notice given to a secured party under the Bill would have to be given at the address specified in the registration. This could be by either delivery to a particular address, sending by pre-paid post, fax or email (section 249). This is intended to allow large scale providers of finance to nominate the contact point in their organisation for receipt of notices under the Bill or otherwise nominate methods of giving of notices that would best accommodate their internal procedures. This may be important given the timeframes allowed by some provisions for secured parties to respond to notices that they might receive.

11.23. A registration will specify only one address for service of notices (section 191, table, item 3). When the registration specifies more than one secured party, it will be sufficient to serve a notice under the Bill on that address, and not on each secured party individually (section 250).

11.24. A registration may include an identifier for the giving of notices to the secured party (section 191, table, item 3). The Registrar may approve a manner for including the identifier in a notice or document, and a notice that does not include the identifier in the specified manner would not be effective (section 199). For example, the Registrar might approve that the identifier specified by the secured party must be included in the subject for all emails that include a notice under the Act. This would facilitate the forwarding of notices to the relevant officer engaged by the secured party to deal with notices relating to the registration.

11.25. A notice that must be served on a person who is deceased could be served on the deceased's legal personal representative or another person specified by the court (section 252). The court would be able to make orders about the service of notices (section 253).

11.26. A notice or document given by fax would be presumed to have been given if the sender's fax machine has generated a record of the transmission. The recipient of the fax would be presumed to have received it at the time specified in the transmission record. These presumptions would apply in the absence of proof to the contrary (section 254).

11.27. A notice or document given by email would be presumed to have been given if the person giving the notice or document proved that it was transmitted by computer system to the email address provided by the recipient. A copy of the e-mail that displayed the recipient's address would be adequate proof of delivery (section 255).

### ***Timing requirements***

11.28. The Bill would provide that a court could extend the number of days within which a person would be required to comply with a provision.

11.29. The court could make such an order if it was satisfied that it would be 'just and equitable' to do so after having regard to the cause of the inability to comply with the timeframe, prejudice to third parties and whether any person has acted in reliance upon the ending of the timeframe.

11.30. The provisions to which this applies are as follows:

- the time for perfection of certain purchase money security interests,
- delivery of collateral on demand to a higher priority party when undertaking enforcement and payment of enforcement expenses by a higher priority party,
- providing statements of account,
- providing proof of interest when objecting to retention of collateral,
- where a defective registration is temporarily unaffected,
- application for amendment of registration,
- application for amendment of a collateral registration after demand, and
- provision of information required by request.

### ***Jurisdiction of courts***

11.31. The Bill would confer jurisdiction in relation to matters arising under the Bill on various Australian courts (Part 6.6). It would also establish rules that restrict cross-jurisdictional appeals and manage the transfer of proceedings under the Bill between those courts. These rules are intended to produce many of the same outcomes as Division 1 of Part 9.6A of the *Corporations Act 2001*.

11.32. The Bill would establish the jurisdiction of a court in respect of a matter (a PPS matter) arising under a provision of the Bill authorising an application to be made to a court, or otherwise arising in relation to the Bill or in relation to a security agreement or a security interest, other than a

matter in respect of which the Federal Court or the Federal Magistrates Court of Australia has jurisdiction under the *Administrative Decisions (Judicial Review) Act 1977* (section 259).

11.33. The Bill would provide that Part 6.6 operates to the exclusion of the *Jurisdiction of Courts (Cross-vesting) Act 1987* and section 39B of the *Judiciary Act 1903* (section 259). It makes it clear that the Part does not limit the operation of the Judiciary Act (other than section 39B) (section 259(3)).

11.34. The Bill would confer jurisdiction with respect to a PPS matter on the following courts subject to any limits on the court's jurisdiction (section 260):

- the Federal Court
- the Family Court of Australia
- the Federal Magistrates Court
- a superior court of a State or Territory, and
- a lower court of a State or Territory.

11.35. Jurisdiction would be conferred on the lower courts of a State or Territory as a means of facilitating access to the court process for parties wishing to enforce their rights under a security agreement regardless of the value of the security interest. A lower court of a State or Territory is a court of a State or Territory that is not a superior court (section 263(3)). A superior court of a State or Territory is a Supreme Court of that State or Territory (section 263(3)).

11.36. The Bill would make it clear that, despite the national nature of the PPS scheme, cross-jurisdictional appeals with respect to PPS matters would not be permitted (section 260).

11.37. Recognising the need not to hinder litigation that may transcend State and Territory borders, the Bill would ensure that, where it was appropriate or otherwise in the interests of justice, courts on which jurisdiction was conferred under the Bill could transfer a PPS matter to a court on which jurisdiction was conferred under the Bill in another Australian jurisdiction (sections 262 to 269).

### ***Other matters***

11.38. The Registrar would be able to approve forms required for the Bill (section 274).

11.39. The Governor-General would be able to make regulations for the purposes of the Bill (section 275).

11.40. The Bill would also require that a person asserting the following facts would have the onus, or responsibility, of proving that fact:

- that a security interest had attached and/or perfected,
- that personal property is acquired free of security interests except in relation to sections 85 and 88,
- that a person acquired personal property without knowledge in insolvency related circumstances,
- whether a fee to provide information does not exceed the reasonable marginal costs of providing the information,

- whether information has been provided to a grantor within 6 months,
- the fact that there has not been a material change in information provided to a grantor since the information was last provided to the debtor,
- whether a secured party pays market value where it purchases the collateral under section 167(3)(b), and
- whether a person that obtains a collateral registration believes on reasonable grounds a security interest will become held by the person under section 190(1) (section 272).

11.41. The onus is placed on the person asserting these facts because they would be matters that are within the knowledge of that person and not any other parties to the proceedings.

11.42. The miscellaneous provisions would contain presumptions regarding transactions between related entities. A related entity would be defined as members of the same household, related companies and between a company and a company director or officer of that company.

The presumptions that applied to a related party would be that the person acquiring the interest:

- had knowledge of the security interest in the collateral,
- was aware that the transaction was a breach of the security agreement, and
- did not pay to acquire the interest (section 272).

11.43. These presumptions could be disproved if the parties involved could demonstrate otherwise beyond a reasonable doubt.

11.44. These presumptions for related party transactions are derived from current State legislation.

### ***Certain unperfected security interests vests in the grantor***

11.45. The Bill would provide that if a security interest remains unperfected at the time:

- a body corporate is wound up,
- an administrator is appointed under the *Corporations Act 2001*,
- a company executes a deed of company arrangement,
- a sequestration order is made against a person under the *Bankruptcy Act 1966*, or
- a person becomes a bankrupt under the *Bankruptcy Act 1966*,

the security interest vests in the grantor (section 233(2)).

11.46. This provision would mean that unperfected security interests generally, regardless of the form of the arrangement, that is, whether they reserve title or not, would be considered to be the estate of the insolvent grantor and would therefore be subject to distribution under insolvency law.

11.47. This outcome is not new to Australian law. The High Court has upheld the concept of a loss of security interests where a supplier under a retention of title arrangement failed to register its interest<sup>4</sup>.

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<sup>4</sup> *Associated Alloys v ACN [2000] HCA 25* and *General Motors Acceptance Corp v Southbank [2007] HCA 19*.

11.48. There are, however, some types of security interests that are exempt from this rule. The types of property not affected by the rule are:

- security interests created by a transfer of an account that does not secure payment or performance of an obligation,
- the interest of a senior creditor under a turnover trust, and
- a short term PPS lease (that is, a security interest created by a lease that does not secure payment or performance of an obligation and is for tangible property that must be described by serial number and is for a term of 90 days or more and 1 year or less (section 233(3)).

11.49. While these transactions would survive the grantor's insolvency, they would remain subject to the priority rules in the Bill.

11.50. Security interests created by a transfer of an account that do not secure performance of payment of any obligation are pure transfers of the account. The insolvent grantor has received value for the transfer, and it would be inappropriate for the Bill to allow the grantor to have the benefit of both that consideration and the transferred account.

11.51. Turnover trusts are a feature of a large number of commercial documents, and are commonly included in guarantees provided in the course of commercial financing. Requiring the registration of turnover trusts would be onerous on financiers. The Bill strikes a balance by allowing unregistered turnover trusts to survive the grantor's insolvency, but would make the senior creditor's interest under the trust subordinate to the interest of another secured party who has registered their security interest.

11.52. Requiring the registration of short term PPS leases before they survive the grantor's insolvency would be onerous. As with turnover trusts, the Bill seeks to strike a balance by allowing unperfected short term PPS leases to survive the grantor's insolvency, but subjecting the short term PPS lease to the priority rules.

11.53. This provision would also provide that a person who acquired the property from the secured party or the receiver would acquire good title provided they gave new value and the person acquiring the collateral had no knowledge that steps to wind up the company or place it into administration or execute a deed of company arrangement had been made (section 233(5)).

11.54. A lessor or bailor under a PPS lease or a commercial consignment which does not secure payment or performance of an obligation whose security interest is lost because it vests in the grantor under section 233 would be taken to have suffered damage. The lessor, bailor or consignor would be able to recover compensation equal to the value of the loss or the market value of the leased, bailed or consigned property. As the grantor is in liquidation or another form of external administration, or in bankruptcy if an individual, the provision would allow the secured party to prove in the external administration or bankruptcy for the amount of their loss.

#### **Example**

LessorA leases a crane to GrantA for more than one year on terms that do not involve securing payment or performance of an obligation. As the lease is for more than one year, it is deemed to be a security interest.

LessorA does not register its security interest. GrantA becomes insolvent.

As LessorA's security interest in the crane is not perfected, LessorA's security interest in the crane vests in GrantA and (subject to other security interests) is available to unsecured creditors in the insolvency.

LessorA is able to seek compensation from GrantA, and can prove its claim in GrantA's insolvency.

### *Fixed and floating charges—circulating assets*

11.55. The Bill implements a functional approach to security interests, and amalgamates into a single structure a range of security transactions that secure a payment or performance of an obligation—including fixed and floating charges. As a result, transactions that are currently structured as fixed charges or floating charges may take the more generic form of a security interest.

11.56. Some statutes currently refer to fixed charges or floating charges – or to charges – and it will be necessary to preserve the effect of these provisions in relation to transactions that are structured as generic security agreements. Parties to a transaction should not be able to avoid these statutes by structuring the transaction as a generic security agreement.

11.57. Similarly, some security agreements may refer to fixed or floating charges despite the Bill implementing a functional approach to security transactions.

11.58. The Bill provides that in a law of the Commonwealth or a security agreement, a reference to a charge will be taken to be a reference to a security that has attached to a circulating asset or personal property that is not a circulating asset (section 51(3)).

11.59. The reference to a charge will apply to a charge only to the extent that the charge has attached to personal property owned by the grantor section 51(1). As a result, a reference to a charge will not apply to property owned by the secured party – such as the collateral in a retention of title arrangement, lease or consignment.

11.60. A reference to a floating charge over property is taken to be a reference to a security interest that has attached to a circulating asset (section 51(4)).

11.61. There would be two classes of circulating asset.

11.62. First, personal property will be a circulating asset if the secured party has given the grantor express or implied authority for any transfer of the personal property to be made, in the ordinary course of the grantor's business, free of the security interest (section 51(1)(b)). The personal property will not be a circulating asset merely because the secured party has given express authority to transfer specific personal property, or a specific class of personal property, free of a security interest (section 51(4)). For example, a particular item of property would not become a circulating asset merely because the secured party has expressly agreed that the grantor may sell it free of the security interest—such as to sell a depreciated lathe (or a class of depreciated lathes) that it is no longer needed.

11.63. Second, personal property will be a circulating asset if it is a current asset (as defined in section 51(5)). A **current asset** would be any one of the following:

- currency,
- a negotiable instrument,



- an ADI account (other than a term deposit),
- inventory,
- an account (other than a term deposit) that is the proceeds of inventory,
- an account that arises from granting a right, or providing services, in the ordinary course of a business of granting rights or providing services of that kind (whether or not the account debtor is the person to whom the right is granted or the services are provided).

11.64. Nor would a current asset be a circulating asset if:

- the secured party has registered a collateral description in relation to the grantor that discloses, in accordance with the regulations, that the secured party has control of the current asset, and
- the secured party has control of the current asset.

11.65. The Bill provides circumstances in which a person will have control of inventory and a non-ADI account that is the proceeds of inventory (section 52 and section 53). These sections are not intended to be exhaustive of when a person might have control of a current asset. It will be open for further circumstances to be developed under the general law.

11.66. The definition of circulating asset embeds the existing case law on floating charges, which provides that in determining whether a floating charge exists over personal property consideration must be given to both the express terms of the agreement between the parties as well as to the actual level of control exerted by the secured party. The provision takes into account current case law on the nature of floating charges so that, in determining whether a charge is a floating charge, consideration would be given to the intention of the parties as demonstrated by their contract as well as their practices.

### ***Constitutional operation of the Bill***

11.67. Part 1.2 in Chapter 1 of the Bill sets out the constitutional basis for the Bill.

11.68. Part 1.2 establishes the relationship between the Bill and other laws. Where the Bill operates in relation to a security interest, other laws would not affect the validity of the interest, except where the Bill provides otherwise. The Bill would otherwise operate with the intention not to exclude or limit the concurrent operation of other applicable laws of the Commonwealth, a State or Territory or a rule of law or equity.

### ***General constitutional basis***

11.69. Pursuant to section 51(xxxvii) of the Constitution, the Commonwealth Parliament may legislate with respect to matters referred to it by the State parliaments. Suitable State references of legislative power would support the Bill. Such references would remove any need to ‘read down’ the Act by reference to existing Commonwealth constitutional powers and ensure that the new legislative framework is fully effective by enabling comprehensive and national coverage.

11.70. The Commonwealth and the States and Territories have agreed to the terms of an inter-governmental agreement underpinning the referral of legislative power from the States to the Commonwealth to enable the Commonwealth to enact the Bill. The Council of Australian Governments signed-off on the inter-governmental agreement on 2 October 2008.

*Operation of the Bill in a referring State*

11.71. The Bill would operate in a referring State to the extent permitted by the constitutional powers of the Commonwealth, including the reference of legislative power by the State.

*Operation of the Bill in a non-referring State*

11.72. The Bill would still operate in a State regardless of whether that State has referred to the Commonwealth the matters that are necessary to enable the Parliament of the Commonwealth to enact the Bill. However, the Bill would operate in a non-referring State only to the extent that the Bill's operation could be supported by the Commonwealth Parliament's legislative powers under section 51 of the Constitution (other than paragraph 51 (xxxvii)).

11.73. In a non-referring State, the Bill would still regulate security interests in personal property where:

- the grantor of the security interest was a person with respect to whom the Commonwealth can legislate, for example a bankrupt or an insolvent (section 11)
- the security interest arose in the course of activities with respect to which the Commonwealth can legislate, for example, activities undertaken by a constitutional corporation (section 12), or
- the security interest was in an item of collateral with respect to which the Commonwealth can legislate, for example, a bill of exchange or promissory note (section 13).

11.74. The Bill also provides that the Personal Property Securities Register would operate in a non-referring State (section 14).

*Operation of the Bill in a Territory*

11.75. The Bill would operate in a Territory as a law of the Commonwealth, to the extent that it can in accordance with the Commonwealth Parliament's legislative powers under sections 122 and 51 of the Constitution (other than paragraph 51(xxxvii))(section 7).

11.76. The Bill would only extend to external Territories that were prescribed (section 4).

*Operation of the Bill outside Australia*

11.77. The Bill would operate outside Australia to the extent that it can under paragraph 51(xxix) of the Constitution (the external affairs power) or any of the other legislative powers that the Commonwealth Parliament has under section 51 of the Constitution (other than paragraph 51(xxxvii))(section 7).

*Referring State*

11.78. A State is not a **referring State** unless the State has referred the necessary legislative power before the Bill receives Royal Assent. If a State were to refer the legislative power after the Bill receives Royal Assent, the PPS Act would need to be amended to include that State as a referring State. Those amendments would be made at the same time as amendments to include special transitional provisions for that State, which would be necessary if it joined the national scheme late.

11.79. The Bill would reflect the matters referred by State parliaments (section 9). The Commonwealth would rely on the referral of legislative power from the States in order to initially make the PPS Act. The reference of power would also extend to the making of express amendments to the PPS Act. An express amendment includes direct amendments of the PPS Act but would exclude the enactment of a provision in a different Act that would have a significant affect on the PPS Act.

11.80. A referring State would stop being a referring State if that State were to terminate the provisions of the referral legislation that conferred the power to initially make the PPS Act and the provisions that permitted subsequent amendments (section 8(5)). However, a referring State would continue to be a referring State even if that State enacts legislation that provides that the referral would terminate in particular circumstances (section 8(4)).

### ***Relationship with other laws***

11.81. The Bill would prevail to the extent of any direct inconsistency over a law of a State or a Territory or a rule of law or equity (section 15(3)). However, the Bill would recognise that some laws of a State or a Territory and rules of law or equity would operate concurrently with the Bill (sections 15(1) and (2)).

11.82. The Bill restricts the laws that the States and Territories may enact to operate concurrently with the Bill. These provisions are explained below. Subject to those restrictions, to the extent that a rule of law or equity, or a law of the Commonwealth or a State or a Territory was not inconsistent with it, the Bill would allow laws that deal with the following matters to operate concurrently with it:

- a law that requires or enables a person to register a security interest,
- a law that requires or enables a person to register the assignment of a security interest,
- a law that requires a security agreement to be in a particular form, or to be executed in a particular way,
- a law that defines a matter or other thing created under that law as personal property,
- a law that prohibits or limits a person creating, acquiring or dealing with collateral or a security interest in collateral,
- a law that prohibits or limits the right of a person to hold, transfer or assign a security interest in personal property,
- a law that imposes limitations or additional obligations in relation to the enforcements of a security interest in personal property,
- a law that operates to extinguish a security interest, or
- a law that relates to matter that is expressly otherwise allowed under the Bill. An example of this is the Consumer Credit Code (see section 158).

11.83. The Bill contains a regulation making power under which (i) a provision of the Bill could be disapplied to a State or Territory law or (ii) the operation of the Bill could be modified so that no inconsistency arises between the Bill and such a law (section 16). For example, the regulations might specify a person, a body or circumstances to which the Bill did not apply. The regulations might also authorise a person to do something that they would not otherwise be authorised to do under the PPS Act.

11.84. This regulation making power could not be used to modify the definitions of *personal property* (section 26) or *licence* (section 40(2)) so far as those definitions exclude certain rights, entitlements and authorities that are granted under Commonwealth, State or Territory law and are declared under that law not to be personal property under the PPS Act. This restriction is in accordance with the terms of the PPS inter-governmental agreement between the Commonwealth and the States and Territories.

11.85. The Bill would ensure that the Commonwealth, by enacting the PPS Act, does not give preference to one State (or part thereof) over another State (or part thereof) in relation to trade, commerce or revenue in contravention of section 99 of the Commonwealth Constitution (section 17). This would be achieved by allowing a court to ‘read-down’ any provision in the Bill that would give such a preference, so that it would not operate to the extent that it gives the preference.

*When other laws prevail*

11.86. The Bill would allow for the *Payment Systems and Netting Act 1998*, the *Cheques Act 1986*, and the *Bills of Exchange Act 1909* to prevail over the PPS Act to the extent of any inconsistency (section 18). The Bill would rely on concepts in these Commonwealth Acts and this provision would ensure that such concepts would not be defeated or altered by a provision of the PPS Act.

11.87. The Bill (section 19) would set out restrictions on the extent to which a security agreement is effective according to its terms under section 58. A security agreement would be subject to any rule of law or equity or any law of the Commonwealth, a State or a Territory. An Act that prevented the granting of security interests in certain kinds of personal property would continue to be effective, for example, the prohibition in the *Gaming Machines Act 2001* (NSW), section 74 on granting certain kinds of security interests in approved gaming machines; or the prohibition in the Consumer Credit Code, section 40(1) that renders void a provision in a mortgage that charges all the property of a mortgagor.

11.88. The contractual relationship between the parties would continue to be regulated by the general contract rules dealing with matters such as formation, validity, interpretation and enforceability of contracts.

11.89. The Bill would allow a law of the Commonwealth, a State or a Territory or a rule of law or equity to prevail over the PPS Act, to the extent of an inconsistency, where that law prohibits or limits a person creating, acquiring or dealing with collateral or a security interest in collateral (section 20). This would include where the relevant law restricts the right of a person to hold, transfer or assign a security interest or where the law would impose further limitations or obligations in relation to the enforcement of a security interest in personal property. This rule would be subject to the rules in the Bill that determine when other laws do not prevail (sections 22 to 25).

11.90. The Bill would allow a referring State or a Territory to declare that a matter be excluded from the application of the whole or part of the PPS Act (section 21). The declaration could also specify the extent to which the matter is excluded. Regulations made under the PPS Act could override any such declaration. These provisions are in accordance with the terms of the PPS inter-governmental agreement between the Commonwealth and the States and Territories.

*When other laws do not prevail*

11.91. While the Bill would allow State and Territory laws consistent with the PPS Act to generally operate concurrently with the PPS Act, the Bill would ensure that such laws would not prevail over the PPS Act in certain circumstances.

11.92. A security agreement or an assignment of a security agreement would not be ineffective under the PPS Act merely because of a failure to comply with certain laws of a State or a Territory. Specifically, where a State or Territory law:

- required or enabled a person to register a security interest or an assignment, a failure to comply with the registration requirements under the relevant State or Territory law would not affect the validity, priority or enforcement or otherwise limit the effect of the security agreement or security interest (section 22) or the assignment (section 23),
- related to a security agreement or an assignment of a security interest and required the security agreement to be in a particular form or be executed in a particular way, a failure to comply with the formal requirements under the relevant State or Territory law would not affect the validity, priority or enforcement or otherwise limit the effect of the security agreement, the security interest or the assignment (section 24). This would only apply to State and Territory laws prescribed by the regulations. It would be possible to prescribe State and Territory laws that impose different formal requirements in different States and Territories, with a view to facilitating the introduction of consistent national formal requirements,
- affected the operation of the rules under the PPS Act that determine when a security interest attaches to personal property (section 61) and how a security interest is perfected (section 64), the operation of the relevant State or Territory law would be excluded to the extent that it affects the specified provisions of the PPS Act (section 25).

11.93. These provisions would ensure there is consistency throughout Australia in relation to registration, assignment, the formal requirements relating to security agreements and the rules relating to attachment and perfection.

## 12. TRANSITIONAL PROVISIONS

The Bill contains provisions to facilitate the transition from the current law in Australia governing the creation, enforcement and priorities of security interests in personal property to the Personal Property Securities Act (PPS Act). Part of this transition is the migration of data from existing State, Territory and Commonwealth registers recording security interests in personal property to the PPS Register.

12.2. The provisions of Chapter 7 act as an exception to the general application the Bill. The Bill will apply to existing security interests subject to Chapter 7, which will generally allow security holders to maintain their priority and preserve existing rights for 24 months from the time the PPS Register commences operation.

12.3. In order to preserve existing rights and priorities, Chapter 7 will ensure that certain parts of the Bill, for example the provisions relating to enforcement, will only apply to new security interests created under the PPS Act and not to existing security interests. These provisions strike an important balance between ensuring the PPS Act deals on commencement with all security interests (whenever created) and protecting existing security holders.

12.4. Chapter 7 covers three main areas, namely, the **Migration Provisions**, the **Application Provisions** and the **Transitional Provisions**.

- Migration Provisions would set up a legal framework for the transfer of data from existing State, Territory or Commonwealth registers to the new PPS Register,
- Application Provisions would set out the kinds of interests in personal property to which the PPS Act would apply, and
- Transitional Provisions would cover security interests existing before the PPS Act comes into force and priority rules for those interests.

### *Constitutional framework*

12.5. Chapter 7 operates in the context of constitutional requirements regarding Commonwealth legislative power, the practical requirements for transferring large amounts of data from existing registers of interests in personal property, and the objective of having a single, comprehensive system for regulating and registering security interests in personal property.

12.6. Under s 51(xxxi) of the Constitution, the Commonwealth can only make laws acquiring property on just terms. The Bill avoids giving an existing security interest in personal property a higher priority relative to another interest in the same property than it had immediately before the PPS Act commences. Doing otherwise could amount to an acquisition of property otherwise than on just terms.

12.7. The Bill is designed to avoid any unjust acquisition of property issues with the PPS Act. It is only where priority comes to be determined because of bankruptcy or insolvency, or where an existing secured party has assented to the new PPS Act by voluntarily registering their interest on the PPS Register, that the Commonwealth can legislate to alter priority between competing interests without engaging the just terms requirement. The Transitional Provisions therefore contain special

priority rules for pre-existing interests where priority arises in these situations. Otherwise, the Bill would ensure pre-existing interests maintain their priority with respect to one another.

12.8. The transitional provisions would preserve existing rights in cases of bankruptcy or insolvency, or assent by a security interest holder whose interest is not migrated to the PPS Register (non-migrated security interest), for a period of up to 24 months (the temporary perfection period). However, the Transitional Provisions would also provide incentives to non-migrated security interest holders to register their interests under the new regime.

12.9. This incentive arises from the fact that should the grantor become insolvent or bankrupt after the expiry of the temporary perfection period, unless that security interest had been otherwise perfected (eg by registration) it would have a lower priority than security interests in the same property that had been perfected. In this way, the Bill strikes a balance between preserving existing rights and providing incentives to register.

12.10. The transitional provisions would apply to existing security interests that had been migrated to the PPS Register without requiring the secured party to indicate their assent to the PPS Act by voluntarily re-registering or amending the registration. However, in circumstances where this would change the priority of a migrated security interest resulting in an acquisition of property otherwise than on just terms, the Transitional Provisions will protect the migrated security interests by ensuring that the secured party retains the priority they would have had if the PPS Act had not been enacted.

### ***Timing***

12.11. Chapter 7 identifies two significant points in time, migration time and registration commencement time.

12.12. The migration time would be the time when agencies in charge of registers maintained currently under a law of the Commonwealth, a State or a Territory start to transfer the data to the PPS Register. The migration time would be the start of a day determined by the Minister (section 276).

12.13. There would be a period of approximately three months during which existing registrations of security interests would be brought across to the new PPS Register.

12.14. The registration commencement time would be the start of the first day of the second month after the month in which the migration time occurs (section 277). This would occur between two and three months after the migration date.

#### **Example**

If the migration time were at the start of 15 November 2007, the registration commencement time would be at the start of 1 January 2008.

### ***Migration provisions***

12.15. Currently registered interests (on registers known as transitional registers in the Bill) would be migrated to the new PPS Register.

12.16. The migration provisions would provide that the Registrar may determine, by legislative instrument, that a class of personal property about which data had been given to the Registrar is registrable, and allow the Registrar to register items in that class before the registration commencement time (section 302). The purpose of the provision is to allow for the migration of property interests from existing registers to the PPS Register.

12.17. This would involve the Registrar determining that, for example, ‘registrations on the Queensland Vehicle Securities Register’ (VSR) is a class of registrable property, and transferring all registrations on the Queensland VSR to the PPS Register. A register may be unsuitable for migration because:

- the information in the register is not clearly set out,
- it is a register of interests to which the PPS Act does not apply, or
- it does not contain sufficient identifying information.

12.18. If a particular interest is not migrated across from an existing register because the Registrar has not determined the information on that register to be a registrable class of property, this will not affect the rights of a secured party with respect to that interest. If the interest is a type of interest governed by the Bill, the transitional provisions would protect the rights of the secured party. The interest will be a non-migrated transitional security interest. The rights of holders of non-migrated transitional security interests are explained at paragraphs 7.38 to 7.40 below.

12.19. Each migrated registration would need to have an end time. This would be the end time in the transitional register, according to the law under which the transitional register was maintained (section 302(4)). Typically, this end time would be listed on the register from which the information is being migrated. If a particular registration fails to list this information, the Registrar would assign an appropriate end time, for example, the latest end date allowed by the legislation governing the particular register.

12.20. Where the Registrar had determined a class of personal property to be registrable and registered data in the class on the PPS Register, the Registrar may remove that data. However, the Registrar may only do so where satisfied that the personal property is not, and is not intended to be, subject to a security interest and there is no reason to retain the data on the PPS Register (section 303). The Registrar would have to give a verification statement to each secured party under section 221 of the PPS Bill.

#### *Preparatory registration for collateral secured by transitional security interests*

12.21. The migration provisions would allow a non-migrated transitional security interest to be registered between the migration time and the registration commencement time (a period of approximately 3 months). A secured party that registers their security interest in this time will receive the same protection under the Bill as a secured party who registers their security interest within the 24 month temporary perfection period. The registration time for registrations of this nature would be immediately before the registration commencement time.

#### *Registration defects*

12.22. The Registrar would be able to determine that certain registrations are effective despite defects that would render them ineffective under the PPS Act (section 307). This provision is necessary because some transitional registers do not include information that will be required on the



PPS register. In the case of other transitional security interests the Registrar may decide that secured parties should be given an opportunity to correct certain details of the registration where they have perfected their interest.

#### **Example**

State vehicle registers do not include information about the grantor of the interest. The Bill would enable the Registrar to determine that a migrated State vehicle registration, for a vehicle that is commercial property, is not ineffective merely because a search of the PPS Register, by reference only to the individual or corporate details of the grantor in respect of the collateral, is not capable of returning the relevant registration.

#### **Example**

The Registrar would be able to determine that a collateral registration that perfects a transitional security interest is not ineffective because a search of the PPS Register, by reference only to the ABN, is not capable of returning the relevant registration.

### ***Application provisions***

#### *Application to interests in personal property*

12.23. The purpose of the application provisions is to set out the variety of security interests and security agreements to which the PPS Bill would apply. The Bill applies to security interests arising and security agreements made both before and after the registration commencement time (section 280). However, the application of the Bill to interests arising and agreements made before the registration commencement time would be subject to the provisions in Chapter 7, in order to protect the holders of interests existing before the PPS Register commences operation.

12.24. The Bill would only apply to interests that are not security interests in personal property (eg a lien) that arise after the registration commencement time. However, the Bill would apply to interests that are not security interests in personal property that are migrated from other registers (section 280).

#### *Application of references to fixed and floating charges*

12.25. The Bill does not use the terminology of ‘fixed’ and ‘floating’ charges. In the Bill:

- a floating charge would be referred to as a security interest that has attached to a circulating asset, and
- a fixed charge would be referred to as a security interest that has attached to an asset that is not a circulating asset.

12.26. In order to avoid confusion, and unconstitutional acquisitions of property, the Bill would ensure that these new definitions apply in all other Commonwealth legislation, and that new security agreements using old terminology are taken to have used the new terms. However, transitional security agreements made before the registration commencement time, and transitional security interests arising before the registration commencement time, using old terminology will not be affected by the change of terminology (section 281).

### ***Different kinds of interests affected by the Bill***

12.27. The transitional provisions would ensure that existing security interests continue to have effect, that is, they will be transitioned to the new regime. The Bill distinguishes two different kinds of security interest arising before the registration commencement time, and treats them as special cases in the transitional provisions. The two categories of security interests which the Bill treats separately are non-migrated transitional security interests and migrated security interests. The application provisions would only apply the Bill to these interests subject to the transitional provisions.

#### *Transitional security interests*

12.28. A transitional security interest is defined as a security interest arising out of a security agreement in force before the registration commencement time. Security agreements in force before the registration commencement time are referred to as transitional security agreements. The transitional security interest can arise before or after the registration commencement time.

#### *Migrated security interests*

12.29. Chapter 7 contains rules relating to the migration of interests from existing registers, which are designed to facilitate a seamless transition from a multi-jurisdictional personal property securities system to a single personal property securities system. This would ensure that secured parties who currently have a registered interest can be certain their interest will continue to be registered on the new PPS Register.

12.30. A migrated security interest is a particular kind of transitional security interest. It is a transitional security interest which was registered on a register maintained under a law of the Commonwealth, a State or a Territory (a transitional register), and was given to the Registrar by an officer or agency in charge of such a register (section 301).

#### *Non-migrated transitional security interests*

12.31. Non-migrated transitional security interests are all those transitional security interests which do not fit the definition of a migrated security interest.

### ***Transitional provisions***

12.32. In order to balance the goals of protecting existing security interests and encouraging secured parties to register their interests, the Bill would limit the period for which holders of transitional security interests, including migrated security interests, can expect to maintain their priority over newly registered interests.

12.33. The Commonwealth cannot alter the rights of transitional security interest holders without facing acquisition of property issues, except where the security interest holder has indicated agreement to the PPS Act, or where priority comes to be determined because of insolvency or bankruptcy.

12.34. The transitional provisions would set up a transitional priority scheme which would apply in cases of bankruptcy or insolvency (section 287), or where both secured parties in a priority dispute between transitional security interests have:

- in the case of a non-migrated security interest, indicated assent to the PPS Act by registering their interest, or
- in the case of a migrated security interest, had their security interest registered by the PPS Registrar (section 288).

12.35. To save migrated security interest holders having to re-register their existing registered security interests, the Bill would not require this in order for them to get the benefit of the transitional priority scheme. However, if the application of the transitional priority scheme would result in an acquisition of property otherwise than on just terms, then the priority would be determined as if the PPS Act had not been enacted (section 293).

12.36. A migrated security interest would not be subject to other provisions of the transitional provisions that would result in an acquisition of property otherwise than on just terms, unless they have indicated assent by registering the collateral in a new registration or amending the registration by application. For example, a migrated security interest would not be subject to the provisions of the Bill which relate to acquiring collateral free of security interests and to vesting of certain unperfected security interests, unless the security interest holder had indicated assent to the provisions of the Bill.

12.37. Generally, this means that migrated security interests will be able to access any benefits available to them under Chapter 7 without indicating their assent to the PPS Act. These interests will not, however, be subject to provisions that would have a detrimental affect on their priority, such as the extinguishment provisions, unless they indicate their assent to the PPS Act.

#### *Temporary perfection or effective registration*

12.38. Temporary perfection is a form of perfection (section 64). The purpose of temporary perfection in the transitional provisions is to protect the interests of parties with non-migrated transitional security interests for a period of time – the temporary perfection period. This period of time provides them with the opportunity to perfect their security interest by registration. Temporary perfection gives secured parties holding non-migrated transitional security interests priority over parties who register their security interest at or after the registration commencement time.

12.39. Non-migrated transitional security interests would be temporarily perfected by the Bill for a period starting immediately before the registration commencement time and ending at the end of the earlier of the following times (section 290):

- the time when the security interest ceased to be continuously perfected otherwise than by temporary perfection, or
- after 24 months.

12.40. This provision ensures that non-migrated transitional security interests will be temporarily perfected for up to 24 months. It is only where such an interest is registered and that registration expires during the 24 month period that the temporary perfection period will be less than 24 months.

**Example**

Dana is an amateur art collector. On 30 August 2020 Fantastic Finance lends Dana \$5 000 and takes a security interest in an original Arthur Boyd painting Dana owns. On 12 September 2020 the new PPS Register commences. On 14 September 2020 Goliath Finance lends Dana \$10 000 and takes a security interest in the same painting. Goliath Finance registers its interest on the PPS Register on the same day.

On 15 October 2020 Dana becomes insolvent. The priority between Fantastic Finance and Goliath Finance comes to be determined. Fantastic Finance's interest is temporarily perfected by the Bill, for a period starting immediately before 12 September, up until 30 September 2022. Fantastic Finance's interest in Dana's painting therefore has priority over Goliath Finance's interest, even though Fantastic Finance's interest is unregistered.

12.41. Migrated security interests are taken to be perfected by registration from a time immediately before the registration commencement time up until their registration end time (section 291). This period of time would vary depending on the duration of the security interest.

*Priority after temporary perfection period*

12.42. The effect of limiting the temporary perfection period would be that individuals are encouraged to register their non-migrated transitional security interests during the 24 month temporary perfection period. Disputes about priorities between security interests most commonly arise in cases of bankruptcy or insolvency, and in these circumstances the Bill will not give priority to unregistered non-migrated transitional security interests for longer than two years. After the temporary perfection period the priorities would be determined under the substantive provisions of the Bill, which would give priority to perfected security interests. However, if secured parties register during this period and maintain that perfection, their interests would have been continuously perfected from immediately before the registration commencement time.

**Example**

Facts as above, except Dana becomes insolvent on 1 October 2022. Fantastic Finance has not registered its interest on the PPS Register. Goliath Finance's registered interest in Dana's painting will have priority over Fantastic Finance's unregistered interest, because the priority provisions of the PPS Act give priority to a perfected interest. The two year temporary perfection period has ended without Fantastic Finance registering its interest, and Goliath Finance's interest is perfected by registration.

**Example**

Facts as above, except Fantastic Finance registers its security interest on 1 October 2022, after the end of the temporary perfection period. Dana becomes insolvent on 5 October 2022. Goliath Finance's registered interest in Dana's painting will have priority over Fantastic Finance's registered interest. The first in time rule in the PPS Act will apply, and Fantastic Finance will not benefit from the temporary perfection period in the Bill because there has been a gap between the temporary perfection period and the registration of the interest.

*Priority between transitional security interests, including migrated security interests*

12.43. The Bill would also provide rules for determining priority between different transitional security interests. The basic principle of these rules is that the interests would have the same priority they would have had if the Bill had not been enacted (section 292). The period for which the rules apply (the priority period) would be limited by the Bill depending on the particular interests involved, set out in a table in section 292.

12.44. After the end of the priority period, the security interests would have priority between themselves that is determined under the PPS Act (section 292(3)(a)).

12.45. Where two non-migrated transitional security interests compete for priority, the priority period would generally be the 24 month temporary perfection period. However, if one of the security interests had been perfected by registration and the registration had expired during that period, the priority period would finish when that registration expired. Where both security interests had been registered and both of the registrations expire within 24 months, the priority period would finish on the earlier of the dates on which the registrations expire.

#### **Example**

On 13 June 2028, Future Finance lends Don's Construction Co. \$18 000 to buy a forklift, and takes a security interest in the forklift. On 16 September 2029, Gala Finance lends Don's Construction Co. \$6 000 and also takes a security interest in the forklift. On 1 August 2030, the PPS Register commences operation.

On 27 September 2031, Don's Construction Co. becomes insolvent. This is within the 2 year temporary perfection period. The two interests will have priority determined as if the PPS Act were not in operation, so Future Finance's earlier interest would have priority.

#### **Example**

Facts as above, except on 1 January 2032 Gala Finance registers its interest on the PPS Register, and on 27 September 2032 Don's Construction Co. becomes insolvent. This is no longer within the two year temporary perfection period. Gala Finance's interest is now perfected by registration, and Future Finance's is unperfected. The PPS Act will give Gala Finance's registered interest priority.

#### **Example**

Facts as above, except on 30 July 2032 Gala Finance's registration ends, and on 20 August 2032 Don's Construction Co. becomes insolvent. This is within the two year temporary perfection period. Future Finance continues to have temporary perfection, and Gala Finance's continuous perfection has stopped and its interest will no longer have temporary perfection. The priorities would be determined under the PPS Act. Gala Finance's interest would be unperfected under the PPS Act and Future Finance's interest would therefore have priority as it is perfected by temporary perfection.

12.46. Where a migrated security interest and a non-migrated transitional security interest compete for priority, the priority period would finish at the earliest of: (i) the expiry of the 2 year temporary perfection period; or (ii) the time when one of the security interest stops being continuously perfected.

#### **Example**

On 10 May 2028, Sawyer lends Denise \$10 000 to buy a car and takes a security interest in the car. He does not register the interest. On 16 June 2029, Steven lends Denise \$3 000 and also takes a security interest in the car. Steven registers his interest on the NSW Register of Encumbered Vehicles, with an end date of 16 June 2035.

The start of the day on 7 June 2030 is the migration time, and officials of the PPS Register migrate all the information on NSW REVS to the new PPS Register. The start of the day on 1 August 2030 is the registration commencement time, and Steven's interest in Denise's car appears on the new PPS Register.

On 27 September 2031 Denise becomes insolvent. As a migrated security interest, Steven's security interest would have effective registration from immediately prior to the registration commencement time. As a non-migrated transitional security interest, Sawyer's security interest would have temporary

perfection from immediately before the registration commencement time. The priority has come to be determined during the priority period (as provided by the table in section 292) and will therefore be determined as if the PPS Act had not been enacted. At this time Steven's security interest will have priority, because s 10A(1) of the *Registration of Interests in Goods Act 1986* (NSW) would have given Steven's registered interest priority over Sawyer's unregistered interest. This will be the case until the end of the 2 year temporary perfection period for Sawyer's interest, on 31 August 2032.

### Example

Facts as above, except Sawyer does not register during the 2 year temporary perfection period and Denise becomes insolvent on 2 October 2032. Because the two year temporary perfection period for Sawyer's transitional interest has ended, the priority between the two interests will be determined by the provisions that apply after the priority period. The priority will therefore be determined by the PPS Act. Because Steven's interest is taken to be perfected by registration until the registration end date and Sawyer's interest is no longer temporarily perfected, Steven's security interest will have priority, as the PPS Act gives priority to a perfected interest.

12.47. Where two migrated security interests compete for priority, the priority period would finish at the earliest date on which one of the registrations expires.

### Example

On 5 March 2028, Golden Finance lends Dudley \$60 000 to buy a car and takes a security interest in the car. Golden Finance registers its interest on 10 March 2028 on the Queensland Vehicle Securities Register, with an end date of 10 March 2035. On 16 June 2029, Faith Finance lends Dudley \$5 000 and also takes a security interest in the car. Faith Finance registers its interest on the Queensland Vehicle Securities Register, with an end date of 16 June 2035.

The start of the day on 7 June 2030 is the migration time, and officials of the PPS Register migrate all the information on the Queensland VSR to the new PPS Register. The start of the day on 1 August 2030 is the registration commencement time, and both Golden Finance's and Faith Finance's interests appear on the new PPS Register.

Dudley becomes insolvent on 1 March 2035. Because the priority has come to be determined during the priority period, the priority will be determined as if the Act had not been enacted. Golden Finance's interest has priority because s 12 of the *Motor Vehicles and Boats Securities Act 1986* (Qld) would have given Golden Finance's earlier registered interest priority.

### Example

Facts as above, except Dudley becomes insolvent on 11 May 2035, after the end date of Golden Finance's registration. Because the priority has come to be determined after the priority period, the priority will be determined by the PPS Act. Golden Finance's interest is now unregistered, so the PPS Act gives priority to Faith Finance's perfected migrated security interest.

12.48. In some cases the PPS Act would give both interests exactly the same priority. This is because the temporary perfection provisions give exactly the same start time for temporary perfection for all transitional security interests. For example, if two non-migrated transitional interest holders have registered during the temporary perfection period, their interests would have been perfected from exactly the same time, and the PPS Act would give them equal priority.

12.49. In any case where the PPS Act would apply and would not result in either security interest having priority over the other, the Bill would give the interests the same priority between themselves they would have had if the PPS Act had not been enacted (section 292(3)(b)).

*Acquiring collateral free of, and voiding of, transitional security interests*

12.50. Chapter 7 would apply the sections of the Bill which relate to acquiring collateral free of security interests and to the voiding of interests to transitional and migrated security interests in cases of bankruptcy or insolvency, or where the secured party has indicated assent to the PPS Act by registering their transitional security interest or re-registering or amending the registration of their migrated security interest (sections 297 and 298).

*Priority not on insolvency/bankruptcy or registration*

12.51. The priority rules would be different where priority comes to be determined between a transitional security interest and a competing interest but:

- priority does not come to be determined because of an insolvency or bankruptcy, and
- priority comes to be determined where the secured party holds a non-migrated security interest but they have not registered it (section 294).

12.52. This alternative priority rule applies to a competing security interest whether or not the competing interest is a transitional security interest.

12.53. The Commonwealth cannot affect the interests of parties in these cases without facing acquisition of property issues. Therefore, the transitional security interest and the competing security interest in the collateral would have the priority between themselves that they would have had if the PPS Act had not been enacted.

12.54. The competing security interest could be any kind of security interest, including a registered security interest.

## APPENDIX A: CONFLICT OF LAWS MODEL

### ***Part 1: Introduction***

The Bill would include rules determining the law that governs the validity of a security interest, the perfection of a security interest, and the effect of perfection or non-perfection of a security interest.

A.2 In order to determine the law that governs these matters it would be necessary to consider three questions.

A.3 The first question relates to whether the transaction involves a sufficient connection with Australia. This issue is considered in Part 2 of this paper.

A.4 The second question is whether the law in question relates to proprietary rights (that is, the validity of a security interest, the perfection of a security interest, and the effect of perfection or non-perfection of a security interest). This issue is considered in Part 3 of this paper.

A.5 The third question is what law governs the validity of a security interest, the perfection of a security interest, and the effect of perfection or non-perfection of a security interest. This issue is considered in Parts 4 (tangible property), 5 (financial property), 6 (intangibles), 7 (priority rules when no foreign register), and 8 (relocation of the grantor or collateral) of this paper.

A.6 Part 9 deals with some definitional issues.

### ***Part 2: Sufficient connection with Australia***

A.7 The Bill currently provides at section 7(5) that:

- (5) It is the Commonwealth Parliament's intention that this Act should operate outside Australia to the extent that it can in accordance with the Commonwealth Parliament's legislative powers under:
  - (a) paragraph 51(xxix) of the Constitution, and
  - (b) the other legislative powers that the Commonwealth Parliament has under section 51 of the Constitution (other than paragraph 51(xxxvii)).

A.8 Concern has been expressed that this provision would apply the Bill to any transaction in the world, without the need for a connection to Australia. For example, the provision would apply the Bill to a security interest when both the grantor and secured party are bodies corporate formed in Japan.

A.9 It is proposed that section 7(5) be replaced. Different rules would apply depending on whether the collateral is:



- (a) tangible property or financial property, or
- (b) an intangible.

*Tangible property or financial property*

A.10 Instead, the Bill would apply to security interests in tangible property or financial property:

- (a) located in Australia, or
- (b) located outside Australia only if the grantor is an Australian entity.

A.11 For this purpose, an Australian entity is individual who is located in Australia (see Rule 13 for when an individual is located in Australia), a company, a registrable Australian body (within the meaning of the *Corporations Act 2001*), a corporation sole formed under a law of Australia, a public authority established under a law of Australia, or an instrumentality or agency of the Crown in right of the Commonwealth, in right of a State or in right of a Territory.

A.12 For this purpose, financial property is chattel paper, investment instruments, currency, documents of title and negotiable instruments.

*Intangible property*

A.13 The Bill would also apply to:

- (a) an intangible (including an account) if the grantor is an Australian entity,
- (b) an account that is payable in Australia,
- (c) an assignment of an account or chattel paper when the assignor is an Australian entity,
- (d) an assignment of an account or chattel paper that is payable in Australia,
- (e) an ADI account,
- (f) an assignment of an ADI account.

A.14 The Bill would also apply to intangibles that are created under an Australian law. For example, the Bill would apply to licences created by a law of State or Territory, and to intellectual property created by a law of the Commonwealth.

***Part 3: Proprietary rights***

A.15 The Bill would provide that nothing in the Bill affects the law governing contractual obligations, including contractual obligations under a security agreement.

The Bill is not to interfere with the freedom of choice allowed under Article 3 of the Convention On The Law Applicable To Contractual Obligations opened for signature in Rome on 19 June 1980 (80/934/EEC)(the Rome Convention) that '[a] contract shall be governed by the law chosen by the parties'—see [http://www.rome-convention.org/instruments/i\\_conv\\_orig\\_en.htm](http://www.rome-convention.org/instruments/i_conv_orig_en.htm).

However, as noted in the Giuliano Lagarde Report accompanying the Rome Convention:

'... since the Convention is concerned only with the law applicable to contractual obligations, property rights and intellectual property are not covered by these provisions. An Article in the original preliminary draft had expressly so provided. However, the Group considered that such a provision would be superfluous in the present text, especially as this would have involved the need to recapitulate the differences existing as between the various legal systems of the Member States of the Community.'

A.16 The Bill would establish the governing law concerning the validity of security interest in personal property (referred to in the PPS Bill as the attachment of a security interest), the perfection of security interests in personal property, and the effect of perfection or non-perfection of the security interest.

### ***Part 3: Governing law rules applying to all kinds of personal property***

#### *Rule 1: Reason to apply Australian law*

A.17 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest may be governed by the law of Australia because of another law of the Commonwealth.

Rule 1 recognises the possibility that a security interest may be governed by Australian law for any other reason. An example would be an Act that expressly provided for Australian law to apply in certain circumstances. This rule helps avoid any inconsistency between the Bill and the other rule that applies Australian law.

#### *Rule 2: Express agreement*

A.18 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest in personal property would be governed by the law of Australia if, at the time the security interest attaches to the collateral, the grantor is an Australian entity and the security agreement expressly provides that it is governed by the law of Australia or of an Australian State or Territory.

It is the security agreement that must be governed by the relevant law, and not merely the validity, perfection, and the effect of perfection or non-perfection of the security interest. The effect is that a security interest granted by an Australian entity would be governed by the law of Australia regardless of where the collateral is located (that is, in Australia or elsewhere), if the security agreement is governed by the law of Australia.

Rule 2 would allow security interests in intangible (eg a chose in action) to be governed by the law of Australia, if the security agreement is governed by the law of Australia and the grantor is an Australian entity. Rules 3, 4 and 5 cannot apply to intangibles, because intangible are not located at a particular place.

#### ***Part 4: Tangible personal property***

##### *Rule 3: Default rule for tangible personal property*

A.19 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection, of a security interest in tangible personal property is governed by the law of the place where the collateral is located when the security interest attaches to the collateral.

A.20 This Rule is subject to Rules 1, 2, 4, and 5.

The tangible property must be in Australia, or the grantor must be an Australian entity (see the discussion in Part 2).

##### *Rule 4: Moveable collateral*

A.21 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest in collateral that is moved from one place to another place would be governed by the law of the place to which the collateral is moved; but only if when the security interest attached to the collateral the secured party believed on reasonable grounds that the collateral would be moved to that place.

A.22 This rule is subject to Rule 1, 2 and 5.

A security interest that attaches to collateral that is moved from one place in Australia to another place in Australia would be governed by Australian law.

A security interest that attaches to collateral that is moved from outside Australia to Australia would be governed by Australian law, provided the secured party believed on reasonable grounds that the collateral would be moved to Australia.

A security interest that attaches to collateral that is moved from Australia to outside Australia would be governed by the law of that other place, provided the secured party believed on reasonable grounds that the collateral would be moved to that other place. However, as the collateral is outside Australia, the rule would only apply if the grantor is an Australian entity.

##### *Rule 5: Property normally used to and from Australia*

A.23 This rule applies when

- (a) a security interest attaches to personal property that is tangible property, and
- (b) the tangible property is of a kind that is normally used in more than one place, and
- (c) the tangible property is commercial property.

A.24 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of the security interest would be governed by the law (excluding the conflict of laws rules) of the place where the grantor is located when security interest attaches to the collateral.

A.25 This Rule is subject to Rules 1 and 2.

This rule applies when the grantor is an Australian entity, or the collateral is located in Australia (see the discussion in Part 2).

This rule has the effect that, if the security interest is granted by an Australian, security interests in commercial tangible property that is normally moves from place to place would be governed by the law of Australia. An example would be shipping containers. Note that the places that the collateral is normally used in need not be in Australia.

This rule would not apply to security interest granted by a foreign entity in commercial tangible property that is normally moves from place to place, unless the property is in Australia when the question is decided.

## ***Part 5: Financial property***

### *Rule 6: Security interest in financial property perfected by possession or control*

A.26 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection, of a security interest in financial collateral that is perfected by possession or control is governed by the law (including the conflict of laws rules) of the place where the collateral is located when the security interest attaches to the collateral.

A.27 This Rule is subject to Rules 1, 2 and 8.

The financial collateral must be in Australia, or the grantor must be an Australian entity (see the discussion in Part 2).

### *Rule 7: Security interest in financial property not perfected by possession or control*

A.28 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest in financial property that is not perfected by possession or control is governed by the law (including the conflict of laws rules) of the place where the grantor is located when the security interest attaches to the collateral.

A.29 This Rule is subject to Rules 1, 2 and 8.

See Rule 14 for where a grantor is located.

Rule 7 applies to financial property that is located in Australia when the secured party does not have possession of the collateral (regardless of whether the grantor is an Australian entity or a foreign entity). When the grantor is an Australian entity, the security interest would be governed by the Australian law. When the grantor is a foreign entity, the security interest would be governed by the law of that foreign entity.

For example, a US company grants a security interest in financial property that is located in Australia, and the secured party does not take possession or control of the property. The security interest would be governed by US law. If the grantor were an Australian entity, the security interest would be governed by Australian law.

Rule 7 would apply to financial property that is located outside Australia only if the grantor is an Australian entity (see the discussion in Part 2). When an Australian entity grants a security interest in financial property that is located outside Australia, and the secured party does not have possession or control of the collateral, the security interest would be governed by Australian law. However, when an Australian entity grants a security interest in financial property that is located outside Australia, and the secured party has possession or control of the property, the security interest would be governed by the law of the place where the property is located (because of Rule 6).

Rule 6 and Rule 7 together determine the law governing financial collateral.

When financial property is located in Australia, third parties would need to work out whether a person has possession or control of the property. When nobody has possession or control of financial property located in Australia, any security interest in the financial property would be governed by the law of the location of the grantor of the security interest (that is, the owner of the financial property)(because of Rule 7). When the secured party has possession or control of financial collateral located in Australia, the security interest would be governed by the law of Australia (because of Rule 6).

When financial property is located outside Australia, the Bill would only apply if the financial collateral is owned by an Australian entity (see the discussion in Part 2). If a secured party has possession or control of financial collateral that is located outside Australia, the security interest would be governed by the law of the place where the financial collateral is located (because of Rule 6). If nobody has possession or control of financial collateral located outside Australia, any security interest in the financial collateral would be governed by the law of Australia (because of Rule 7).

*Rule 8: Non-negotiable document of title*

A.30 The validity, perfection, and the effect of perfection or non-perfection, in proceedings in an Australian court, of a security interest that is attached to a non-negotiable document of title is to be governed by the law of the place where the tangible property is located when the security interest attached to the non-negotiable document of title.

A.31 This Rule is subject to Rule 1.

This rule would apply only if the document of title is located in Australia, or if the grantor of the security interest in the non-negotiable document of title is an Australian entity (see the discussion in Part 2). In each case, the security interest would be governed by the law of the place where the tangible property is located.

***Part 6: Intangible personal property***

*Rule 9: Default rule for intangible personal property*

A.32 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest in an intangible is governed by the law (excluding the conflict of laws rules) of the location of the grantor when the security interest attaches to the collateral.

A.33 This Rule does not apply when the intangible is intellectual property, an intellectual property licence, an assignment of an account, an assignment of chattel paper, an ADI account, or an assignment of an ADI account.

A.34 This Rule is subject to Rules 1, 2 and 11.

The Bill applies to these intangibles only if the grantor is an Australian entity (see the discussion in Part 2).

This Rule would not apply when the intangible is an account that is payable in a particular place (as Rule 11 would apply).

A security interest in an intangible granted by an Australian entity would be governed by the law of Australia (except when the intangible is intellectual property, an intellectual property licence, or an ADI account)(because of Rule 3(b)). The Bill would not affect the law governing a security interest in these intangibles granted by a foreign entity (see the discussion in Part 2).

*Rule 10: Assignment of accounts and chattel paper*

A.35 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest in an assignment of an account (other than an ADI account) or an assignment of chattel paper is governed by the law (excluding the conflict of law rules) of the location of the grantor when the security interest attaches to the collateral.

A.36 This Rule is subject to Rule 1 and 11.

This Rule differs from Rule 9 in that it is not subject to Rule 2.

The Bill applies to an assignment of an account or chattel paper when the assignor is an Australian entity, or the account or chattel paper is payable in Australia (apart from accounts payable in Australia)(see the discussion in Part 2).

This Rule does not apply when the assigned account is payable in a particular place (as Rule 11 would apply).

Under the Bill, the assignor of an account or chattel paper is the grantor.

An assignment of an account or chattel paper by an Australian entity would be governed by the law of Australia, regardless of where the account or chattel paper is payable.

An assignment of an account or chattel paper that is payable in Australia would be governed by the law of the location of the assignor.

The Bill would not affect the law governing an assignment of an account or chattel paper payable outside Australia when the assignor is a foreign entity.

*Rule 11: Accounts payable in Australia*

A.37 This rule applies to a security interest that is:

- (a) attached to an account (other than an ADI account) that is payable in a particular place, or
- (b) an assignment of an account (other than an ADI account) that is payable in a particular place.

A.38 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection perfection, of the security interest is governed by the law (excluding the conflict of law rules) of the location of the grantor when the security interest attaches to the collateral.

A.39 This Rule is subject to Rule 1 and Rule 14.

The Bill would only apply to accounts and assignments of accounts when the grantor is an Australian entity or the account is payable in Australia (see the discussion in Part 2).

Australian law would govern security interests in accounts owed by an Australian entity, regardless of where the account is payable (because of Rules 9 and 11).

Australian law would govern security interests that are an assignment of an account by an Australian entity, regardless of where the account is payable (because of Rules 10 and 11).

A security interest in an account that is owed by a foreign entity, but payable in Australia, would be governed by the law of the location of the foreign entity (because of Rule 11(a)). For example, a security interest granted by a NZ company in an account payable to it in Australia would be governed by NZ law.

The Bill would not determine the law that governs a security interest in an account owed by a foreign entity that is payable outside Australia.

However, an assignment of an account by a foreign entity, but payable in Australia, would be governed by the law of the location of the foreign entity. For example, an assignment of an account owed by a NZ company, but payable in Australia, would be governed by NZ law. The Bill would not determine the law that governs the assignment of an account owed by a foreign entity that is payable outside Australia.

It would not matter if the assigned account is owed by the foreign entity. All that is required is that the account is payable in Australia. For example, a NZ company is owed an amount that is payable in Australia. The NZ company assigns the account to a US company. This assignment would be governed by NZ law (because of Rule 11). The US company assigns the account to a Canadian company. This assignment would be governed by US law (because of Rule 11), despite the fact that the account being assigned is owed by a NZ company.

### *Rule 12: Intellectual property*

A.40 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection, of a security interest that is attached to intellectual property or a licence to use intellectual property is governed by the law of the jurisdiction in which the intellectual property or licence is granted applies.

A.41 This Rule is subject to Rule 1.

This rule applies when the intellectual property is created under an Australian Act, or the grantor is an Australian entity, or (see the discussion in Part 2).

It would apply to security interests in Australian intellectual property regardless of whether the grantor is an Australian entity. Security interests in Australian intellectual property would always be governed by Australian law.

When the grantor is an Australian entity, and the intellectual property is governed by the law of a jurisdiction other than Australia, the security interest would be governed by the law of that other jurisdiction.

### *Rule 13: ADI Accounts*

A.42 In proceedings in an Australian court, the validity, perfection, and the effect of perfection or non-perfection of a security interest that is attached to an ADI account, or an assignment of an ADI account, is governed by the law of the jurisdiction that governs the ADI account.

A.43 However, the parties to the security agreement may agree in writing that the law of another jurisdiction applies to the security interest, provided the application of that law would not be manifestly contrary to public policy.

A.44 This Rule is subject to Rule 1.

This rule would apply regardless of whether the grantor is an Australian entity. All that matters is that the collateral is an ADI account. This is sufficient to attract the operation of the Bill (see the discussion in Part 2).

***Part 7: Priority rules when no foreign register***

***Rule 14: Assignment of accounts payable in a particular place, but no perfection***

A.45 This rule applies when:

- (a) a security interest (the first security interest) attaches to an account (other than an ADI account) that is payable in a particular place,
- (b) the law that governs the validity of the security interest does not provide for public registration or recording of the security interest or a notice relating to it,
- (c) the security interest is perfected by registration under the Bill, and
- (d) after the security interest is perfected by registration, another security interest attaches to the account.

A.46 In proceedings in an Australian court, the first security interest has priority over the other security interest.

This Rule would apply when a foreign entity assigns an account that is payable in Australia, so that the assignment is governed by the law of the location of the assignor (because of Rule 11).

The foreign entity may have assigned the account twice. It would become necessary to determine which assignment has priority.

If the first assignment is perfected by registration under the Bill when the second assignment is made, then the first assignment would have priority over the other assignment.

***Rule 15: Interest in financial property payable in a particular place, but no control or possession***

A.47 This rule applies when:

- (a) a security interest (the first security interest) attaches to financial property that is not in the possession or control of the secured party,
- (b) the law that governs the validity of the security interest does not provide for public registration or recording of the security interest or a notice relating to it,
- (c) the security interest is perfected by registration under the Bill, and
- (d) after the security interest is perfected by registration, another security interest attaches to the financial property.

A.48 In proceedings in an Australian court, the first security interest has priority over the other security interest.



This Rule applies when a foreign entity grants a security interest in financial collateral that is located in Australia, and the security interest is not perfected by possession or control: with the result that the security interest is governed by the law of the location of the foreign entity (because of Rule 7).

The foreign entity would have granted two security interests in financial property that is located in Australia.

If the first security interest is perfected by registration under the Bill when the second security interest is granted, then the first security interest would have priority over the second security interest.

### ***Part 8: Relocation of grantor or collateral***

The law that governs the validity, perfection, and the effect of perfection or non-perfection, of a security interest may be determined by the law of the location of the grantor.

However, the grantor may change its location, or transfer its interest in the collateral to a person who is at a different location.

In these circumstances, the Bill would not affect the law that governs the validity of the security interest. The validity of the security interest would continue to be determined in accordance with the location of the grantor when the security interest attached to the collateral.

However, the Bill would include rules about the perfection of the security interest, and the effect of perfection or non-perfection, when the location of the grantor changes.

#### ***Rule 16: Grantor relocates***

A.49 In proceedings in an Australian court, when:

- (a) the law of a place governs the perfection, or the effect of perfection or non-perfection of a security interest, and
- (b) the security interest is perfected in accordance with the law of that place, and
- (c) the grantor changes its location to another place, or transfers the security interest (wholly or partly) in the collateral to a person who is located in another place

the security interest (or the part that is transferred to the other person) continues to be perfected in Australia if it is perfected in accordance with the law of the other place by the earliest of the following times:

- (a) the end of 56 days after the grantor changed its location, or transferred the security interest,
- (b) the end of 5 business days after the secured party has actual knowledge that the grantor changed its location, or transferred the security interest, and
- (c) when the security interest stops being perfected under the law of the first place.

The law of the location of the grantor when the security interest attaches to the collateral determines the law that governs the perfection, or the effect of perfection or non-perfection, of security interests in certain kinds of collateral: see Rules 7 and 11.

A person contemplating taking an interest in this kind of collateral would reasonably look to the jurisdiction in which the grantor is located to determine if a security interest has been granted in the collateral. This rule would ensure that the perfection of a security interest would continue to be governed by the law of the location of the grantor.

A security interest granted by a foreign entity in financial property located in Australia, but not perfected by possession or control, would be governed by the law of the location of the foreign entity (because of Rule 7). If the foreign entity were to change its location to another place, the perfection, and the effect of perfection and non-perfection, of security interests in the financial property, would be governed by the law of the other place provided the security interest is perfected in accordance with the rules of that other place within the times mentioned in Rule 16.

A security interest in an account that is payable in Australia owed by a foreign entity would be governed by the law of the location of foreign entity (because of Rule 11). If the foreign entity were to change its location to another place, the perfection, and the effect of perfection and non-perfection, of security interests in the account, would be governed by the law of the other place provided the security interest is perfected in accordance with the rules of that other place within the times mentioned in Rule 16.

*Rule 19: Perfection of collateral moved to Australia*

A.50 A security interest in tangible property that is moved to Australia is temporarily perfected under the Bill from the time when it was located in Australia until the earliest of the following events:

- (a) if the security interest was not perfected under the law of the jurisdiction in which the property was located before it was moved to Australia – the end of the 5th business day after it moves to Australia;
- (b) in any other case, the earliest of the following events:
  - the end of 56 days after the collateral is moved to Australia
  - the end of 5 business days after the day the secured party has actual knowledge that the collateral is moved to Australia, and
  - the end of the day the security interest ceases to be perfected under the law of the other jurisdiction.

A.51 However, this rule does not apply if the security interest is not perfected in accordance with the Bill within the periods mentioned in Rule 13(b).

***Part 9: Interpretation***

*Rule 17: Location of collateral*

A.52 Chattel paper that is evidenced by an electronic record is located in the jurisdiction whose law governs the chattel paper.

A.53 An investment instrument that is not evidenced by a certificate is located in the jurisdiction in which the issuer is located.

A.54 A negotiable instrument that is evidenced by an electronic record is located in the jurisdiction whose law governs the negotiable instrument.

A.55 Otherwise, chattel paper, negotiable document of title, investment instrument, currency or negotiable instrument is located in the jurisdiction in which the paper, document, instrument or currency is located.

*Rule 18: Location of collateral or grantor*

A.56 Personal property may be registered on the PPS Register regardless of whether it is located in Australia or elsewhere.

A.57 Personal property may be registered on the PPS Register regardless of whether the grantor is located in Australia or elsewhere.

*Rule 20: Location of persons*

A.58 A person is located:

- (a) for bodies corporate—in the jurisdiction in which they are incorporated,
- (b) for bodies politic—in that place, and
- (c) for individuals—at the person's principal place of residence at the relevant time.

## **APPENDIX B: SUMMARY OF KEY CHANGES SINCE THE CONSULTATION DRAFT PPS BILL OF MAY 2008**

In May 2008, the release of the consultation draft Personal Property Securities Bill 2008 signalled the beginning of an intensive three-month consultation period. The consultations were instrumental in refining the Bill to its current embodiment in the Exposure Draft Personal Property Securities Bill 2008. This appendix discusses key changes made in response to stakeholder concerns, and should assist those following the reforms to understand how and why the Bill has been amended since the release of the PPS Consultation Bill.

### ***Key issues addressed or removed from the PPS Bill***

B.2 When developing an inter-governmental agreement for a referral of powers to support the new PPS regime, State and Territory governments indicated concern about the interaction between the Bill and State and Territory laws, particularly in relation to licences and land title law. They also expressed concern that the operation of other laws might be unintentionally affected or ousted.

B.3 To address these issues, the Exposure Draft Bill sets out the circumstances under which other laws (including a law of the Commonwealth or a State or Territory) would prevail over the Bill (sections 18 to 21), and the conditions under which concurrent operation would occur (section 15). As was previously the case, regulations would provide that the Bill would not apply to particular matters (section 16). An amendment ensures that this could occur in circumstances that might otherwise give rise to a direct inconsistency with the Act. That is, the Bill preserves the operation of prescribed State and Territory laws in specified circumstances despite section 109 of the Constitution (sections 15 and 20).

B.4 The Bill would not apply to water rights unless and until governments agree to an expansion of the Bill to include security interests arising in this significant area. Further, the Bill no longer contains priority provisions dealing with fixtures. Substantial changes have been made to ensure that the administration of government issued licences is not disturbed by the reforms. For example, the regulations would not be able to alter the definition of 'licence'. Other changes are outlined below.

B.5 The Bill provides that the *Payments Systems and Netting Act 1998*, the *Cheques Act 1986* and the *Bills of Exchange Act 1909* will prevail over the PPS Act to the extent of any inconsistency (section 18). These Acts are fundamental to the effective operation of the Australian financial system and must be wholly preserved.

B.6 The Bill no longer contains provisions dealing with governing laws (also known as conflict of laws or choice of laws) which concern the resolution of disputes with an international dimension. The rules proposed in the consultation Draft Bill differed from the common law approach, and gave rise to differences of opinion about the merit of codifying the law in this area. As a result, the Department proposes a possible model for these provisions in Appendix B. The Department invites comment on the model.

B.7 Provisions previously set out in the Personal Property Securities (Transitional Provisions and Consequential Amendments) Bill 2008 have been moved into Chapter 7 of the Exposure Draft PPS

Bill at the request of the States to facilitate their inclusion in the referral of power to the Commonwealth.

### *Changes to key concepts*

B.8 A number of concepts used in the Bill have been amended. Key changes are outlined below.

#### *Inventory*

B.9 The definition of inventory is revised to ensure that it captures a broader range of property that might be described as inventory, including where that property is a depreciating asset. The definition includes property held in various circumstances including property as raw materials.

#### *Knowledge*

B.10 Under the Bill, many outcomes depend upon whether a party has knowledge of a fact. Separate tests apply to persons who act in relation to bodies corporate and those who are individuals.

B.11 For bodies corporate, the knowledge test operates upon the knowledge held by directors, employees or agents whose duties it is to receive information about, and act in relation to, the circumstances (section 55). This replaces a test which had operated on the knowledge of directors, employees or agents with actual or apparent authority to act. The change was considered necessary because those who have actual or apparent authority may gain knowledge of certain facts, but have limited knowledge of the broader circumstances of the case or limited opportunity to act upon the knowledge.

B.12 The general knowledge test applying to individuals has also been revised (section 56). It will now be based upon the individual having actual knowledge of circumstances or a benchmark that the person would have acquired such knowledge had they made inquiries ordinarily made by an honest and prudent person, or would have made such inquiries had they had actual knowledge of the circumstances. This test more closely reflects the current law on constructive notice than earlier proposed tests based around concepts of 'substantial risk', 'unjustifiable risk' and 'significant probability'.

#### *Licences*

B.13 Consistent with the intergovernmental agreement, the definition of 'licence' has been amended to exclude rights, entitlements and authorities that are granted by a law of the Commonwealth, a State or a Territory, and declared by that law not to be personal property for the purposes of the PPS Act (section 40). This is an important change as it confirms that the capacity of the States and Territories to administer licences and the conditions associated with their issue will not be affected by enforcement outcomes. The definition of 'licence' also now includes intellectual property licences.

#### *PPS Leases*

B.14 The Bill applies to leases over personal property security, an interest in which may be a 'purchase money security interest' regardless of whether the interest secures payment or the

performance of an obligation. The rules applying to leases form an important part of taking a functional approach to PPS reform. Certain lease property will be subject to rules that currently do not apply such as requirements to be in writing and signed and voluntary registration for priority purposes.

B.15 The Bill has been amended to include a definition for ‘PPS lease’ (section 31) rather than a ‘lease for more than one year’. The definition picks up those arrangements under which the lessee or bailee of the property maintains an outward appearance of ownership. There is a general rule, and a special rule aimed at serial numbered tangible property (such as motor vehicles, boats, aircraft and other prescribed property). PPS leases will include bailments in which the bailor provides value to the bailee in respect of the bailment (section 31(3)).

B.16 Reflecting the previous definition, a ‘PPS lease’ would include leases for a term of more than one year (section 31(1)(a)). It would also cover leases of an indefinite term, leases of less than one year that are renewable, and leases where the lessee or bailee might retain (substantially) uninterrupted possession of the property for more than one year with the consent of the lessor or bailor (section 31(1)(b),(c) and (d)). For serial numbered tangible property the same rules apply, although the relevant term is 90 days rather than one year.

B.17 A carve-out removes from the definition of ‘PPS lease’ those leases and bailments made by persons that are not regularly engaged in the business of leasing or bailing the tangible property as well as prescribed leases and bailments (section 31(2)). The question of whether a lease of personal property, in substance, secures payment or performance of an obligation would be determined by the facts (section 30(1)). However, the Bill provides guidance relating to the value provided by the lessee, rights of possession and use and the economic life of the leased property. The effect is that in determining whether a lease of personal property in substance secures payment or performance of an obligation, the key consideration is whether the lease is for the economic life of the property (section 30).

### ***Fixed and floating charges - circulating assets and non-circulating assets***

B.18 Provisions dealing with fixed and floating charges have been fine-tuned to maintain the current legal outcomes that apply to employees upon employer insolvency.

B.19 The provisions aimed at existing references to fixed and floating charges (and charges more generally) will only apply to personal property in which the grantor has title to the property (section 50). This means that personal property that is subject to a retention of title arrangement, lease or consignment will not fall within the pool of property available for distribution to preferential creditors upon insolvency.

B.20 The definition of a ‘circulating asset’ has been expanded to include collateral in respect of which the secured party has given the grantor implied approval to deal with it in the ordinary course of the grantor’s business (section 51). This reflects existing case law on floating charges, which provides that consideration be given to the express terms of the agreement between the parties and their practices, including the level of control exerted by the secured party over the asset.

B.21 The definition of ‘current asset’ will apply to assets commonly subject to a ‘floating charge’ such as ADI accounts, accounts that are the proceeds of inventory or accounts that arises from granting a right or providing a service in the ordinary course of business, for example, credit card receivables (section 51(5)). A transferee secured party would have control of a transferred non-ADI

account that holds the proceeds of inventory where payment by the account debtor would discharge the obligation due by that debtor (section 52(3)).

### ***Investment instruments and investment entitlements—definitions and control***

B.22 Provisions that deal with ‘investment instruments’ and ‘investment entitlements’ are revised to reflect commercial practice as identified by submissions from banks, law firms and government agencies. These forms of property must be comprehensively defined as they are likely to be held as controllable property and therefore are not required to be registered on the PPS Register.

B.23 The definition of ‘investment instrument’ will cover a broader range of property, for example, shares in a co-operative and assignable options. It removes artificial distinctions such as whether the instrument is quoted or not quoted.

B.24 A person will have control of an investment instrument if the issuer registers that person as a registered owner (section 45(1)). In addition, for certificated investment instruments, a person will also have control of an instrument if the controller has possession of, and is able to transfer, the instrument or is able to otherwise deal with it (section 45(2)).

B.25 A person will have control of an *uncertificated investment instrument* where there is an agreement between the controller and the grantor that allows the controller to initiate or control a dealing with the instrument, including a transfer (section 45(3)). A person would also have control where another person is registered as the owner of the instrument and an agreement exists under which the controller is able to initiate or control messages for a dealing with the instrument (section 45(4)).

B.26 The definition of ‘investment entitlement’ has also been reframed. It now focuses on the rights that arise from the crediting of a financial product to a financial product account rather than on any particular interest in one or more specified financial products (section 54).

B.27 The Bill now includes rules about how a secured party may obtain control over an investment entitlement. This will occur where there is an agreement between the secured party, the grantor and the intermediary who maintains the account, and the agreement provides that the intermediary: (1) must not comply with the grantor’s instructions without seeking the secured party’s consent; and (2) must comply with the secured party’s instructions without obtaining the grantor’s consent. A person would have control of an investment entitlement even if the account holder retains rights to make substitutions, originate instructions to the issuer or otherwise deal with the instrument (section 48).

### ***Control of ADI accounts***

B.28 For the purposes of the Bill, a secured party would have control of an ADI account in certain circumstances. These arise when the secured party is able to direct disposition of the funds from the account without further consent of the grantor. Thus, there would be no requirement for a three-way agreement between the grantor, secured party and the ADI for the direct disposition of funds. In addition, the provisions are amended to ensure that a secured party will not have control where a deposit would result in a person coming under a present liability to pay the debtor or a related body corporate. Finally, the provision does not limit the ways in which a secured party may have control over an ADI account (section 46).

### ***Transfer and assignment of rights in collateral***

B.29 The Bill facilitates the transfer of a grantor's rights in collateral despite the existence of an anti-assignment clause preventing such transfers. The transfer provisions have been amended to clarify that grantors do not have a right to transfer collateral that they would not have had apart from the Bill (section 124).

B.30 The provisions dealing with rights of a transferee of an account or chattel paper have been amended to ensure that those rights are subject to: the terms of the original contract and any defences, claims and remedies under the general law that arise from that contract; and any other defences that arise before the debtor becomes obligated to pay the transferee (section 125). This ensures that any defences are available against the transferee and transferor as appropriate.

B.31 The scope for a modification of, or substitution for, the contract between the account debtor and transferor is effective against the transferee where the transferred right has not been fully earned by performance (section 125(3)). This clarifies that the contract and any rights accruing under it will come to a natural end.

B.32 An anti-assignment clause will be unenforceable against third parties and binding upon a transferor (in respect of a possible damages claim) where that clause relates to currency due, or to become due, under chattel paper or the whole of an account that is the proceeds of inventory or arising in the ordinary course of a business granting such rights or providing such services (section 126). This means that the whole of the interest in the property must be transferred for these outcomes to apply.

### ***General Principles***

#### ***Attachment***

B.33 A security interest will attach to a particular right in personal property when the grantor has rights in the property or has the power to transfer rights in the property, and either the secured party gives value or the grantor otherwise does an act by which the security interest is created (such as executing a deed or declaring a trust)(section 61). This means that a security interest may arise in personal property even though the secured party has not provided any new consideration. This is consistent with current commercial practice. A debtor's limited rights in the collateral, short of full ownership, would be sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or as limited as those rights may be.

#### ***Future advances***

B.34 The Bill provides that a security agreement may secure a 'future advance', which can extend to later provided currency or credit as well as enforcement expenditure or costs in relation to the enforcement of a security interest. The meaning of 'future advance' has been amended to apply also to the performance of an obligation under the security agreement. While enforcement expenditures and costs must generally be reasonable, this would not need to be the case where the security agreement expressly provides that the security interest secures enforcement expenditures or costs (section 60). This is consistent with current commercial practice and the notion that parties must manage their risks at the time of contracting as well as in enforcement.



### ***Priority of purchase money security interests***

B.35 The Bill would establish super-priority for holders of purchase money security interests (or PMSIs). To establish super-priority for PMSIs in inventory, the secured party must, among other things, send a notice to all other secured parties who have a registration that describes the inventory immediately at the time before the inventory is to be registered. The Bill has been amended to provide that the notice is valid if it is in the approved form or otherwise meets notice the requirements (sections 100(1) and (3)). Notices will not be required in certain circumstances. The circumstances have been broadened to apply to persons of a class prescribed by the regulations, if any (section 100(2)).

### ***Agricultural products, accessions and commingling***

B.36 The provisions relating to fixtures have been omitted from the Exposure Draft PPS Bill at the request of the States and Territories who were concerned about the operation of these provisions upon State and Territory based land laws.

B.37 The Bill revises and simplifies the provisions dealing with accessions. The definition of 'accession' has been amended with the effect that an accession will only arise where the separate identities of the attached property are lost as a result of the affixation or installation (section 27). Property conceived of as having a separate identity to the improved property (such as an outboard boat engine) will be subject to general priority rules, whereas property that is melded into the identity of improved property will be affected by special rules which take account of that melding.

B.38 The Bill retains the rule that a security interest in an accession has priority unless an exception applies (section 134). However, there will be only two exceptions. The first arises where the accession is installed prior to a person purchasing the improved property, and the accession is unperfected immediately after its affixation or instalment (section 135). The second arises where a person purchases the improved property and the accession is afterwards installed or affixed without the security interest in accession having attached to it. In both cases, the security interest in the improved property will prevail (section 136).

B.39 In relation to commingled property, the Bill has been revised to make it clear that property that is manufactured, processed, assembled or commingled is lost in a product or mass if it is not commercially practical to restore the property to its original state (section 138(2)). The change overcomes potential issues raised by the High Court of New Zealand case of *New Zealand Associated Refrigerated Food Distributors Limited v Simpson* (unreported).

### ***Enforcement***

B.40 The focus of the enforcement provisions has been amended to remove a range of compliance obligations, particularly in relation to the giving of notice to persons with an interest in the collateral.

### ***Non-application to investment instruments***

B.41 The enforcement provisions now exclude from their operation investment entitlements that are perfected by control (section 158(2)). This is modelled on the existing exclusions relating to investment instruments perfected by possession or control (section 158(2)).

*Enforcing party does not accrue additional rights in enforcement*

B.42 The Bill is amended to ensure that when exercising rights and remedies under the enforcement provisions, a secured party can only deal with the collateral to the same extent of the grantor's entitlement to deal with it. This provision does not apply where the secured party held title immediately before the exercise of an enforcement right or remedy, or in relation to deemed security interests (such as the transfer of an account or a commercial consignment that does secure payment or the performance of an obligation). Nor does it apply to the extent that it would prevent transfer or be declared to be a default under an agreement (section 151(2)).

*Enforcement of licences*

B.43 A secured party may only seize, purchase or dispose of a licence subject to the terms and conditions of the licence and any applicable Commonwealth, State or Territory law (section 151(3)). This new provision will ensure that enforcing parties do not deal with licence collateral in a manner inconsistent with terms upon which it was originally granted, for example, licences for taxi and bus services in respect of which maintaining public safety is an important consideration.

*Contracting out*

B.44 Parties to a security agreement are able to contract out of a large number of the enforcement provisions. This capacity been extended to allow the parties to agree that a secured party not be entitled to remove collateral from the property to which it is affixed (section 154(1)(a)). The capacity to contract out of giving notices under sections 145 (notice of removal of accession) and 168 (notice of disposal) has been limited to the extent that the provisions require the secured party to give a notice to the grantor. The reason for this limitation is that other interested parties still need to be notified of removal and disposal events in order to act upon their own interests.

B.45 Also in relation to contracting out, a person other than a grantor may contract with the secured party to forego notice of a enforcement event (section 154(5)), and two secured parties may contract out of the notice of one of the secured parties right relating to the payment of the enforcing party's costs (section 154(6)). Finally, the parties to a security agreement relating to consumer goods may contract out of the apparent possession provisions (section 154(3)). This is consistent with the Consumer Credit Code, which does not provide for such possession.

*Notices on disposal and retention of collateral, and written statements of account*

B.46 Notification requirements upon enforcement have been simplified. An enforcing secured party will only have to provide notice of disposal to the grantor and parties with an interest in collateral that has a higher priority ranking (section 168). Where a secured party decides to retain collateral, a secured party will only have to give notices to the grantor and any secured party who has a registration in respect of the same collateral. Where the security interest involves a PMSI, the secured party will only need to give notices to the grantor and lower ranking secured parties who have a registration describing the collateral (section 173). These amendments will reduce red tape and facilitate speedy enforcement action. Secured parties will not be required to identify and notify all interested parties.

B.47 When a secured party has disposed of collateral, a statement of account must only be given to the debtor and interested persons upon request rather than as a matter of course. The period within

which a secured party must furnish the information is amended to 20 business days or further period as is reasonable (section 170).

### *Distribution of proceeds*

B.48 One of the most significant changes to the enforcement regime is that an enforcing secured party must now pay out the obligations owed to higher ranking secured parties (including enforcement costs) before satisfying obligations secured by their agreement (section 177). This change is consistent with a stable enforcement regime under which lower ranking parties cannot precipitate enforcement action without a compelling commercial basis.

### *Personal Property Securities Account*

B.49 New Part 4.5 would establish an account called the Personal Property Securities Account (PPS Account). Secured parties would be required to deposit the proceeds of enforcement action and any proceeds where there is uncertainty about either the amount of, or the order in which proceeds of, enforcement action should be paid. The Commonwealth would hold the amount until the dispute is resolved, and would discharge any liability from the account, together with interest. The PPS account would be a special account for the purposes of the *Financial Management and Accountability Act 1997*, which would mean that it is subject to Commonwealth prudential controls.

### *Personal Property Securities Register*

B.50 The Bill contains new provisions specifying that a person must not apply for a registration or an amendment to add property to a registration unless they reasonably believe that a security interest has or will be granted to the person named in the registration as the secured party (sections 194A and 206A). A person who applies for a registration or amendment in contravention of this provision may be liable for damages under section 237. This provision is aimed at protecting consumers and businesses from bogus or hedged registrations, which may impair their capacity to obtain finance.

B.51 The Bill is amended to ensure that where property is serial numbered consumer property, the grantor's details will not be recorded. This is consistent with the approach taken in the current REVS and VSR systems, and will improve individual privacy.

B.52 Secured parties will be required to describe collateral on the PPS Register as either 'consumer property' or 'commercial property' – the latter definition covers collateral that previously would have been described as 'equipment' or 'inventory' or both (sections 26 and 191, table item 2). Stakeholders found the distinction between equipment and inventory confusing, and noted that it was unnecessary for registration purposes. 'Commercial property' is defined as property other than consumer property.

B.53 A person will not be able to search the register or use data obtained from the PPS register for an unauthorised purpose. If a person contravenes this requirement, that person will be taken to have failed to discharge an obligation owed to the persons whose details were used to perform the search (sections 227(2) and (3)). This will constitute an act or practice involving interference with an individual's privacy (section 228). It may also give rise to a claim for damages under section 236. This is an important change as it removes the ability of users, including information brokers, to recycle data obtained from the PPS Register for other purposes.

### ***Void Transactions***

B.54 The Exposure Draft PPS Bill omits provisions that would have resulted in the voidness of a security interest made in favour of an officer of a company within a certain period prior to an insolvency related event (such as the making of a winding up order or commencement of administration). The omitted provisions were modelled on existing sections 266 and 267 of the *Corporations Act 2001*, which are now proposed to be retained in that Act.

B.55 The Exposure Draft PPS Bill provides that certain unperfected security interests would be void as against the liquidator (section 233). However, the Bill has been revised so that certain security interests are unaffected by this rule such as security interests created by the transfer of an account, the interest of a senior creditor under a turnover trust and a short term PPS lease.

### ***Standard time***

B.56 The consultation process elicited substantial feedback about the periods of time to perform certain actions. The Bill now allows a party to apply to a court to extend the period within which an action must be performed under specified sections. The court would be empowered to extend the period even where it has passed (section 257).

B.57 In recognition of the different time zones that apply around Australia, the legal time applying in the Australian Capital Territory would be the standard time for the purposes of the Bill (section 258). The reckoning of time is important for the occurrence of events and requirements for a range of actions to be performed within a specified period of time such as: temporary perfection periods; perfecting certain interests such as PMSIs or transfers of accounts or chattel paper; start, end and amendment times for registrations; change demand processes; giving notices; and taking enforcement action.

### ***Transitional provisions***

B.58 In recognition of the substantial changes faced by businesses that have not previously been subject to a PPS regime or registration system, the Exposure Draft Bill provides some additional transitional rules to facilitate the adjustment. Among these, there will be no requirement for commercial consignments that arise out of a transitional security agreement to be signed by the parties (section 282). That is, a transitional security interest will be enforceable against a third party if it would have been enforceable prior to the new scheme.

B.59 Transitional security interests arising prior to the commencement of the new scheme will be able to be pre-registered on the PPS Register (sections 305 and 306). This would not affect the priority position of these interests within the two-year transition period, but may give such interest holders greater comfort that they are prepared for the new scheme.