

# Personal Property Securities Reform

**James Popple**  
**First Assistant Secretary**  
**Personal Property Securities Division**  
**Australian Attorney-General's Department\***

## Introduction

When a credit provider provides credit to an individual or a business, the debt is often secured by the credit provider taking a security interest in property, known as *collateral*, which the borrower owns or has an interest in. If the collateral is real estate (including fixtures), or an interest in real estate, the security interest is a *real property security*. Security interests in other types of property are *personal property securities* (PPS). Personal property includes tangible property (such as goods, livestock and equipment) and intangible property (such as receivables and intellectual property).

## Why is reform necessary?

There are more than 70 separate Acts that regulate PPS in Australia. Each of the six States, two Territories and the Commonwealth has its own PPS schemes and registers. This abundance of legislation is due to the fact that there has not previously been a single, considered approach to PPS law in Australia. Instead, the law has developed through intermittent legislative and judicial intervention over many years. This intervention has occurred separately within each jurisdiction, in response to specific needs as they have arisen, and has resulted in considerable inconsistency in PPS arrangements across Australia.

PPS law in Australia is very complex, and varies according to: the location of the collateral; the nature of the collateral; and whether the debtor is a corporation or an individual.

At the Commonwealth level there are several PPS registers, which apply consistently regardless of the location of the collateral, but which treat different collateral differently. For example, there is a register of company charges, a register of ships and a register of trade marks, all created by Commonwealth legislation.<sup>1</sup>

There are some types of collateral that can be registered in all States and Territories. Examples include the various Bills of Sale Acts<sup>2</sup> and legislation providing for the registration of securities in motor vehicles.<sup>3</sup> Different State and Territory Acts deal with liens on crops, wool and stock, but they are not consistent in their registration requirements and in the consequences of registration.

There are also some types of collateral that can be registered in only some States and Territories, sometimes only on registers established exclusively for one type of collateral.<sup>4</sup>

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\* This paper has been prepared with assistance from Robert Patch, Alexander Daniel and William Barr, who also work in the Personal Property Securities Division of the Attorney General's Department.

<sup>1</sup> See the *Corporations Act 2001*, the *Shipping Registration Act 1981* and the *Trade Marks Act 1995*.

<sup>2</sup> *Bills of Sale Act 1886* (SA); *Bills of Sale Act 1898* (NSW); *Bills of Sale Act 1899* (WA); *Bills of Sale Act 1900* (Tas) and *Bills of Sale and Other Instruments Act 1955* (Qld).

<sup>3</sup> *Sale of Motor Vehicles Act 1977* (ACT); *Registration of Interests in Motor Vehicles and Other Goods Act 1983* (NT); *Motor Vehicles Securities Act 1984* (Tas); *Registration of Interests in Goods Act 1986* (NSW); *Motor Vehicles and Boat Securities Act 1986* (Qld); *Goods Securities Act 1986* (SA); *Chattel Securities Act 1987* (Vic); *Chattel Securities Act 1987* (WA).

<sup>4</sup> For example, South Australia has the *Liens on Fruit Act 1923*; Queensland has the *Liens on Crops of Sugar Cane Act 1931*.

As a result of this complexity, PPS law in Australia is unnecessarily uncertain. This uncertainty leads to higher transaction costs, and might dissuade a potential borrower or lender from entering into a credit transaction and/or registering it.

As detailed below, the Australian Government and the States and Territories have recently agreed to establish a single national PPS system. One important result of this reform will be that lenders will have the ability to register security interests in relation to property where they might not have been able to before or (if they had been able to) they would have had to comply with a different regime depending on the jurisdiction (or jurisdictions) in which they wanted to register.

So, for example, book debts owed by a partnership (which are currently only registrable in Queensland) will, with the implementation of the new system, be registrable anywhere in Australia. The registration process, and the consequences of registration, will be consistent across all jurisdictions.

### Reform process

PPS law was reformed in the United States in 1952 when Article 9 of the original edition of the *Uniform Commercial Code* was promulgated. Various Canadian provinces have PPS legislation based on Article 9. The register established in New Zealand by the *Personal Property Securities Act 1999* came into operation in 2002.

In Australia, work on reforming PPS law started as early as 1971.<sup>5</sup> An Australian Law Reform Commission report and draft bill was published in 1993.<sup>6</sup> The Australian Government published a discussion paper in 1995.<sup>7</sup>

The then Banking Law Association established a committee with representatives of interested stakeholders whose work culminated in a draft bill that was discussed at a special Workshop held at Bond University in 2002. The proceedings of this workshop were published in a special issue of the *Bond Law Review*.<sup>8</sup>

The drive to reform PPS law received fresh impetus when the Australian Government put reform of PPS law on the agenda of the Standing Committee of Attorneys-General (SCAG). A SCAG options paper was released in April 2006.<sup>9</sup> A series of seminars was held in May 2006. The response to the options paper and at the seminars was generally supportive of a single national PPS regime based on a functional approach (see below) that included a single national online register.

In July 2006, the Australian Attorney-General released a report prepared by Access Economics on the proposed PPS reform. It concluded that 'PPS reform is, in principle, an obvious and worthwhile microeconomic reform to pursue', and that, if done well, it will realise 'significant net gains'.<sup>10</sup> That same month, the Department hosted a policy development workshop in Sydney involving a number of presenters with experience of PPS in Canada and New Zealand. This workshop offered participants the opportunity to discuss issues relating to PPS, to ask questions about the reforms, and to hear from those from jurisdictions where PPS reform had been successfully implemented.

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<sup>5</sup> The 1971–72 report of the Molomby Committee, an ad-hoc committee of the Law Council of Australia: see David E. Allan, 'Uniform personal property security legislation for Australia: Introduction to the workshop on personal property security law reform', (2002) 14 *Bond LR* 1 at 2.

<sup>6</sup> Australian Law Reform Commission, *Personal Property Securities*, 1993, ALRC 64.

<sup>7</sup> Australian Attorney-General's Department, *Personal property securities: A national approach*, 1995.

<sup>8</sup> (2002) 14 *Bond LR*

<[http://www.bond.edu.au/study-areas/law/publications/BLR/vol14-1/index\\_vol14\\_1.html](http://www.bond.edu.au/study-areas/law/publications/BLR/vol14-1/index_vol14_1.html)>.

<sup>9</sup> Australian Attorney-General's Department, *Review of the law of personal property securities, options paper, Standing Committee of Attorneys-General*, April 2006.

<sup>10</sup> Access Economics, *The costs and benefits of personal property securities (PPS) reform*, 6 July 2006, p. 24.

In July 2006, the Council of Australian Governments (COAG) added PPS to its list of agreed areas for cross-jurisdictional regulatory reform.<sup>11</sup> At that meeting, COAG also endorsed the development of a national PPS scheme and asked SCAG to report back to it on progress with developing options and timeframes for implementing a national system.<sup>12</sup>

In September 2006, the Attorney-General established the PPS Review Consultative Group to advise on PPS reform. The Consultative Group consists of high level business, professional, academic and government representatives, and includes representatives of banks and finance companies (such as the Australian Bankers' Association and the Australian Finance Conference) and lawyers (including representatives of the Law Council of Australia). Also represented are the States and Territories, the Ministerial Council on Consumer Affairs, the Motor Traders' Association of Australia, the Australian Consumers' Association and (from the Australian Government) the Attorney-General's Department, the Treasury, the Australian Securities and Investments Commission and the Inspector General in Bankruptcy.

At its first meeting, in September 2006, the Consultative Group proposed that the Australian reforms be benchmarked against the recent reforms in New Zealand.

In 2006–07, the Attorney-General issued three discussion papers on PPS reform, prepared by the Attorney-General's Department in consultation with State and Territory officers and the Consultative Group. These discussion papers highlighted various issues that the reform will need to address, and invited public comment on various questions. The topics, and dates of release, of these discussion papers were:

1. Registration and search issues (November 2006)
2. Extinguishment, priorities, conflicts of laws, enforcement, insolvency (March 2007), and
3. Possessory security interests (April 2007).

A large number of stakeholders and other interested people made submissions in response to these discussion papers. These comments are being taken into account in the development of PPS policy and legislation.

These three discussion papers, and other documents relevant to PPS reform in Australia, are available on the Attorney-General's Department's PPS website: <<http://www.ag.gov.au/pps>>.

In April 2007, COAG agreed in principle to establish a national PPS system. COAG agreed that the system would be implemented by 2009, would be funded by the Commonwealth and implemented by Commonwealth legislation supported by a referral of power from the States. This in-principle agreement was subject to further consideration of financial arrangements.<sup>13</sup> Immediately after the COAG decision, the Personal Property Securities Division was established in the Attorney-General's Department.

The Commonwealth Parliament already has the power to legislate for the vast majority of PPS transactions using the corporations, bankruptcy and insolvency, banking and inter-state trade and commerce powers.<sup>14</sup> Nearly all lenders and commercial debtors are corporations. And, regardless of the nature of the lender or debtor, the enforcement of security interests usually only becomes a matter of practical concern in the context of bankruptcy or insolvency. A referral of powers from the States will ensure that Commonwealth PPS legislation will also apply to that very small class of transactions not covered by Commonwealth legislative power, ensuring that the new PPS scheme is of national application.

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<sup>11</sup> COAG has identified ten 'regulation "hotspots" where cross-jurisdictional overlap is impeding economic activity': COAG communiqué, 14 July 2006, pp. 7–8. In addition to PPS, these include rail safety regulation, occupational health and safety, national trade measurement and product safety. COAG communiqués, and related documents, can be accessed at <<http://www.coag.gov.au/>>.

<sup>12</sup> COAG communiqué, 14 July 2006, Attachment E.

<sup>13</sup> COAG communiqué, 13 April 2007, p. 2; Supplementary Information: *COAG regulatory reform plan*, pp. 3–4.

<sup>14</sup> Constitution, sections 51(xx), 51(xvii), 51(xiii) and 51(i), respectively.

In May 2007, the Australian Government announced that it will provide \$113.3 million over five years to harmonize PPS laws in one Commonwealth Act and to develop a single national online PPS register.<sup>15</sup> It is intended that this register will be searchable 24 hours a day, 7 days a week on the web, and (in relation to motor vehicles) searchable using SMS from a mobile phone. The register will also allow for business-to-government connections for users such as banks and finance companies with a significant number of transactions. States and Territories, whose road traffic authorities may want to access the new register, which will be replacing their existing REVS (Register of Encumbered Vehicles) registers, will also be users of the new register. The register will operate on a cost-recovery basis, which is estimated to offset the budget funding by approximately \$62.9 million by the end of 2010–11.

### **Policy objectives**

The objectives of PPS reform in Australia are to increase legal certainty in relation to PPS, by increasing consistency and reducing complexity, which should lead to reduced costs for business.

There has been some suggestion that the proposed new scheme will be more complex than the existing arrangements.<sup>16</sup> The new Australian PPS Act will contain priority rules that will cover transactions currently covered by more than 70 Acts, and other transactions as well. These rules will be expressed simply, and in one place, greatly increasing the transparency of PPS law in Australia. And, of course, not all of the priority rules set out in the new Australian PPS Act will apply in each situation. Only certain priority rules will apply for a particular transaction and these rules will often be no more complex than they are now, in some cases less complex. For these reasons, this reform will simplify the existing situation in Australia.

Increasing certainty and consistency, and reducing complexity, should result in reduced transaction costs for lenders, which should, in turn, reduce the costs to borrowers.

### **Reform strategy**

At present, the application of PPS law to a transaction generally depends on the form of that transaction. The new PPS system will be based on a *functional* approach, by looking to the substance of a transaction. The new scheme will start from the premise that, if the substance of a transaction is to secure a payment or performance of an obligation, then the transaction will be treated as creating a security interest.

This approach will mean that some transactions which are not currently treated as security interests will be treated as such. (This will apply only for the purposes of the PPS legislation; it will not affect concepts in other areas such as accounting standards and taxation.) For example, a lease of more than one year, an interest created by an assignment of an account receivable, and a commercial consignment will all be deemed security interests. This will increase certainty and transparency for third parties in relation to these transactions.

The High Court took a functional approach in *General Motors Acceptance Corp Australia v Southbank Traders Pty Ltd*.<sup>17</sup> The Court held that a retention of title arrangement for motor vehicles was a security interest for the purposes of the Victorian *Chattel Securities Act 1987*. In its decision, the Court looked at the purpose of the arrangement, rather than its form, and concluded that the arrangement was in substance a security agreement.

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<sup>15</sup> Commonwealth of Australia, *Budget Paper No. 2, Budget Measures 2007–08*, 8 May 2007, p. 79.

<sup>16</sup> Angela Flannery and Greta Burkett, 'Personal property securities law reforms: An update', (2004) 18 *Journal of Banking and Finance Law and Practice* 143.

<sup>17</sup> [2007] HCA 19.

The new PPS Act will treat security interests differently only where there are policy reasons to do so, not just to reflect the previous ad hoc development of the law. The most significant example of this will be the preservation of consumer safeguards in consumer credit transactions: the Consumer Credit Code<sup>18</sup> will not be affected by the new PPS Act. Another example, discussed in more detail below, is the determination of priorities of interests in investment property.

### **Some issues**

The consultation process, including comments made on the three discussion papers, has highlighted several significant policy issues for resolution in the development of the new PPS Act. Some of these are set out below.

#### *Duration of registration*

In New Zealand, a financing statement is effective for up to 5 years. The rule is the same as the rule in the USA, though limited exceptions apply (for example, a limit of 30 years applies to public finance transactions and manufactured homes). In Canada, it is possible to register financing statements for 1 to 25 years, or with no limit (except in Ontario, which has a maximum of 5 years for consumer goods).

A number of Australian stakeholders have expressed concern that inadvertent loss of priority will flow from a failure to re-register financing statements. These stakeholders support the Canadian approach (that is, possibly no limit to registration), with a maximum of 7 years for consumer goods. Other stakeholders are concerned that the duration of registrations should be limited so as to avoid cluttering the register with financing statements that have, in fact, expired. After all, creditors will be in a position to search the register for those of their own registrations that are close to expiry, so as to be able to renew them if appropriate. Put most simply, the concern is that inefficient creditors will have an incentive to clutter the register by specifying unnecessarily long registration periods and failing to remove expired registrations, at the expense of otherwise more efficient users of the register who will be forced by competitive pressures to follow suit.

#### *Close or exact match searching?*

The Australian PPS register could have a close match or an exact match searching system. New Zealand provides for an exact match system, but with a wildcard option. Canada (except Ontario) and the USA employ a close match system. In Australia there is stakeholder support for a very close match system, one that would allow for typographical errors but otherwise function as an exact match system. One strategy for partially addressing this issue might be to encourage use of Australian Company Numbers and Australian Business Numbers—combined with validation of these numbers against the relevant register.

#### *Effectiveness of unregistered security interests on insolvency*

The effect of an unregistered security interest on insolvency differs between jurisdictions. In New Zealand, despite it not being registered, a security interest can be enforced (though there will be priority consequences as a result of the failure to register). In North America, an unregistered security interest is unenforceable.

In Australia there is very strong stakeholder support for the North American model. This would provide greater certainty for the insolvency process.

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<sup>18</sup> The Consumer Credit Code, set out in the appendix to the *Consumer Credit Act 1994* (Qld), applies in all States and Territories through legislation in each of those jurisdictions.

### *Effectiveness of anti-assignment clauses in contracts for accounts receivable*

In New Zealand, a debtor may enforce a contract prohibiting or restricting the assignment of a debt. In North America (except Ontario), a debtor may not enforce such a contract against a person to whom the debt has been assigned, but may enforce the contract against the assignor to the extent that the assignor is liable in damages for breach of contract.<sup>19</sup> Some stakeholders have suggested that Australia should follow the North American approach. Comments on this issue are especially welcome, as the issue was not raised directly in any of the three discussion papers. The North American approach appears to provide greater certainty for those in the debt markets, and is also consistent with the United Nations convention on the Assignment of Receivables in International Trade.

### *Provision of notice when claiming a PMSI*

A purchase money security interest (PMSI) is a security interest that finances all or part of the purchase price of the collateral. A PMSI may have priority over non-PMSI interests in the same collateral, despite its registration being later in time. For example, a general financier will have a security interest in a debtor's assets generally and an inventory financier will take a PMSI in relation to the debtor's inventory it has financed. In this example, the PMSI would have priority over the general security interest.

In New Zealand, a secured creditor claiming a PMSI does not have to give notice of the PMSI to earlier registered secured parties. In North America, a secured creditor claiming a PMSI in inventory must give notice in writing to any person who has an earlier registration over the same inventory. Australian stakeholders have generally supported the inclusion of a requirement to give notice in the new legislation.

### *Agricultural PMSIs*

An agricultural PMSI is an advance made to finance crops planted in the next six months or currently growing (for example, for seeds, planting, care and harvesting a specific crop).

In New Zealand there is no specific priority rule for crops. In North America, a PMSI in a specific crop will have priority over another security interest in that crop, such as a security interest in all of the debtor's property. Australian stakeholders have generally supported the inclusion of an agricultural PMSI in the legislation.

### *Priority rules for investment property*

The new PPS Act will determine priorities as between secured parties, which becomes particularly relevant when a debtor reaches a point where they are not able to repay all of their creditors. For most security interests, priority will be determined on the basis of the first party to register or have possession of the collateral. However, this overarching priority rule may not be suitable for all situations.

For some assets (for example, investment property such as shares, interests in registered managed investment schemes and quoted securities), registration may not be practical because the assets are frequently traded. A requirement to register interests in these assets would add disproportionate costs to transactions. For some assets, particularly intangible assets, it may be difficult to determine who has possession of the asset.

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<sup>19</sup> See also Roy Goode, 'Contractual prohibitions against assignment', paper presented to the 24th Annual Banking and Financial Services Law and Practice Conference, Adelaide, 10–11 August 2007.

For this investment property, it is intended that priority will be determined on the basis of possession (where that is practicable) or control (where a possession test is not practicable). So, for example, a control test could be used to determine priority issues for quoted securities that are subject to a control agreement between the issuer, debtor and the sponsoring broker. This would depart from the New Zealand approach, which makes no distinction between possession and control of investment property, but would be similar to the approach taken in the USA and Ontario where that distinction is made.

### **Next steps**

In April 2007, COAG asked SCAG to prepare an inter-governmental agreement on referral of powers for COAG's consideration.<sup>20</sup> Officers of the Commonwealth and State and Territory governments are working on the drafting of this agreement, and on the migration of data from existing State and Territory PPS registers into the new national register.

The Attorney-General's Department is preparing a draft PPS Bill which, subject to Australian Government approval, will be released as a consultation draft for comment before being introduced into the Commonwealth Parliament. State and Territory governments will be preparing consequential legislation to facilitate the decommissioning of existing State and Territory PPS registers and the movement to a national scheme.

The Attorney-General's Department will go to tender, probably before the end of 2007, for systems integration services to build the new PPS register.

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<sup>20</sup> COAG communiqué, 13 April 2007, supplementary information: *COAG regulatory reform plan*, p. 4.