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**PERSONAL PROPERTY SECURITIES LAW:
A BLUEPRINT FOR REFORM**

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August 1992

DISCUSSION PAPER

PERSONAL
PROPERTY
SECURITIES
LAW:
A blueprint for
reform

Queensland Law Reform Commission
Discussion Paper No. 39

Law Reform Commission of Victoria
Discussion Paper No. 28

DISCUSSION PAPER

Personal Property Securities Law: A blueprint for reform

by

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August 1992

This is a discussion paper, *not* a report. Your comments on the matters raised in the paper would be most welcome. They will be taken into account by the Commission in compiling its report and treated as public documents unless confidentiality is requested. Comments should be addressed to the Chairman, Queensland Law Reform Commission, P O Box 312, North Quay, Queensland, 4002.

The closing date for comments is 23 October 1992.



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PREFACE

The Victorian Law Reform Commission (VLRC) and the Queensland Law Reform Commission (QLRC) have been given references by their respective Attorneys-General to examine the law relating to securities over personal property with a view to the introduction of uniform Australian legislation on the subject. These references were consequent upon a reference by the Attorney-General of Australia to the Australian Law Reform Commission (ALRC) on the subject. The reference to the ALRC included the object of harmonising the law with respect to personal property securities between Australia and New Zealand and to take account of a report of the Law Commission of New Zealand on a Personal Property Securities Act for that country.

The ALRC had consultations with the New South Wales Law Reform Commission (NSWLRC), the VLRC and the QLRC with a view to the production of a joint discussion paper leading ultimately to a joint report by the relevant Commissions. Initially it was agreed by the Commissions that the ALRC should have prime carriage of the work on personal property securities.

It has become apparent that the ALRC has different policy objectives which it wishes reflected in the final recommendation from the policy objectives of the VLRC and the QLRC. The ALRC has as one of its objectives the development of a model which will expand disclosure of information of the property of a company being used as security and its level of debt. The model requires mandatory registration of all security given over property. Registration is enforced by criminal sanction.

The VLRC and the QLRC take the view that any appropriate model must be one of voluntary registration. The incentive to comply is economic not criminal; the sanction is that non-registration leads to loss of priority against competing registered interests.

There are two aspects to the objective of public disclosure of security interests granted and the level of debt. The first is disclosure for the benefit

of shareholders in public companies and for the market place. The second is for the protection of creditors or prospective creditors or lenders to a company. Attainment of the first objective does not require that all companies be compelled to register every security interest granted by the company at any point in time. There are other ways to achieve this objective. The second objective is attained by a system of voluntary registration which denies to the holder of an unregistered security interest any advantage over creditors or secured creditors who register a security interest over personal property of a company.

The VLRC and the QLRC hold the view that the issue of public disclosure of information by companies is a separate and distinct issue from the development of a uniform model law dealing with personal property securities. Any model law should relate to all securities whether corporate or non-corporate. The law should stand alone and be self-contained. It should not be implemented as part of the Corporation Law which is driven by different policy considerations. The imperative of uniformity requires that a model law be developed in the first instance for personal property securities. Thereafter the issues raised by the objective of public disclosure require independent consideration.

Because of the difference between the Commissions as to what was sought to be achieved by the reference, the VLRC has withdrawn from the joint reference. The QLRC determined not to delay the work of the ALRC and the NSWLRC in preparing and distributing a discussion paper containing a number of tentative proposals directed towards the creation of a model to achieve both policy goals. Accordingly, the QLRC did not participate further in the preparation of that discussion paper.

The VLRC and the QLRC have decided to publish their own discussion paper on the subject. It is the hope of both Commissions that the issues raised in both discussion papers will lead to the formulation of a model law which is uniform and to the greatest degree possible eliminates the problems under the existing law in relation to personal property securities. This paper is intentionally restricted to a discussion of what is an appropriate model law for personal property securities.

The discussion paper was written for the two Commissions by Tony Duggan and Simon Begg, two of Australia's leading experts in the field. The Queensland and Victorian Commissions express their deep gratitude to

them for the large amount of work they have done for the project in a purely honorary capacity.

The Commissions adopt the authors' views as their own in relation to the problem and the possible solution so far as personal property securities are concerned. The authors in section 3.7 of the discussion paper raise the question "What about land?". Security interests over and in respect of land form no part of the references to the Commissions. Whether or not the development of an appropriate model for personal property securities leads logically to the development of a similar model for securities over and in respect of land is a matter for another day. Accordingly the QLRC does not adopt the authors' observations in section 3.7 and expresses no view one way or the other on them.

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INTRODUCTION

1.1 WHAT IS THIS PAPER ABOUT?

1.1.1 The concerns

The main concern is with competing claims to personal property where one or more of the claims rests on a security interest, and with the need for a coherent set of legal rules to deal with the problem. Some reference will be made to the need for reform of the rules governing the rights and obligations of the parties to a security transaction between themselves. Although the focus is predominantly on personal property security law reform, the paper will also have something to say about the related problem of competing claims to ownership, and about land dealings.

1.1.2 Registration

The present law is a patchwork system of statutory rules and common law and equitable principles. There are numerous forms of security arrangement, and the tendency is for the law to regulate them by reference to their form rather than their substance. In other words, the rules vary in accordance with factors which, for the most part, lack any sound basis in policy or commercial practice. Registration is required in certain circumstances as a means of preventing competing claims from arising, but the law is piecemeal. In this sense, the commitment to registration has been insufficient. On the other hand, there is a plethora of registration statutes directed to different kinds of transactions, as well as (in many instances) separate registration requirements for the one kind of transaction from State to State. In this sense, the commitment to registration has been excessive. In short, there are both

gaps and overlaps in the current requirements for registration. This means that in some cases there is no provision for registration at all, while in others the same security interest is required to be registered more than once.

1.1.3 Priority rules

Some registration statutes include priority rules for resolving competing claims to property, while others do not. Where there is no provision for registration, or where the relevant registration statute does not include priority rules, common law rules apply. The statutory priority rules vary from one statutory scheme to another, so that at this level, too, there is no coherent pattern of regulation. In the cases where registration statutes overlap, there is the potential for a transaction to be subject to conflicting sets of priority rules. The non-statutory ("common law") priority rules are in fact a mix of common law and equitable inputs codified and modified as to part by the sale of goods legislation. The rules have developed piecemeal over the centuries, and they turn for the most part on purely formal considerations (such as whether the competing interests are legal or equitable in nature). The rules are unsystematic, unnecessarily complicated and lacking any sound basis in principle.

1.2 WHAT IS PERSONAL PROPERTY?

1.2.1 Personal property

Personal property is any property other than land. It includes tangibles (goods), and also intangibles such as: insurance policies; patents, trademarks and copyright; shares; and negotiable instruments. The reference to debts is to a debt owing by a third party to the giver of the security interest, including: book debts; debentures; and deposits.

1.3. WHAT IS SECURITY?³

1.3.1 The nature of security

Security can be defined as "a right to take possession and sell property and apply the proceeds in satisfaction of a debt owed to the secured party".⁴ The interest is essentially of a proprietary character in the sense of involving rights against the secured property, and not merely against a person. According to Sykes, in the case of a mere personal right:⁵

"Enforcement lies only by action at law or in equity, and, though execution after judgment can be levied by the appropriate mode against the debtor's assets, at any given moment before the process of execution is set in train, there is no right to any specific asset of the debtor. If, however, a security is held over the debtor's property, then the creditor on default has an instant right to proceed to satisfy his claim out of the property itself, namely by sale or some other process".

The main function of security is to give the creditor protection in the case of the debtor's insolvency. As a general rule, a security interest enables the creditor to claim the secured property in priority to the debtor's unsecured creditors.

3 The following derives from Duggan, Begg and Lanyon, *Regulated Credit: The Credit and Security Aspects* (1989), paras 7.1.1-7.1.4.

4 Committee of the Law Council of Australia, *Report to the Attorney-General for the State of Victoria on Fair Consumer Credit Laws* (1972), para 5.9.1.

5 Sykes, *The Law of Securities* (4th ed, 1986), p. 3.

1.3.2 Consensual and non-consensual securities

There are various categories of security transaction. One distinction is between consensual and non-consensual securities. A consensual security is one that is created by agreement between the parties (for example, a mortgage, charge or pledge), whereas a non-consensual security is one that arises by operation of law (for example, the various kinds of common law, equitable and statutory lien). The concern of this paper is with consensual securities.

1.3.3 Possessory and non-possessory securities

Another distinction is between possessory and non-possessory securities. A possessory security entails the transfer of possession of property or documents of title without the transfer of any proprietary rights. A non-possessory security, by contrast, entails the transfer of proprietary rights, but not necessarily possession. Examples of possessory securities include the pledge and the possessory lien. Examples of non-possessory securities include the mortgage and the charge.

1.3.4 Mortgages and charges

The main forms of non-possessory consensual security are the mortgage and the charge. A mortgage of property has the effect of transferring ownership to the creditor, subject to the debtor's right to redeem. A charge on property (sometimes called a hypothecation) confers no proprietary interest on the creditor, but simply represents an encumbrance attaching to the property giving the creditor a right to look to the property for satisfaction of the debt.⁶ A mortgage may

⁶ The distinction between the two forms of security has become blurred. Equity confers on the mortgagor a proprietary right of redemption, and the consequence of this is to endow the mortgage with some of the characteristics of a hypothecation. Correspondingly, special rights and remedies deriving from the general law governing mortgages have been conferred by statute on the charge

be either legal or equitable in character. A charge may be either equitable or statutory and, if the latter, is probably legal in character in the absence of any provision to the contrary. An equitable charge may be either fixed (given over a particular item of property) or floating (given over property owned by the debtor from time to time, including property such as stock in trade with which the debtor remains free to deal pending crystallisation of the charge).

1.3.5 Title retention

The common feature of the security transactions just described is that each entails either the transfer of a proprietary interest in the subject property from the debtor to the creditor, or the creation of a new proprietary interest in the creditor's favour. There is another category of transaction which does not possess this feature, so that it is therefore not in form a security, but which nevertheless may fulfil exactly the same function. The category comprises the various kinds of title retention arrangement, including the conditional sale (or "Romalpa agreement"), hire-purchase and the finance lease. In this kind of case, the creditor has a right to take possession which derives from retained ownership (as opposed to transferred ownership). The transactions in question therefore fit the functional description of security discussed in para. 3.1 above, even though they are formally distinct.

1.3.6 Stock in trade financing

A business debt may be secured by a security interest given or retained in a fixed asset (such as plant or equipment), or by a security interest over stock in trade (or inventory). The distinguishing feature is that, in the latter case, the debtor needs to be able to dispose of the

in certain circumstances and the consequence of this has been to endow the charge with some of the characteristics of a mortgage: *ibid* 14-15.

subject property in the ordinary course of business, unencumbered by the security interest. The main kinds of stock in trade (or inventory) financing include: the floating charge; bailment and other kinds of floor plan arrangement used particularly in connection with motor vehicle dispositions; and Romalpa agreements. The particular advantage of the floating charge is that, in the case of a sale in the ordinary course of the debtor's business, it allows for the crossover of the creditor's security interest from the asset that has been disposed of to the proceeds of the sale. The facility of other kinds of transaction for performing this crossover function is more problematical. Book debts can be made the subject of separate financing arrangements, including outright sale (factoring), or assignment by way of security.

1.4 WHAT KINDS OF DISPUTE CAN ARISE?

1.4.1 Theft

There are three main sets of circumstances which may give rise to competing claims in personal property. The first case is where property owned by A is stolen by X and sold to B who buys it without knowing that X is a thief. This kind of case involves competing claims to ownership. If A wins, the consequence is that B will be treated as never having obtained title, whereas if B wins, A's title will be extinguished. A variant on this scenario is where the stolen goods are the subject of a security interest held by A1. In these circumstances, if B wins, the interest of both A and A1 in the property will be extinguished. On the other hand, B may lose in whole or part. A total loss would result in B obtaining no interest at all in the property. A partial loss would result in B obtaining an interest, free from any claim by A to ownership, but subject to A1's security interest.

1.4.2 Fraudulent conversion

The second case is where A holds a security interest and X (the debtor), without A's consent, sells the asset to B who buys it without knowing of the security arrangement. This kind of case involves a claim to ownership (by B) in competition with A's security interest. If A wins, the consequence is not that B gets nothing (as in the first case), but that B takes the asset subject to A's security interest. Conversely, if B wins, the consequence (as in the first case) is that A's security interest is extinguished.

1.4.3 Wrongful creation of subsequent security interest

The third case is where A holds a security interest and X (the debtor) without A's consent creates another security interest in the asset in favour of B who transacts without knowing of A's prior entitlement. This kind of case involves competing claims to priority. If A wins, the consequence is that (as in the second case), B takes the asset subject to A's security interest. If B wins, the consequence is not that A gets nothing (as in the second case), but that A takes the asset subject to B's interest. Whoever wins gets first claim to the asset. The other party gets any surplus after the winner's debt has been satisfied.

1.5 WHAT ARE THE PURPOSES OF REGISTRATION?

1.5.1 Choice between two innocent parties

In each of these three cases, the dispute between A and B is not of their making in any direct sense. The wrongdoer is X, but in many cases X is likely to be judgment-proof. Accordingly, the law is faced with the dilemma of having to choose between two innocent parties.

1.5.2 The competing principles

The intractability of the problem is reflected in the fact that the law has fluctuated down the centuries between two opposing principles:⁷

"[t]he first is for the protection of property; no-one can give a better title than he himself possesses. The second is for the protection of commercial transactions; the person who takes in good faith and for value without notice should get a better title".

The first principle is embodied in the Latin maxim, *nemo dat quod non habet*. It favours A. The second principle is known to civilian law as *possession vaut titre*. It favours B. In Anglo-Australian law, the *nemo dat* rule has tended to predominate, but the commitment to it has been whittled down by the admission of exceptions (most notably, as a consequence of the Factors Acts). In Victoria and Western Australia, the drift to the other extreme is almost complete following the adoption in the chattel securities legislation of a statutory bona fide purchaser rule to deal with the case mentioned in para. 1.4.2, above.

1.5.3 Registration

The conflict of principle means that there can never be an entirely satisfactory *ex post* solution to these kinds of problems. The challenge, therefore, is to devise an *ex ante* solution, in the form of a method of preventing the problem from arising in the first place. This is where registration comes in. The purpose of registration is to give B a means of discovering the existence of A's

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Bishopsgate Motor Finance Corporation v Transport Brakes Ltd [1949] 1 KB 332 at 336-337 per Denning L.J.

interest before B transacts with X. If A's interest is registered, B should discover it by searching. Then (assuming B is honest), the transaction with X will not go ahead and the problem of conflict is avoided. This will not be the outcome if A fails to register or B fails to search, but then, in either case, there is a clear principled basis for arriving at an ex post solution.

1.5.4 Title registers

Different forms of register are needed to deal with the three kinds of case discussed above. In the first case, what is required is a register of title, similar to the Torrens system of registration applicable to land dealings. A title register for ships has been established pursuant to the *Shipping Registration Act 1981* (Cth), but there are few other examples of this kind of registration system in Australia. In the United States, there is in many jurisdictions provision for the registration of title to motor vehicles but there is no corresponding legislation in this country. This issue will be discussed further below (see para. 3.6).

1.5.5 Asset-indexed register of security interests

In the second case, what is required is a register of security interests indexed against the asset in question. The best local example of this kind of scheme is the provision in all States for the registration of security interests in motor vehicles. This kind of registration scheme (as with title registration) is only possible in the case of property that is capable of being individually identified, by means such as a serial number. Examples include cars, caravans, trailers, motor boats, ships, aircraft, patents and insurance policies.

1.5.6 Debtor's name-indexed register and asset-indexed register compared

In the third case, what is required is a register of security interests indexed either against the asset or the name of the debtor. Neither alternative is perfect. A debtor's name-indexed registration system provides information about prior security interests in an asset created by a particular person. However, it will not necessarily provide information about security interests in an asset created by a prior owner.⁸ Furthermore, the system is vulnerable to the use of false names. An asset-indexed system is subject to neither of these limitations. On the other hand, what this kind of system will not disclose is information about all the security interests a particular person has created. This information may be of value to intending creditors, and it can only be generated by a debtor's name-indexed registration system. A further limitation of an asset-indexed system is that it does not enable the recording of information relating to unascertained goods until they are ascertained. This is because registration depends upon the asset being capable of precise identification.⁹ An example of an asset-indexed registration scheme directed to the third case is the *Chattel Securities Act 1987* (Vic), section 10 of which deals with competing claims between the holders of registered security interests in motor vehicles.¹⁰ An example of a debtor's name-indexed registration scheme directed to the third case is the registration of charges provisions set out in Part 3.5 of the *Corporations Law*.

8 Cf *Corporations Law*, s. 264 which provides for registration in the case where a company acquires property subject to a charge that would have been registrable if it had been created by a company in the first place. However, this provision is only relevant where the company contracts for title in the property subject to the encumbrance. It does not apply where the debtor (fraudulently) purports to transfer an unencumbered title to the property.

9 See Begg, "The Registration of Security Interests in Chattels" (1981) 55 *Australian Law Journal* 649 at 651-652.

10 See also *Chattel Securities Act 1987* (WA), s. 10; *Motor Vehicles Securities Act 1986* (Qld), s. 12; *Goods Securities Act 1986* (SA), ss 11 and 12.

1.5.7 Protection of creditors

A debtor's name-indexed registration system may serve another purpose, additional to the one described in para. 1.5.6, above. It can be used as a means of informing an intending unsecured creditor about the extent to which assets in the debtor's possession are the subject of security interests created in favour of other creditors. This information goes to the debtor's credit worthiness, and is relevant to the decision about whether to lend. Legislation enacted for this purpose will typically provide that failure to register results in avoidance of the security interest against the debtor's trustee in bankruptcy or liquidator. If A holds a security interest over an asset and X (the debtor) becomes bankrupt or goes into liquidation, a form of priority dispute arises with respect to the asset between A and X's unsecured creditors ("B"), represented by the trustee in bankruptcy or liquidator. In this context, a statutory provision invalidating a security interest for non-registration can be seen as a kind of priority rule. If A's security interest is registered, then A will have a prior claim to the asset over B. Otherwise, A will at best rank equally with B in respect of any claim. The bills of sale legislation is a case in point. The bills of sale legislation establishes a debtor's name-indexed registration system. The main purpose of the legislation was to protect any creditor (not just an intending secured creditor) advancing money to a debtor on the strength of the debtor's apparent ownership of goods when the goods had, in fact, secretly been transferred to another party (whether by way of security or otherwise). Another example of legislation enacted for this purpose is the provision in Victoria for the registration of assignment of book debts.¹¹ The *Corporations Law* is also directed to this purpose, but only as a secondary matter. The primary purpose of the *Corporations Law* is as stated in para. 1.5.6, above. This is reflected in the

fact that the registration requirement is limited to security interests, whereas under the bills of sale legislation (consistently with its primary objective) any assignment without transfer is registrable.

THE PRESENT LAW

2.1 WHAT IS WRONG WITH THE EXISTING REGISTRATION REQUIREMENTS?

2.1.1 Overview

The existing registration requirements are unsatisfactory for three main reasons: (1) they are piecemeal in their application; (2) they overlap in a way that results in duplication of effort on the part of registrants and searchers; and (3) they are in many respects outdated.

2.1.2 Piecemeal registration requirements

The existing registration requirements are piecemeal. The question as to whether registration is required turns on a number of variables, including: (a) the status of the debtor; (b) the subject matter of the security interest; and (c) the form of the security arrangement.

- (a) The most important example of registration requirements which turn on the status of the debtor is the *Corporations Law*. Part 3.5 of the Act requires the registration of charges (including mortgages) over certain kinds of property, but only where the debtor is a company. There is no corresponding requirement for registration in the case of a business debtor who is not incorporated. In view of the underlying policy (see para. 1.5.6, above), there is no reason in principle for restricting the registration requirement to companies. The relevant distinction, from a policy perspective so far as the third case is concerned, is not between company debts and other debts, but between business debts and

consumer debts (see further, para. 3.3.2, below).

(b) Examples of registration requirements which turn on the subject matter of the security interest are as follows.

(i) In some States, registration of assignments of goods is required subject to the bills of sale legislation, but assignments of other kinds of personal property are not registrable. Victoria is an exception on two counts, both because the bills of sale legislation has been repealed, and because of the requirement (still in force) for the registration of assignment of book debts.

(ii) The *Corporations Law* requires the registration of company charges, but only in respect of certain kinds of property. For example, while a charge on a book debt is registrable, a charge on a non-trading debt (for example, a bank account) probably is not. Again, there is no requirement for the registration of a charge on an insurance policy held by a company. A charge on shares or other securities held by a company is registrable, but there are significant exceptions.¹²

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The following is registrable:

"A charge on a marketable security, not being:

- (i) a charge created in whole or in part by the deposit of a document of title to the marketable security; or
- (ii) a mortgage under which the marketable security is registered in the name of the charge or a person nominated by the charge";

Corporations Law, s. 262(1)(g).

(iii) In addition to the foregoing, there are numerous specialist debtor's name-indexed registers which are restricted in their application to security interests given over a particular kind of property. Some of these owe their origins to a desire to facilitate the financing of particular kinds of activity (most notably, farming activities). Examples include the registration requirements relating to securities over livestock, wool, growing crops, sugar cane (in Queensland), and fruit (in South Australia). Others owe their origins to the fact that there was a title registration scheme already in existence or in contemplation, so that the provision for registration of security interests as well was a relatively easy matter. Examples include the registration requirements governing ships and patents. In either kind of case, it is hard to justify the retention of separate registers of security interests, at least for the purpose of dealing with disputes of the kind referred to in para. 1.4.3, above (competing security interests). There would be considerable savings to be made from collapsing the various security registers into a single, comprehensive debtor's name-based register of

The purpose of the exceptions is to prevent the registration requirement from unduly impeding portfolio management (change of investments). There would be no need for the exceptions if registration were optional (see para. 3.3.5, below), and if it were possible to register a security interest in shares held by the debtor at large without having to specify particulars in the registration notice (see para. 3.3.3, below).

security interests given for business purposes (see further, paras 3.3.1-3.3.7, below).

- (c) An example of a registration requirement which turns on the form of the security arrangement is the *Corporations Law*. As already mentioned, a charge (including a mortgage) given by a company is registrable. However, other transactions which serve the same functions as security are not subject to the legislation. Most important among these are the title retention arrangements discussed in para. 1.3.5, above (conditional sales, hire-purchase and the finance lease). This limitation is impossible to justify in terms of either the primary or the secondary purpose of the registration requirements (see paras 1.5.6 and 1.5.7, above). Similarly, while registration is required of a charge on a book debt, a factoring agreement is not registrable even if the assignment is with recourse (the provisions in Victoria governing the registration of assignments of book debts are to be contrasted in this respect). This limitation is difficult to justify in terms of the primary purpose of the registration requirements, and impossible to justify in terms of the secondary purpose. Similar criticisms can be levelled at the bills of sale legislation. This covers an assignment of goods without transfer whether by way of security or otherwise, as well as a charge on goods, but not a conditional sale or a hire-purchase agreement. In fact, both forms of transaction were the product of the deliberate exploitation of this shortcoming,¹³ and as Sykes has pointed out, the rise in

popularity of hire-purchase destroyed the assumptions underlying the legislation.¹⁴

2.1.3 Overlapping registration requirements

The existing registration requirements are also subject to criticism on account of overlap. This results in the need either for multiple registration or multiple searches. There are two kinds of overlap problem: (a) where the same security interest is subject within the jurisdiction to different registration statutes; and (b) where there is corresponding legislation in more than one State, each State statute establishing a separate register.

- (a) The first kind of case is exemplified by *Australian Central Credit Union v Commonwealth Bank of Australia*.¹⁵ The case involved competing security interests given by a company in relation to a motor vehicle. The first security interest was registered under the *Goods Securities Act 1986 (SA)*, but not the *Companies (South Australia) Code*. The second security interest (a floating charge over the whole of the debtor's undertaking, including the motor vehicle) was registered under the *Companies (South Australia) Code*, but not the *Goods Securities Act*. Each statute included a priority rule favouring the first to register, but neither stated which law was to take precedence in the event of any conflict. White J., at first instance, held that in the absence of any such provision, the priority rules in the *Goods Securities Act* took precedence over the companies legislation. This conclusion was overturned on appeal, the majority concluding that it was the rules in the companies legislation that

14 Op. cit. 531.

15 (1990) ASC 55-987 (SA S Ct); reversed (1991) ASC 56-037 (Full SA S Ct).

prevailed. It was further held that the bank was not fixed with constructive notice of the credit union's security interest, for the purposes of the priority rules in the companies legislation, by virtue of the fact that it had been registered under the *Goods Securities Act*. This conclusion favours searchers over security holders, in the sense that it requires a security holder to register twice in order to be sure of protection, while enabling a searcher to obtain protection by searching only once (at the Registry of Company Charges). The opposite conclusion (which was advocated by Olsson J., in dissent) would have led to the mirror-image problem. Security holders would then be favoured over searchers, in the sense that one registration would be sufficient (under the *Goods Securities Act*), whereas a searcher would need to search both registers in order to be sure of its position. The lesson to emerge from the case is that overlapping registration requirements necessarily result in duplication of effort. It does not matter which statute is given precedence. The adoption of one rule will mean that multiple registration is required, while the alternative rule will give rise to the need for multiple searches. The solution is to have only a single (national) register, or alternatively, a series of separate registers which are computer-linked to facilitate simultaneous searching.¹⁶

- (b) The second kind of case is exemplified by *Douglas Financial Consultants Ltd v Price*.¹⁷ This case concerned the familiar situation of a motor vehicle which was the subject of a

16 For further discussion of the *ACCU* case, see Notes (1991) 19 *Australian Business Law Review* 152 and (1992) 20 *Australian Business Law Review* 82.
17 (1991) ASC 56-046 (Full Qld S Ct).

security interest created in State A being removed by the debtor to State B before being sold. The motor vehicle securities legislation in each State provides for the registration of security interests in motor vehicles. It also provides, in effect, that (subject to some exceptions) a registered security interest will not be extinguished upon purchase of the vehicle by a third party. The question that arises is whether registration of a security interest in State A will protect the credit provider if the vehicle is later sold in State B. The answer, as the *DFC* case confirms, is "no". Accordingly, under the present law it is necessary for a credit provider to register its security interest in each State in order to be sure of obtaining comprehensive protection. If the reverse were the case, registration in one State would be sufficient, but then there would be the problem of searchers having to search each State register in order to be sure of their position. Either way, therefore, the overlap entails duplication of effort.¹⁸ Various solutions are possible. One alternative would be for the States to make reciprocal arrangements for the recognition of interstate registration.¹⁹ Another alternative would be for each State to impose an administrative rule to the effect that no vehicle brought from interstate could be re-registered without the applicant producing a search of the securities

18 For further discussion of the *DFC* case, see Note (1992) 20 *Australian Business Law Review* 82 at 84-85.

For other examples of the two kinds of overlap discussed in para. 6.3, see Note "Company Charges and the Corporations Law" (1991) 2 *Journal of Banking Finance Law and Practice* 112. These cases arise out of what appear to have been unintended changes to the law brought about following the enactment of the *Corporations Law*.

19 There is provision for this in the motor vehicles securities legislation of each of the States except New South Wales, but the system has not been activated: see Duggan, Begg and Lanyon, *op. cit.*, paras 7.3.94-7.3.97.

register in the other jurisdiction, and procuring registration in the State concerned of all security interests disclosed by the search.²⁰ The optimal solution would be to have either a single national register of motor vehicle security interests or, alternatively, separate but computer-linked State registers.

2.1.4 Outdated registration requirements

Many of the existing registration statutes are outdated.

- (a) The clearest example is provided by the bills of sale laws. These owe their origins to legislation that was first enacted in England in 1854 to deal with a particular problem that was prevalent at the time, namely the secret transfer of ownership in chattels with a view to defrauding intending creditors. The purpose of the register was to enable intending creditors to discover the existence of such transfers and, consistently with this purpose, failure to register meant that a bill was void against certain creditors and the debtor's trustee in bankruptcy. The legislation is narrow in focus, and this makes it quite unsuited to modern conditions. In any event, its efficacy was largely destroyed with the advent of hire-purchase. Australian versions of the legislation survive in all States and Territories, except Victoria and Western Australia. These local statutes are clumsily drafted, heavy-handed and archaic. They impose unnecessary restrictions on doing business, while failing to address the pressing

20 Ibid., para. 7.3.98.

policy concerns adverted to in para. 1.5, above.²¹

- (b) In many cases, registration is compulsory. Sometimes, failure to register is an offence (as in the case of the *Corporations Law*), while sometimes it results in the avoidance of the security transaction as between the parties themselves (as in the case of the bills of sale legislation in some States, and the provisions in Part IX of the *Instruments Act 1958* (Vic) governing registration of assignments of book debts). Where the purpose of registration is to resolve competing claims to personal property, formal sanctions for non-compliance are unnecessary. It is sufficient if priority is made to turn on whether the security interest is registered. Then it will be a matter for the business judgment of the creditor to decide whether or not the cost of registering the security interest is outweighed by the risk of postponement or extinguishment in the event of non-registration. By contrast, where registration is compulsory, it falls to the legislature to make this kind of judgment, in determining whether or not to grant exemptions from the registration requirement. It is questionable whether legislatures are better placed than the parties themselves to make such cost-benefit assessments.
- (c) The process of registration is in many instances clumsy and outdated. The information required from the creditor should

21 See Sykes, *op. cit.* 531:

"The bills of sale legislation then represents a social theory which now lacks credibility but the legislation, though there are few to praise it, in the main still stands as a nuisance factor imposing senseless shackles on many bona fide transactions. It cannot be denied that the existence of the legislation still has a profound effect on the law governing chattel securities".

be the minimum necessary to alert a searcher to the existence of the prior entitlement. If further information is required, it can be obtained upon request from the holder of the registered interest. In other words, the filing of a short financing statement should be all that is required for registration purposes. Furthermore, it should be possible to register by computer. Many Australian registration statutes require lodgment of the security document itself (for example, the bills of sale legislation and, in Queensland, the *Motor Vehicles Securities Act* 1986). The *Corporations Law* requires both the filing of a financing statement (notice) and lodgment of the instrument creating the charge. Instrument filing has the following disadvantages: (1) it is commercially impracticable where the security is of a kind which is constantly changing, such as accounts receivable or dealers' inventory (unless the security is in the form of a floating charge); (2) it precludes the creditor from getting anything on the register until the debtor has actually signed the security agreement; (3) where the security agreement is lengthy, the obligation to prepare an extra copy for filing is inconvenient; (4) the security agreement may contain provisions that are not relevant to the security, and which neither party wishes to make public; and (5) the accumulation of lengthy security agreements of varying sizes is administratively inconvenient, and impedes the computerisation of records.²² The *Corporations Law* creates a scheme of provisional registration to deal with the case where a notice is lodged before stamp duty has been paid on the relevant security document.

This is another respect in which the legislation is needlessly complex. The requirement detracts from the advantages of a registration system because it creates uncertainty for searchers during the provisional registration period as to whether the provisionally registered security interest will end up obtaining priority under the legislation or not. A creditor's entitlement to the protection of the register should not be made to turn on the payment of stamp duty. The policing of stamp duty requirements should be a matter for the stamp duties laws themselves, not for registration statutes. Otherwise, the law is likely to impede the process of transacting, making some kinds of transaction difficult (or impossible) to achieve, while needlessly slowing others down.

2.2 WHAT IS WRONG WITH THE EXISTING PRIORITY RULES?

2.2.1 Overview

There is little consistency in the rules presently applicable to the kinds of dispute identified in para. 1.4, above. The rules vary according to: (1) whether or not registration is required; (2) the form of the security transaction; and (3) the nature of the subject matter.

2.2.2 Statutory and common law priority rules

Some registration statutes include priority rules to determine disputes between competing registrable interests (for example, the *Corporations Law*), while others do not (for example, the bills of sale legislation). In the absence of statutory priority rules, the common law rules apply. The various statutory rules represent a

departure from the common law position, but they are also different as between themselves.

2.2.3 The Corporations Law and the concept of notice

The *Corporations Law* includes priority rules for resolving a competition between registrable interests. They are relevant to the kind of dispute referred to in para. 1.4.3, above. There is nothing in the *Corporations Law* directly relevant to the kinds of dispute referred to in paras 1.4.1 and 1.4.2. The priority rules are based on the legislation governing registration of title deeds for general law land. They are complex and unsatisfactory. As between competing registered interests, the rule is that priority is determined in accordance with the order of registration. However, the first to register rule is displaced in a case where the later charge was the first registered, and the holder of the later charge had notice of the earlier charge at the time the later charge was created. "Notice" includes constructive notice. The effect of this rule is to detract from the paramountcy of the register, and to reduce the efficacy of registration. There should be no place for the concept of constructive notice in a modern registration statute. Priority between competing security interests should be determined in accordance with the register, as in the case of the Torrens system statutes, except where there are clear policy reasons for preferring the unregistered or subsequently registered security interest (see further, para. 3.4.4, below).

2.2.4 Tacking under the Corporations Law

The rules in the *Corporations Law* relating to tacking for further advances are also unsatisfactory. Priority in respect of future advances depends on whether the charge specifies the maximum amount of "prospective liabilities" (possible future advances) or leaves the prospective liabilities unspecified, and whether the lodged notice of the charge indicates the nature or

maximum amount of the prospective liabilities. Priority can also depend on whether the holder of the first charge had actual knowledge of the later charge when making the advance. A further factor is whether there was an obligation to make the future advance. Part of the rationale is that if the register discloses the maximum amount that may be lent under the umbrella of the security, a searcher will be able to determine the extent to which the company's assets are committed to the security holder. However, this rationale has been undermined by the widespread practice of specifying artificially high maximum amounts of prospective liabilities. This secures for the creditor the full protection of registration, while at the same time preserving flexibility with respect to future lending decisions. It also results in the information disclosed on the register being virtually meaningless so far as the searcher is concerned. A much simpler rule would be one which gave priority upon registration in respect of all future advances, provided they were contemplated by the loan agreement and subject to any limit that the parties may have specified. This outcome could be varied by agreement between competing security holders.

2.2.5 The motor vehicle securities legislation

The motor vehicle securities legislation in all States includes priority rules for resolving a competition between a registered security interest and a third party purchaser. They are relevant to the kinds of dispute referred to in para. 1.4.2, above. In some States (Victoria, Western Australia, Queensland and South Australia), there are also provisions for resolving a competition between registered security interests (the kind of dispute referred to in para. 1.4.3, above). In the other States, this kind of dispute remains subject to the common law priority rules (or any other statutory priority rules that might be applicable). The provisions in the Victorian and Western Australian statutes

governing the second kind of dispute are uniform, but the Queensland and South Australian versions are quite different, both from the uniform model as well as from each other.²³

2.2.6 Motor vehicle securities (Victoria and Western Australia)

In Victoria and Western Australia, the statutory rule relevant to the second kind of dispute determines priorities strictly in accordance with the order of registration. Priority extends to future advances, but it may be waived by agreement.²⁴ These provisions are to be contrasted with the scheme in the *Corporations Law* (see paras 2.2.3 and 2.2.4, above). There is the potential for overlap between the two sets of priority rules (as in the case where the debtor is a company and creates a charge on a motor vehicle). In that case, the Victorian and Western Australian statutes provide that the priority rules in the *Corporations Law* take precedence. It needs to be emphasised that the consequence of this is not to avoid the need for dual registration. It merely removes uncertainty as to which set of priority rules is to apply in the case of conflict (see para. 2.1.3(a), above).

2.2.7 Common law priority rules

Where there are no applicable statutory priority rules, the nature of a dispute is determined in accordance with common law principles. In a case of the kind described in para. 1.4.1 (competing claims to ownership), the governing principle is *nemo dat quod non habet*. In a case of the kind described in para. 1.4.2 (competition between a security interest and a later third party purchaser), the starting point is, again, *nemo dat quod*

23 For an account of the differences, see Duggan, Begg and Lanyon, *op. cit.*, paras 7.3.15-7.3.88.

24 See, e.g., *Chattel Securities Act 1987* (Vic), s. 10.

non habet, but the outcome turns substantially on the form of the security transaction. For example, if it is a security in the strict sense (a mortgage or a charge), it will be relevant to know whether it is legal or equitable. If it is a legal interest, then application of the *nemo dat* principle will result in the purchaser obtaining (at best) whatever equitable interest was remaining in the debtor at the date of the disposition. By contrast, if the security transaction gives rise only to an equitable interest, then the *nemo dat* principle is displaced and the purchaser will take free of the security provided the purchase was *bona fide* for value and without notice of the prior entitlement. If the first transaction was not a security transaction in the strict sense, but instead comprised a title retention arrangement, it will be relevant to know the details. If it is a conditional sale, the *nemo dat* rule will be displaced by the buyer in possession provision in the sale of goods legislation, so that the purchaser will obtain unencumbered title if the purchase was *bona fide* for value and without notice of the prior entitlement. On the other hand, if it is a hire-purchase agreement, the buyer in possession provision does not apply so that the outcome will be determined by reference to the *nemo dat* principle.²⁵ The difference between a conditional sale and a hire-purchase agreement is a purely formal one, yet the legal consequences which attach to it are dramatic. Broadly comparable considerations are relevant in a case of the kind described in para. 1.4.3 (competing security interests).

2.2.8 Chattel securities (Victoria and Western Australia)

In Victoria and Western Australia, the criticism of the law that is implicit in para. 2.2.7, above has partly been met following the enactment of the chattel securities legislation. In each case, there is a statutory rule relevant to the kind of dispute described in para. 1.4.2

(competition between a security interest and a later third party purchaser). The rule favours the bona fide third party purchaser (subject to a number of exceptions). The rule applies regardless of the form of the transaction entered into between the debtor and the holder of the security interest. It applies to dealings in goods of any kind, up to a value of \$20,000 (as measured by the conversion price). In other States, there is a corresponding rule but it is limited to motor vehicles. Thus, the law varies according to the subject matter of the transaction.

2.2.9 Choses in action

In the case of a dispute involving competing claims to goods, the governing principles are as described above. However, where the subject matter is a debt or other chose in action, the starting point (in the absence of any applicable statute) is the rule in *Dearle v Hall*.²⁶ This is to the effect that where there are successive mortgages or assignments of an existing equitable interest, priority depends on the order in which the competing claimants gave notice of their interests to the trustee. In the case of assignments of choses in action, the rule translates into the proposition that priority goes to whoever first notifies the debtor.

2.3 WHAT IS WRONG WITH THE PRESENT LAW?

2.3.1 Summary

In summary, it can be said that the present law governing competing claims to personal property is deficient in the following principal respects:

- Transactions are regulated according to their form rather than their substance. The rights of

the immediate parties and third parties are made to turn on variables which have no basis in policy or commercial convenience.

- Existing registration requirements are piecemeal. They discriminate irrationally between different kinds of transactions, different classes of debtor, and different kinds of property.
- On the other hand, there is excessive overlap between existing registration statutes. Some transactions are subject to more than one registration requirement in the same jurisdiction, while others are subject to separate (though similar) requirements from State to State. The consequence of overlap is duplication of effort on the part of either registrants or searchers (depending on what rule is employed for dealing with the overlap).
- In many cases, the registration process is unduly cumbersome, while the consequences of failing to register are heavy-handed. In both respects, the existing law adds needlessly to the cost of doing business and impedes the free flow of transactions.
- Existing priority rules are an uneasy mix of statutory, common law and equitable inputs. The overall picture is one of inconsistency and unpredictability. Some of the statutory rules detract from the paramountcy of the register and are needlessly complicated, while the non-statutory rules are excessively reliant on formal (technical) considerations.

THE PROPOSED REFORMS

3.1 WHAT IS THE SOLUTION?

3.1.1 The United States Uniform Commercial Code

The model for a solution to the kinds of problem discussed above is to be found in Article 9 of the United States Uniform Commercial Code (UCC). The UCC was promulgated by the National Conference of Commissioners on Uniform State Laws and the American Law Institute in 1951. Various revisions have been made subsequently. The UCC (which is a model statute) has since been adopted in every State. It represents a comprehensive reform of almost the whole of the commercial law of the United States. There are eleven main divisions, called "Articles". Article 1 contains general provisions (definitions, etc.). Article 2 deals with the sale of goods. Articles 3-8 relate to negotiable instruments, aspects of banking law, bills of lading and warehouse receipts, and the purchase of stocks and other investment securities. Articles 10 and 11 deal with commencement and repeals. In 1988, a new set of provisions was included dealing with goods leases (Article 2A).²⁷ Article 9 relates to "Secured Transactions". The following is a short account of the main features of the Article 9 scheme.

3.1.2 Overview of Article 9

The key feature of Article 9 is that it looks to the substance of a security transaction, not its form. As a general rule, it catches all transactions intended as security, whether in the form of a mortgage or a title

retention device.²⁸ The parties are free to adopt whatever form of transaction they choose,²⁹ but the form chosen does not determine the legal outcome. Article 9 deals with every phase of a security agreement, from its creation to its enforcement, and subjects all kind of agreement to a common set of rules unless a distinction can be justified on functional grounds. Accordingly, the distinctions between legal interests and equitable interests, and between title transfer and title retention cease to carry any significance. The kinds of formal variable that dominate Australian security law play no part in the American scheme.

3.1.3 Attachment

In the case of a non-possessory security interest, there is a minimal formal requirement: the security interest is not enforceable against the debtor or third parties unless the debtor has signed a security agreement which contains a description of the property subject to the security interest (called "collateral"). The enforcement of a security interest against the debtor depends upon "attachment". In order for a security interest to attach:

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- 28 Thus, s. 9-102 provides as follows:
- "(1) Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies
- (a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also
- (b) to any sale of accounts or chattel paper.
- (2) This Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310.
- (3) [Not reproduced.]"
- 29 Subject to the provisions of the Code, a security agreement is effective according to its terms: s. 9-105. A "security agreement" is an agreement which creates or provides for a security interest: s. 9-105.

(1) there must be a security agreement signed by the debtor (non-possessory security), or possession held by the creditor (possessory security); (2) the creditor must have given value; and (3) the debtor must have rights in the collateral. The third requirement is particularly significant with respect to the giving of security over after-acquired property. It reflects the common law rule that there can be no effective transfer in such a case until the property comes into the debtor's hands.

3.1.4 Perfection

The enforcement of a security interest against the debtor is dependent upon attachment. However, there is an additional requirement which must be satisfied before the security interest will be enforceable against third parties. Third parties include the debtor's trustee in bankruptcy or liquidator, a receiver, an execution creditor, a competing secured creditor and a purchaser of the subject property. This additional requirement is referred to in the legislation as "perfection". Article 9 establishes a register of personal property security interests, and in the usual case, perfection is achieved by filing for registration. In the case of a possessory security interest (and in certain other circumstances) perfection can be achieved by the creditor taking possession of the collateral. In many cases perfection will follow attachment, but this is not invariably true. Registration is permissible in advance of attachment. So, for example, in the case of a security agreement relating to future property, the security interest may be registered before the property comes into the debtor's hands. In this kind of case, perfection is retrospective to the date of filing for registration.

3.1.5 The process of registration

The Article 9 register is a debtor's name-indexed register. Registration is achieved by notice filing. A short financing statement is required which incorporates

the names of the debtor and the creditor, is signed by the debtor, gives the creditor's address so that further information concerning the security agreement may be obtained, gives a mailing address for the debtor and contains a statement indicating the subject matter or type of the security interest. A detailed description of the subject matter is not required. A financing statement may be filed at any time and, as already mentioned, filing is permissible before the security agreement is made, or the security interest otherwise attaches. Where a succession of security agreements is contemplated between the same parties, separate registration is not required in respect of each agreement. A single filing at the outset will be effective for all subsequent agreements and, in each case, perfection will date back to the time of filing. The keynote is flexibility. The aim is to achieve the advantages of registration without delaying the transaction process, or preventing particular methods of dealing.

3.1.6 Consequences of non-registration

The consequence of failing to file is that (in most cases) the security interest will remain unperfected. An unperfected security interest is not valid as against persons such as the debtor's trustee in bankruptcy or liquidator, or an execution creditor. As a general rule, it is also ineffective against a purchaser of the collateral, and it will be postponed to a later registered security interest. Apart from these consequences, there is no sanction for failing to register. This means that it is left to the creditor in each case to decide, as a matter of business judgment, whether or not the advantages of registration are outweighed by other commercial considerations. There are some limited exceptions to the rule that registration is necessary in order to protect a security interest (for example, as already mentioned, in some cases perfection can be achieved by the creditor taking possession). There are also some exceptions to the rule that perfection through registration will protect

the creditor against third party interests. The most important (and obvious) of these is where the security interest relates to stock in trade (i.e., an "inventory security interest"), and the sale takes place in the ordinary course of the debtor's business without knowledge on the purchaser's part of any restriction on the debtor's right to deal with the goods. There are some other exceptions favouring the third party purchaser, but it is not necessary to go into detail about these matters, because they are peripheral to the scheme overall. Different rules could be adopted in relation to them without affecting the integrity of the Article 9 concept.

3.1.7 The priority rules

In the case of a competition between two or more security interests in the same property, the usual rule is that priority is given to the creditor who first files for registration. Where only one of the security interests is registered, priority goes to the registered interest. Where neither is registered, priority is determined in accordance with the order of attachment. There is an exception in the case of a purchase money security interest. A "purchase money security interest" is a security interest taken by the seller of goods to secure payment of the price, or by the lender of the money which is used to pay for them. Examples of a purchase money security interest in the Australian context would include the interest of the owner of goods under a hire-purchase agreement, the interest of a lender pursuant to a mortgage taken to secure repayment of a car loan (the mortgage being taken over the car), and the interest of the supplier pursuant to a Romalpa agreement. Subject to certain conditions, the holder of a perfected purchase money security interest takes priority over an earlier perfected security interest in the same goods (such as, in the Australian context, a floating charge). The rationale is that the supply of the goods adds value to the debtor's estate. Accordingly,

the taking of a security interest over them does not prejudice other creditors and may actually advantage them if the goods are used productively by the debtor for income-producing purposes. In addition to the foregoing, there are also special rules relating to fixtures, accessions and commingled goods.

3.1.8 Tracing into sale proceeds

Under Article 9, where property the subject of a perfected security interest is sold (whether with or without the secured creditor's consent), perfection extends to the proceeds of sale in the hands of the debtor, for as long as they remain identifiable. This result follows automatically under the legislation, and it is not subject to the common law or equitable rules governing tracing. In particular, it is not necessary (as it arguably is in Australia, except in the case of a floating charge) for the creditor to establish the existence of a fiduciary relationship. Nor is there any need for the security agreement to stipulate that the security interest continues into the proceeds. The creditor may agree to release the asset from the security interest altogether, and where the sale takes place with the creditor's consent, a question may arise as to whether this was the intention. However, in the absence of proof to the contrary, it is presumed that no release was intended. Where the secured property is sold for cash and the cash is used to purchase other property, the original security interest continues into the new property, but a fresh financing statement must be filed in certain circumstances.

3.1.9 Tracing asset into purchaser's hands

Where collateral is sold without the secured creditor's consent, as a general rule the security interest continues notwithstanding the disposition, and the creditor will be entitled to seize the property from the third party purchaser. However, as already mentioned, in certain

circumstances the legislation favours the third party purchaser over the holder of a registered security interest, so that the general rule may be displaced. There is also an exception which applies in favour of the holder in due course of a negotiable instrument.

3.1.10 Tacking

Where a loan agreement provides for the making of further advances and there is a perfected security interest, the priority accorded to the creditor over subsequently perfected security interests extends to the further advances. This priority can be waived or modified by means of a subordination agreement.

3.1.11 Creditors' remedies

Article 9 also incorporates standard provisions governing a secured creditor's remedies on default. The basic scheme, consistent with the underlying philosophy of the legislation, is to provide for a single set of remedies which is applicable regardless of the form of the security transaction. The remedies are similar to those that are available at common law in Australia to a mortgagee. They include the right to: (1) realise the security; (2) retain the property in full satisfaction of the debt (in effect, foreclosure); or (3) ignore the security and sue on the debt. There are also rules governing the sale of collateral, and accounting for the proceeds. In particular, any surplus remaining after satisfaction of the secured creditor's debt must be paid to the debtor (assuming there are no other security interests in the property). The debtor may exercise a right of redemption at any time before sale of the property by tendering payment of the outstanding balance of the debt together with the creditor's enforcement expenses.

3.2 IS ARTICLE 9 EXPORTABLE?

3.2.1 Canada

Personal property securities legislation based on the Article 9 model has been adopted in a number of Canadian provinces. Each of the Canadian versions is different in various points of detail from the Article 9 model, but the substance of the legislation is the same. The two most obvious areas of difference relate to: (1) terminology (the drafting style of the Canadian Acts would be more familiar to an Australian lawyer than the United States model); and (2) the register (the Canadian registers are computerised, with varying degrees of sophistication, whereas in the United States most of the registers are still paper-based systems). The law that the Canadian legislation replaced is in many respects similar to the law that currently applies in Australia. For these reasons, the Canadian models offer a better immediate source of guidance for Australia than Article 9 itself. Draft New Zealand personal property securities legislation (see para. 3.2.3, below) is based substantially on the British Columbia and Saskatchewan statutes.

3.2.2 United Kingdom

In the United Kingdom, the Crowther Committee as part of its report on consumer credit published in 1971,³⁰ recommended the reform of personal property securities law based on the Article 9 model, as discussed above. The recommendations were not adopted at the time, but they were the subject of further consideration in a report completed in 1983 and published in 1986 by the Scottish Law Commission (the "Halliday Report").³¹ The Halliday Report supported the broad thrust of the

30 United Kingdom, *Report of the Committee on Consumer Credit*, Cmnd 4596 (1971).

31 Scottish Law Commission, *Report of the Working Party on Security over Movable Property* (1986).

Crowther Committee's proposals, and recommended the implementation in Scotland of a modified version of the Article 9 solution. In 1985, Professor Aubrey Diamond was commissioned by the Minister for Corporate and Consumer Affairs to examine the need for personal property security law reform in the United Kingdom, taking account of what had earlier been said by the Crowther and Halliday Committees. Professor Diamond's report was published in 1989.³² In it, he gives a lucid account of what is wrong with the present law, and makes a persuasive case for adoption of the Article 9 solution. He endorses the Crowther Committee's proposals (with some slight modifications), saying:³³

"Many of [the] defects in the law...were to be found in the law of the United States before the adoption of the Uniform Commercial Code and in the Provinces of Canada. It seems clear to me that the legislation embodied in Article 9 of the Uniform Commercial Code...and in the Personal Property Security Acts of some Canadian Provinces...has taken the law a long way forward and has succeeded in solving some of the problems to which I have referred.

...I am quite clear that there would be major advantages in Great Britain in adopting a new law that was practical, addressed itself directly to known problems and provided clear solutions, free from historical anomalies and legal fictions".

32

Diamond, *A Review of Security Interests in Property* (HMSO, 1989).

33

Ibid. paras 8.3.1, 8.3.3.

3.2.3 New Zealand

The New Zealand Law Commission became interested in the topic of personal property security law reform in the course of conducting a review of the *Companies Act* 1955 (NZ). In 1987, the Commission engaged Professor John Farrar, then Dean of the Law School at the University of Canterbury in Christchurch, and Mr Mark O'Regan, a partner in a Wellington law firm, to visit North America, review the United States and Canadian systems in operation, and report back. Farrar and O'Regan's report was published by the Law Commission in 1988.³⁴ The report recommended adoption in New Zealand of a personal property security statute modelled on Article 9. This recommendation was endorsed by the Law Commission, and a draft statute was prepared together with a detailed commentary.³⁵ The Commission's work draws heavily on the Canadian experience. The bill has not yet been enacted, and its future is uncertain. Part of the reason for this is that, having regard to the Closer Economic Relations accord, the New Zealanders have been reluctant to proceed with a major commercial law reform initiative in the absence of a corresponding development in Australia. If the case for reform in Australia is taken up, the New Zealand initiative would probably be revived.³⁶ In any event, valuable work has been done in preparation of the New Zealand reports and draft statute, and this work deserves close study in Australia. The draft bill and commentary, in particular, will be very useful when it comes to the stage of fleshing out the details of any reform proposal that might go forward.

34 Farrar and O'Regan, *Reform of Personal Property Security Law: A Report to the Law Commission* (Preliminary Paper No. 6, 1988).

35 New Zealand Law Commission, *A Personal Property Securities Act for New Zealand* (Report No. 8, 1989).

36 See Farrar, *New Zealand Considers a PPSA* (unpublished paper, 1990), 7-8.

3.2.4 Australian developments to date

The implementation in Australia of personal property security law reforms along the lines of Article 9 was recommended by the Molomby Committee in its report on consumer credit in 1972.³⁷ The Committee's proposals are similar to those made by the Crowther Committee in England at almost the same time (see para. 3.2.2, above), though the proposals were formulated quite independently of each other. The main difference between the two proposals is that the Crowther Committee envisaged the establishment only of a debtor's name-indexed register (as in the United States). By contrast, the Molomby Committee's first preference was for the establishment of several cross-linked registers of security interests, one debtor's name-indexed, the other(s) asset-indexed (for example, a motor vehicle securities register), with special provision to facilitate multiple registration and searches. The aim was to secure for all parties (registrants and searchers) the best of both the worlds described above (see para. 1.5.6). The Molomby Committee's proposals were partly implemented with the enactment of the motor vehicles securities legislation in the various States and Territories. As already noted, these statutes establish asset-indexed registers for security interests in motor vehicles and (in some jurisdictions) caravans and trailers. The influence of Article 9 is evident in all these statutes, but most particularly in the *Chattel Securities Act 1987 (Vic)* and the *Chattel Securities Act 1987 (WA)*.³⁸ However, the Committee's proposals for

37 Committee of the Law Council of Australia, *Report to the Attorney-General for the State of Victoria on Fair Consumer Credit Laws (1972)*, paras 5.10.1 et seq.

38 Note, in particular, the definition of "security interest". Section 3(1) of the *Western Australian Act* provides as follows:

"'Security interest' means an interest in or a power over goods (whether arising by or pursuant to an instrument or transaction) which secures payment of a debt or other pecuniary obligation or the performance of any other obligation and includes any interest in or power over the goods of a lessor, owner or other supplier of goods, but

the establishment of a debtor's name-indexed register have not been adopted. Instead, a scheme for the registration of company charges was enacted based on recommendations made by the Eggleston Committee, also in 1972.³⁹ These recommendations were made without reference to the work of the Molomby Committee, and they do not draw on the Article 9 experience. The company charges provisions are deficient for reasons that have already been discussed.

3.3 HOW SHOULD NEW AUSTRALIAN LEGISLATION BE FRAMED?

3.3.1 A debtor's name-indexed register

There should be provision for a debtor's name-indexed register of consensual security interests in personal property based on the Article 9 model, as previously described.

does not include a possessory lien or pledge".

The influence of Article 9 is also apparent in the provisions of the credit legislation governing regulated mortgages. Section 5(1) of the Credit Act 1984 (Vic) provides as follows:

"'Mortgage' means an instrument or transaction by or under which a security interest is reserved or created or otherwise arises"

'Security interest' means an interest or power -

- (a) reserved in or over an interest in goods or other property; or
- (b) created or otherwise arising in or over an interest in goods or other property under a bill of sale, mortgage, charge, lien, pledge, trust or power,

by way of security for the payment of a debt or other pecuniary obligation or the performance of any other obligation..."

39 Company Law Advisory Committee to the Standing Committee of Attorneys-General, *7th Interim Report: Registration of Charges* (1972).

3.3.2 Business dealings only

The register should be limited to business transactions. This is a departure from the Article 9 approach. In the United States, there is provision for the filing of security interests in consumer goods, but a purchase money security interest in consumer goods (other than a motor vehicle) for most purposes can be perfected without filing or possession.⁴⁰ On the other hand, a person who purchases goods for personal use will generally acquire title to them free of a security interest, even if it has been perfected, provided the goods were bought without knowledge of the security interest. It is simpler to prohibit altogether the filing of security interests in consumer goods in the debtor's name-based register. There would be a separate asset-indexed register for security interests in motor vehicles (as there is at present), and this would cover both business and consumer dealings (see para. 3.3.8, below). The main reasons for excluding consumer dealings from the debtor's name-based register are: (1) to avoid cluttering the register with transactions which for the most part involve relatively small amounts of money; and (2) that it would be unreasonable to expect a consumer to search a register of this kind before making a purchase.

3.3.3 The process of registration

Registration should be by notice filing. As in the United States, the financing statement should be required to contain the minimum information necessary to enable the statutory priority rules to work properly. In contrast to the present position in many United States jurisdictions, filing should be possible by computer, with computer filing being encouraged by cheaper fees. Notice filing should be permissible in advance of a transaction, but it would require the consent of the

40 "Consumer goods" are goods used or acquired for use primarily for personal, family or household purposes: s. 9-109(1).

debtor and be of limited duration. Where multiple transactions are envisaged (for example, as in the case of a Romalpa agreement), a single notice filing at the outset should be sufficient to cover all future dealings. In such a case, perfection would date from the time of registration. Similarly, where the collateral comprises a share portfolio, it would not be necessary to file a new financing statement each time shares were bought or sold as part of the portfolio management process. A single filing at the outset would be all that was required.

3.3.4 Compensation for system errors

Registration should take effect from the time the security interest is entered on the register. There should be a compensation scheme to protect users of the register against system malfunction. Where a financing statement is filed, but (due to system error) is not entered on the register or is incorrectly entered, the holder of the security interest should be entitled to compensation. Where a security interest is registered, but (due to system error) is not disclosed in the course of a search, the searcher should be entitled to compensation.⁴¹

3.3.5 Consequences of non-registration

Registration would be optional, in the sense that there would be no sanction for failing to register apart from the risk associated with an unperfected security interest being unenforceable against third parties. In the case of possessory security interests, registration would be permissible, but it would not determine perfection.

41

Compare Chattel Securities Act 1987 (Vic), ss 23, 25.

In each of the Canadian statutes, there is provision for secured parties to be compensated for loss suffered as a consequence of system error. Under Article 9, perfection is achieved upon filing, so that the secured party does not bear the risk of system errors. The defect in the Article 9 approach is that it reduces the reliability of the register so far as the searcher is concerned.

3.3.6 A national register or State registers?

The optimal solution would be for the establishment of a single national register. This would be the obvious outcome if the reforms were implemented by Commonwealth legislation. However, even if the reforms were made at the State level (a more likely scenario, in view of the constitutional position), a national register could still be achieved by means of a co-operative venture. The running of a co-operatively established register could be entrusted to an agency created for the purpose by the participating Governments. Alternatively, the function could be contracted out to private enterprise. If a national register is not achievable, an alternative would be the establishment of separate State registers which were cross-linked, in the sense that: (1) a single filing in one State would be sufficient to secure registration on all registers; and (2) all registers would be covered by a single search. The registration system should be self-financing.⁴²

3.3.7 Repeals

The new system would replace the following existing debtor's name-based registers

- company charges
- bills of sale
- securities over stock, wool, crops and so on
- assignments of book debts.

There is no case for retaining the provisions in the *Corporations Law* for registration of company charges. The Crowther Committee in England argued that their proposed new register of security interests should be

42 Another solution, in the absence of computerised interlinking of State registers, would be the making of reciprocal arrangements between the States for the recognition of interstate registration (see para. 2.1.3(b), above).

additional to that under the *Companies Act*. The Committee thought that the two registers served different functions. However, this view was decisively rejected by Professor Diamond. He said:⁴³

"I do not think that duplicate registration in this way is necessary or desirable. I do not think it is necessary to distinguish the two functions mentioned by Crowther by having two registers, and I think that the new register of security interests...should replace the registration of charges under the *Companies Act*".

The proposed New Zealand scheme envisages repeal of the provisions governing registration of company charges.

3.3.8 Asset-indexed registers

Existing asset-indexed registers (such as the registers for security interests in motor vehicles) would not be replaced under the proposed scheme. They would operate in conjunction with the new legislation. As already mentioned, an asset-indexed register and a debtor's name-indexed register serve different functions, and by providing for both kinds of registration it is possible to maximise the protection afforded to both registrants and searchers (see para. 1.5, above). At present, there are separate registers in each State for motor vehicle security interests, and the governing legislation is not uniform. There is a need for new, uniform legislation incorporating the priority rules discussed in para. 3.4, below. The establishment of a single, national register of motor vehicle security interests would be a desirable goal, but it is not

essential. As in the case of the proposed debtor's name-indexed register, an alternative would be to retain separate State registers, but to cross-link them by computer so as to facilitate one-stop registration and searching (see para. 2.1.3(b), above). One consequence of having both a debtor's name-indexed register and an asset-indexed register is that in many cases dual registration and searching would be necessary. Dual registration and search requirements are indefensible when they result from overlap (see para. 2.1.3(a), above), but the position is different where the registers serve complementary purposes. In that case, users of the system obtain additional benefits from being able to register or search twice. In any event, it ought to be possible, by appropriate computer networking, to establish a system of one-stop registration and search in all relevant registers (asset-indexed and debtor's name-indexed, as well as from State to State where applicable). There are other asset-indexed registers for security interests, apart from those relating to motor vehicles. These include registers established at the Commonwealth level for shipping, aircraft and patents and trademarks. All (or any) of these registers could be accommodated with the proposed new debtor's name-indexed register in the manner just described. Amendments would be required to the governing legislation in order to incorporate the priority rules to be discussed below.

3.3.9 Partial reform feasible

The stand-alone nature of many of these recommendations needs to be emphasised. The reform package described above is based on the concept of a computerised system for the registration of security interests against the debtor's name, coupled with a network of systems (also computerised) for the registration of security interests against various kinds of asset. However, while this might be the ideal outcome, it would be perfectly feasible to introduce the proposed

new personal property securities statute without making any changes at all to the existing asset-indexed registers or the legislation by which they are governed. While this outcome would fall short of the ideal, it would still represent a substantial improvement on the existing position.⁴⁴ By the same token, many of the proposed changes would be well worthwhile even if, at least in the short-term, a fully computer-integrated system of registers is not achievable. For example, to have separate computerised registers that are not cross-linked is better than not having a register at all. In any event, there are other ways, apart from computerisation, of tackling the problems that arise out of separate State registers (see para. 2.1.3(b), above). It is also better to have a paper-based registration system (assuming it is properly conceived) than not to have registration at all. United States experience bears this out. Finally, and perhaps most importantly, a strong case can be made for reform of the existing priority rules, along the lines set out below (modified as necessary), even in the absence of any registration system.

3.4 HOW SHOULD THE NEW PRIORITY RULES BE FRAMED?

3.4.1 Overview

The new legislation should contain rules for determining competing claims to personal property in a case of the kind referred to in para. 1.4.2, above (prior security holder and subsequent purchaser), and also in a case of the kind referred to in para. 1.4.3, above (holders of competing security interests in the same property). However, the rules for determining competing claims of the former kind should be expressed not to apply in a case where the security interest is registrable in a

⁴⁴ There would need to be provisions in the new personal property securities legislation to deal with the problem of overlapping priority rules.

specialist asset-indexed register (for example, motor vehicles). The aim would be to ensure that only one set of rules was applicable to any given case. The rules in the legislation creating the asset-indexed register are the logical choice for this kind of dispute, because this is the register where the purchaser is most likely to search. Correspondingly, competing claims of the latter kind should be subject only to the priority rules set out in the new debtor's name-indexed register. This means that any provisions in legislation establishing an asset-indexed register which purport to determine priority disputes of this kind should no longer apply, and it should be made clear that the priority rules in the personal property securities statute apply instead. Again, the aim is to avoid overlap. In this case, the priority rules in the personal property securities statute are the logical choice, because the name-indexed register is the place where the holder of the later security interest is most likely to search. One exception is needed. This is to deal with the case of competing security interests in the same asset created by different debtors.⁴⁵ In this case, the priority rules in the asset-indexed register should apply. The rationale is that a search of the debtor's name-indexed register is unlikely to reveal the prior conflicting security interest, whereas a search of the asset-indexed register should do so (see para. 1.5.6, above).

3.4.2 Dispute between security holder and subsequent purchaser: the PPSA rules

The case of competing claims to personal property between the holder of a security interest and a subsequent purchaser would need to be provided for in the new personal property securities statute, as well as in any legislation creating a specialist asset-indexed

45 This kind of conflict is not likely to arise often. In most cases, it will turn out that one of the security interests was created by a person without ownership and therefore incapable of transferring rights. Nevertheless, the legislation should cater for the possibility.

register. The rules in the personal property securities statute would apply in any case where there was no relevant asset-indexed register. Otherwise, the rules in the specialist legislation would apply. The rules to govern this kind of dispute in the personal property securities statute should be as follows.

- (a)
 - (i) If a security interest is registered (in the debtor's name-indexed register established pursuant to the statute), then it prevails over the purchaser.
 - (ii) If the security interest is registrable under the statute, but is not registered, then the purchaser should obtain unencumbered title provided the purchase was made in good faith, for value and without notice of the existence of the security interest.
 - (iii) If the security interest has been perfected by the creditor taking possession, rather than by registration, then it should prevail over the third party purchaser.
- (b) Some exceptions will be necessary to the rule that a registered security interest prevails over a subsequent purchaser.
 - (i) It should be provided that a third party purchaser of goods in the ordinary course of the debtor's business will take the goods free of any inventory security interest even if it is registered, unless the purchaser knew of any relevant restriction arising out of the security agreement on the debtor's right to sell the goods. Where the sale is in

violation of a restriction of which the purchaser is unaware, the purchaser would obtain unencumbered title to the goods, but the security interest would continue in the identifiable proceeds of the sale in the debtor's hands (see (d), below).

- (ii) There should also be an exception to deal with the case where goods are purchased from a dealer whether the purchaser is (in turn) a dealer or a private buyer. In that case, the purchaser should prevail, provided the purchase was made in good faith, for value and without notice of the existence of the security interest. The relevance of this exception is to the case where a security interest (not being an inventory security interest) is created by the dealer itself over goods of a kind in which the dealer trades. The rationale is that it would create an undue hindrance to trade if purchasers were expected to search the register for a security interest in these circumstances. The exception should only apply where the goods are of relatively low value. Where the value exceeds (say) \$40,000 (measured by the price the purchaser pays), the holder of the security interest should prevail. In the case of valuable goods, the rationale for the exception does not apply.

- (iii) A third exception is needed to deal with the case where a security interest is registered against the

name of a debtor other than the person with whom the purchaser deals. For example, A creates a security interest in favour of X, and the security interest is registered in X's name; later, A wrongfully sells the asset to B who, in turn, sells it to Y. In these circumstances (assuming X's security interest survives the sale of the asset to B), the purchase (Y) should prevail provided the purchase was made in good faith, for value and without knowledge of X's security interest. The rationale is that a search of the register is unlikely to reveal the existence of the security interest. As in the case of (ii), above the exception should not apply where the value of the asset exceeds (say) \$40,000. The reason is that, the greater the value of the asset, the more cost-effective it becomes for purchasers to take precautions additional to searching the register. The taking of these additional precautions should not be discouraged. Furthermore, the greater the value of the asset the more costly to the financier in a particular transaction would be a rule that favoured the purchaser. Accordingly, if there were no limits on the rule, a likely consequence would be to discourage certain kinds of financing activity.

- (c) Where the security interest is unregistrable in the debtor's name-indexed register (in other words, if it is given to secure a consumer debt) and the creditor has not taken possession, the

applicable rule in the personal property securities statute should vary, depending on whether the purchaser is a dealer or a private buyer.⁴⁶

- (i) If the purchaser is a dealer, then the rule should favour the holder of the security interest. The reason is that, in such a case, the dealer is likely to be better placed than the holder of a security interest to take precautions against the debtor's fraud. The objective of the rule would be to confront second-hand dealers with the incentive to check the credentials of persons from whom they purchase their stock.

- (ii) On the other hand, if the purchaser is a private buyer, then the rule should favour the purchaser, provided the purchase was made in good faith, for value and without knowledge of the existence of the security interest. The reason is that, in such a case, it cannot be said so confidently that the purchaser is the party best placed to take precautions against the debtor's fraud (this is particularly true where the purchaser transacts, not with the debtor directly, but with a dealer to whom the debtor has sold the goods in the meantime). The objective of the rule would be to confront a

⁴⁶ The rules proposed in this paragraph to deal with cases involving consumer debt have no direct counterpart in Article 9. The reason is, in part, that under Article 9 a security interest taken in connection with a consumer debt is registrable, though perfection does not turn on registration. The relevant priority rules are necessarily quite complicated on this account. Generally speaking, though, they tend to favour the third party purchaser.

creditor with the incentive to check the debtor's credentials before making the loan.

- (iii) The rule favouring the purchaser in (ii), above should only apply where the goods are of relatively low value. Where the value exceeds (say) \$40,000, the holder of the security interest should prevail. The rationale is as stated in (b)(iii), above.

These suggested rules come as close as it is likely to prove possible to a principled compromise between the value which underlie the *nemo dat* and *bona fide purchaser* rules, respectively (see para. 1.5.2, above).⁴⁷

- (d) There should be rules, along the lines of the Article 9 model, relevant to the case where collateral is wrongfully disposed of by the debtor, giving the holder of the security interest a claim on the proceeds (see para. 3.1.8, above). The rules should apply in the case of a registered security interest, and also where the security interest is not registrable under any system.

3.4.3 Dispute between holder of security interest and subsequent purchaser: the asset-based statutory rules

How should legislation establishing a specialist asset-indexed register provide for the case of competing claims between the holder of a security interest and a subsequent purchaser? The rules should be as follows.

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A scheme similar to the one described in this paragraph has been adopted in *Chattel Securities Act 1987 (Vic)* and *Chattel Securities Act 1987 (WA)*.

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- (a) (i) First, if the security interest is registered (in the asset-indexed register), then it prevails over the purchaser.
- (ii) If the security interest is registrable under the statute but is not registered and the creditor has not taken possession of the asset, then the purchaser should obtain unencumbered title provided the purchase was made in good faith, for value and without knowledge of the existence of the security interest.
- (b) (i) There will need to be an exception to deal with the case of a registered inventory security interest (see para. 3.4.2(b)(i), above).⁴⁸
- (ii) For certain classes of asset, such as motor vehicles, there should be an exception to deal with the case where the asset is purchased from a dealer by a private buyer. In that case, the purchaser should take the asset free of the security interest, even if it is registered, provided the purchase was made in good faith, for value and without notice of the security interest.⁴⁹ There should be a compensation fund made up of dealers' contributions, out of which the holder of a registered security interest would be paid in the event that the security interest is

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Compare, e.g., *Chattel Securities Act 1987* (Vic), s. 7(1).

49

This is the rule under some of the motor vehicles securities statutes. See, e.g. *Chattel Securities Act 1987* (Vic), s. 7(2); *Registration of Interests in Goods Act 1986* (NSW), s. 9(3).

extinguished by the operation of the rule.⁵⁰ The rationale is that the purchaser is entitled to expect that the dealer will discharge the security interest at the time of the sale. If there is a compensation fund, why not allow the registered security interest to prevail, leaving the purchaser to claim on the fund? The reason is that such a rule would lead to a reverse of the parties' preferred outcomes. It would leave the holder of the security interest in possession of the asset, and the purchaser with a money payment. A swap would then have to be negotiated, involving transactions costs for both parties. The advantage of the proposed rule is that it enables these costs to be avoided.

(iii) Certain qualifications must be made to what has been said in (ii), above:

- The proposed rule should only apply if there is a compensation fund, as described. In the absence of a fund, the rationale underlying the rule is substantially weakened, and there would be insufficient justification for

50 This measure has been adopted in Victoria in relation to motor vehicles. Part V, Div. 2 of the *Motor Car Traders Act* 1986 makes provision for the establishment of a Motor Car Traders Guarantee Fund. Persons who suffer loss as a result of the dealer's default may claim compensation from the Fund, including a financier who suffers loss as a result of the extinguishment of a registered security interest pursuant to s. 7(2) of the *Chattel Securities Act* 1987. The compensation fund should also be open to the holder of a registered security interest (not being an inventory security interest) which is extinguished in the circumstances described in para. 3.4.2(b), above).

derogating from the
paramourcy of the register.⁵¹

- The proposed rule would be inappropriate where there is provision for title registration. In that case, the security interest will be noted on the title, and the purchaser can be expected to conduct a title search. Accordingly, the rationale underlying the proposed rule does not apply.
- The proposed rule would not be appropriate for all classes of asset. Where the purchaser can reasonably be expected to search (assuming there is a register available to search in), the rule should not apply. This is most likely to be the case where the class of asset comprises complex and expensive items of machinery or equipment. Aircraft would be a case in point.

(c) There would be no need for legislation establishing an asset-indexed register to provide for the case of a competition between a security interest which is unregistrable (in that system) and a third party purchaser. That kind of case would be governed by the rules set out in the personal property securities statute (see para. 3.4.2, above).

51 The motor vehicle securities legislation in States other than Victoria is open to criticism on this ground. See, e.g.: *Registration of Interests in Goods Act 1986* (NSW) and *Chattel Securities Act 1987* (WA).

3.4.4 Dispute between successive security holders: the PPSA rules

The case of competing claims to personal property between the holders of successive security interests would need to be provided for in the personal property securities statute, but also in any legislation creating a specialist asset-indexed register. The rules are needed in the specialist legislation to deal with the two kinds of case mentioned in para. 3.4.1, above, namely where: (1) the competing security interests are registrable in the asset-indexed register, but not in the debtor's name-indexed register (being securities given in respect of consumer debts); and (2) there are competing security interests created by different debtors in an asset to which the specialist legislation applies. Outside these cases, the priority rules in the personal property securities statute would apply. The rules to govern this kind of dispute in the personal property securities statute should be as follows.

- (a) (i) As between competing registered security interests, as a general rule priority should be determined according to the order of registration.
- (ii) One issue that will need to be addressed in this connection is whether an exception should be made for the case of a purchase money security interest (see para. 3.1.7, above). Article 9 gives a special priority to purchase money security interests subject to certain conditions. If the purchase money security interest is not perfected (registered) at the time the debtor takes possession of the goods, the creditor has a further ten days to file

and, failing this, the special priority will be lost. Where the asset in dispute is equipment, no more is required. However, where the asset is inventory, there is an additional formality. The party claiming the inventory security interest must give written notice to the holder of the earlier registered security interest that it expects to acquire a purchase money security interest in certain kinds of property. Such a notice remains valid for five years. In the Australian context, an example of the kind of situation in issue is where a debtor creates a floating charge over its stock in trade in favour of Bank A, and subsequently acquires stock from Supplier B pursuant to a Romalpa agreement. In the American law, there is nothing to prevent the holder of an inventory security interest (A) from including a negative pledge clause in the security agreement, effectively prohibiting the transaction with B by making it an event of default. The notification requirement in Article 9 facilitates enforcement by the creditor of such a provision. The consequence is substantially to erode the strength of B's position. Under Professor Diamond's proposals for reform of the law in the United Kingdom, purchase money security interests would be given special priority, subject to a ten day filing rule but there would be no additional notice requirement in cases where

inventory was involved.⁵² It is doubtful whether this concession in B's favour would make much difference in practice.

- (iii) Should there be an exception to deal with the case where a security interest is registered against the name of a debtor other than the person with whom the holder of the later security interest deals (compare para. 3.4.2(b)(iii), above)? The answer is, "no". This is because, in such a case, the holder of the later security interest can take precautions, such as asking the intending borrower where the asset was obtained. The taking of these additional precautions should not be discouraged. There is therefore insufficient reason to detract from the paramountcy of the register. Not to make an exception is unlikely to affect future lending patterns because, over the longer term, a financier is as likely to find itself on one side of the fence as the other.

- (b) In the case of a competition between a registered security interest and an unregistered but registrable security interest, the former

52 Op. cit., paras 11.7.5-11.7.7.

Under the Diamond proposals, a Romalpa agreement would be treated as giving rise to a purchase money security interest only if it was given to secure payment by the purchaser of the price for the goods in question, and only if the interest claimed by the supplier was limited to the goods themselves, and any resale proceeds. Accordingly, an all-monies Romalpa clause would not be treated as giving rise to a purchase money security interest. Nor would a clause which purported to give the supplier a claim to the end product of a manufacturing process in which the goods supplied had been used up: *ibid.* Chapter 17.

should prevail, regardless of the order in which the security interests attached.

- (c) Where the conflict is between two unregistrable security interests, priority should be determined in accordance with the order of attachment.
- (d) The priority achieved for a security interest over another security interest pursuant to any of these rules should not be prejudiced by actual notice of any unregistered security interest (in the absence of fraud).⁵³ The rationale is that the contrary rule, by rewarding ignorance, would discourage the search for information about property in the first place. Also, by favouring the unregistered security interest, it would reduce the incentive to register.⁵⁴
- (e) Where the loan contract contemplates the making of further advances, the priority should extend to all amounts that are lent up to the limit (if any) specified in the financing statement or the loan agreement. Priority in respect of further advances should not be dependent on whether there is any obligation to provide credit. It should be possible for priority to be waived or varied by agreement between the holders of competing security interests.⁵⁵

53 Compare, e.g., *Transfer of Land Act* 1958 (Vic), s. 43 and see Sykes, op. cit 454-455 on the meaning of "fraud" in this context.

54 In the case of a competition between a security holder and a third party purchaser, the policy considerations are different. In that context, the third party should be affected by knowledge of an unregistered security interest, because the contrary rule would encourage fraudulent conversions, by making it easier for the debtor to transfer unencumbered title (see para. 3.4.1, above).

55 This proposed new rule relating to further advances would replace the existing statutory provisions governing tacking: see, e.g., *Property Law Act* 1958 (Vic), s. 94.

3.4.5 Dispute between successive security holders: the asset-based statutory rules

How should legislation establishing a specialist asset-indexed register provide for the case of competing claims between the holders of successive security interests? The rules should be as follows.

- (a) As between competing registered security interests, priority should be determined according to the order of registration.
- (b) In the case of a competition between a registered security interest and an unregistered but registrable security interest, the former should prevail.
- (c) Priority accorded to a security interest pursuant to the legislation should extend to the making of further advances if these were contemplated by the original loan agreement.
- (d) It should be possible for priority to be waived or varied by agreement.⁵⁶

3.4.6 Non-registration and unsecured creditors

The personal property securities legislation should provide that an unperfected security interest is ineffective against the debtor's trustee in bankruptcy or liquidator, and also against an execution creditor.⁵⁷ The rule should be that if a security interest is registered either upon attachment or beforehand, it will take priority over the general body of unsecured creditors in

56 Rules similar to the ones described in this paragraph have been adopted in *Chattel Securities Act 1987 (Vic)*, s. 10 and *Chattel Securities Act 1987 (WA)*, s. 10.

57 The United States and Canadian legislation contains such a provision, though the draft New Zealand bill does not. This feature of the New Zealand bill has been criticised: see Farrar, *op. cit.* 6.

the event of the debtor's insolvency. However, a later registered security interest would lose priority to the unsecured creditors if the debtor's bankruptcy or liquidation commenced within six months after the date of registration. Under the *Corporations Law*, the rule is that the holder of a registrable charge loses priority in the circumstances just described, but only if the charge is not registered within 45 days after its creation.⁵⁸ There is no warrant for the 45 day period of grace. It reduces the reliability of the register, and disadvantages searchers.

3.5 SHOULD THE NEW LEGISLATION DEAL WITH CREDITORS' REMEDIES?

3.5.1 The case for standard remedies

A further matter that will require consideration is whether the personal property securities statute should include provision for the standardisation of remedies, along the lines of Article 9 (see para. 3.1.11, above). The New Zealand draft bill does not deal with remedies, partly because there were time constraints affecting its preparation, and partly because it was felt that remedies could be dealt with more effectively as a separate topic. However, at least one of the architects of the bill has since had second thoughts.⁵⁹ In Australia, the credit legislation contains detailed standard provisions governing a secured creditor's remedies. The basic concepts are the same as in Article 9 (in particular, the comprehensive definition of "security interest").⁶⁰ There are, however, numerous differences of detail, attributable mainly to the fact that the *Credit Act* provisions are concerned with consumer transactions. The question that needs to be addressed is whether there is a case for the enactment of a less restrictive set of standard provisions, applicable to commercial dealings. The concern is that, if remedies are not standardised, the legislation will have been only partially successful in eliminating the formal distinctions between transactions which preoccupy the current law. New standard provisions governing remedies would replace existing legislation, such as the remedies provisions in the surviving hire-purchase statutes, and in the *Property Law Act* 1958 (Vic) and equivalent laws in other States.⁶¹

59 Farrar, *op. cit.* 4-5.

60 See, e.g., *Credit Act* 1984 (Vic), s. 5(1).

61 The hire-purchase legislation should be repealed in any event: see Law Reform Commission of Victoria, *Deregulation of Hire-Purchase* (Report No. 4, 1986).

3.6 SHOULD THERE BE PROVISION FOR TITLE REGISTRATION?

3.6.1 The benefits of title registration

There is some limited provision in Australia already for the registration of title to certain kinds of personal property (see para. 1.5.4, above), and consideration should be given to extending other asset-indexed registers to cover title. The strongest case for this kind of reform is in relation to motor vehicles. In most states of the United States, there are motor vehicle title registration schemes. The advantage of title registration is that it offers protection in the case of stolen property (see para. 1.4.1, above). However, a secondary benefit is that where there is a certificate of title, security interests can be endorsed on it, and this obviates the need for intending purchasers to conduct a register search (see para. 11.15, above). The method of integrating a title registration statute with the personal property securities legislation would be essentially the same as in the case of any other asset-indexed registration scheme (see para. 11.8, above).

3.6.2 Indefeasibility of title

Under a title registration statute, a registered title would be indefeasible, except in the case of fraud. The rules in this regard should be the same as in the case of the Torrens system of land registration.⁶² Similarly, a registered title would (in the absence of fraud on the part of the title holder) take priority over an unregistered or subsequently registered interest in the asset. Subject to this, the rules set out in para. 3.4.3, above for dealing with the case of a competition between the holder of a prior security interest and a subsequent purchaser would apply. Provision would need to be made for the case

62 See, e.g. *Transfer of Land Act 1958* (Vic), ss 42 and 43. See Sykes, loc. cit. for the meaning of "fraud" in this context.

where an asset is sold by the registered owner, subject to reservation of title as security for payment of the price. In these circumstances, the seller should be entitled to remain registered as the owner until paid, and should not be required to re-register its interest in the asset as a security interest. The seller's interest would, however, be registrable as a security interest in the debtor's name-indexed register.

3.7 WHAT ABOUT LAND?⁶³

3.7.1 Land not a special case

The reference to title registration in para. 3.6 above raises obvious questions about the viability of extending the reform proposals canvassed in this paper to cover land dealings. Historically, land has always been treated differently from personal property. The difference in treatment might be attributed to the permanence and lack of mobility of land. However, land can rise above the waves or fall below them and, of more likely relevance, strata titles depend on buildings that can be pulled down as well as constructed. In the 19th century, the development of the Torrens system of registration of both ownership and security interests in land represented a major advance. It is worth noting, however, that this system was developed from the United Kingdom shipping register which is still reflected in the Register of Ships established pursuant to the *Shipping Registration Act* 1981 (Cth). In truth, there is no material difference between land and other property, and no good reason why competing claims to land should be resolved differently from the way they are resolved in the case of personal property. Indeed, because Torrens system registration covers title interests as well as security interests, it plays a very useful part in resolving

63 See the preface in relation to the Queensland Commission's position in relation to the following paragraphs.

competing claims of ownership to land, as well as in resolving disputes between owners and the holders of security interests, and between the holders of competing security interests.

3.7.2 Relationship between land registers and personal property security registers

The Torrens system register is an asset-indexed register of title and security interests. It could be accommodated within the scheme proposed above in much the same way as the other asset-indexed registers that have already been referred to. In particular: (1) competing claims to ownership would continue to be resolved, as at present, by reference to the rules in the Torrens system legislation; (2) the Torrens system legislation would also be the paramount scheme for determining disputes between the holder of a prior security interest and a subsequent purchaser; but (3) the proposed new debtor's name-indexed register would become the paramount scheme for determining priority claims between competing security interests in land created by the same debtor,⁶⁴ and also between the holder of a security interest in land created by a particular debtor and the debtor's unsecured creditors.

3.7.3 Tacking

The priority which goes to the holder of a security interest in respect of further advances should be the same whether the asset in question is land or personal property. At present, in the case of Torrens system land, the position is governed by the equitable rules relating to tacking.⁶⁵ These are different from the statutory rules that apply where other kinds of property

64 A dispute between competing security interests in land created by different debtors would be subject to the priority rules in the Torrens system legislation. The reason for this is explained in para. 11.10, above.

65 *Metzner v Clyde Securities Ltd* [1975] 2 NSWLR 293; *Mercantile Credits Ltd v ANZ Banking Group Ltd* (1988) 48 SASR 407.

are involved,⁶⁶ and different again from the rules that apply in the case of a security interest that is registrable under the *Corporations Law* (see para. 2.2.4, above). All these rules are unnecessarily complicated and lacking any firm basis in principle. An advantage of bringing Torrens system land within the proposed new scheme is that the simple rule governing security for further advances set out in para. 3.4.4(e), above would apply in all cases regardless of the kind of property that was involved. This is as it should be.

3.7.4 Multiple registrations and searches

There is a further advantage to be gained from including land in the proposed reform process. If a security interest in land were registrable in the proposed new debtor's name-indexed register of security interests, the kinds of problem that presently arise under the *Corporations Law* in the case of a competition between security interests covering both land and other property would be avoided. Moreover, it would become possible for an intending creditor to discover, in a single search, all the assets (real, as well as personal) that were the subject of existing security interests created by the debtor. The co-existence of the two kinds of register would give rise to the need for dual registration and search. The creditor would need to register in the debtor's name-indexed register in order to obtain priority over competing security interests, and over unsecured creditors in the event of the debtor's insolvency. It would also need to register in the asset-indexed register (the Torrens system register) in order to gain protection against the risk of a fraudulent disposition of the property by the debtor. Correspondingly, searchers would need to look in the debtor's name-indexed register to check for existing encumbrances. They would also need to look in the asset-indexed register to be sure of the debtor's

ownership. However, there is nothing special in these respects about the case of land, and they are no particular cause for concern (see para. 3.3.8, above).

CONCLUSION

4.1 IS IT WORTH THE TROUBLE?

4.1.1 The pain

The proposals canvassed above involve radical changes to the present law. They would: lead to the ascendancy of substance over form in the regulation of security transactions; involve the repeal of long familiar legislation, including the registration of charges provisions in the *Corporations Law* and the bills of sale statutes; and bring in a whole new regime of priority rules to govern competing claims to personal property. It will take lawyers and their clients some time to acclimatise themselves to the new order. In these circumstances, the status quo must inevitably hold some appeal. It is tempting to assert that the present system works well enough, and that the pain associated with moving to a new system would be too much.

4.1.2 A transitory problem only

However, several things need to be borne in mind. First, although no doubt there would be some pain inflicted by the changes, it is pain of a transitional nature. Over the past 20 years, the Canadians, one province after another, have been moving from a system very like the Australian one to the Article 9 model. In no case have the transitional pains proved to be unbearable. On the contrary, although faults have been found with the new system, there is no enthusiasm at all for a return to the old regime. The attitude in America is similar though, there, because the reforms were undertaken earlier, there are perhaps fewer whose memories stretch back to the pre-Article 9 days.

4.1.3 The costs of the present system

Though the Article 9 solution might at first glance seem to be complicated, that is mainly because it is unfamiliar. It is in fact a reform which, if implemented properly, will significantly simplify the law. The costs attributable to the inefficiencies in the present system are undoubtedly very large. They include the costs associated with: (1) the business uncertainty that is created by priority rules that are both unnecessarily complicated and for the most part unprincipled; (2) an excessive commitment by Government to administration, in the running of multiple registers; (3) requirements imposed on business for multiple registration and searching; and (4) excessively restrictive statutory requirements which impede the transacting process and stifle innovation. The transitional costs of reform are likely to prove small compared with the costs of the present system. That is why, as mentioned above, neither the Canadians nor the Americans have any desire to turn back the clock.

4.1.4 Impact on business practices

The final point is that the changes in question are for the most part changes in the legal environment. If the reforms are implemented properly, they will not require significant changes to the way in which business is carried on. Firms will be free to enter into the same kinds of transaction as they presently do, using more or less the same processes as they presently do. In fact, a wider range of transactions may be possible as a result of the removal of regulatory restrictions, while the transacting process itself should be simplified. Few, if any, changes will be required to existing security documents. The most obvious change to the transacting process is that registration of security interests will be required in a wider range of circumstances than it is at present. However, given the ease of registration, creditors should have little difficulty adapting. The New

Zealand Law Commission consulted widely in the course of formulating its proposals for reform, and the reaction from lawyers and industry in particular confirmed them as being "long overdue, sensible and appropriate".⁶⁷ There is no reason why the response in Australia should be any different.
