

# Personal Property Securities Reform and Security Interests in Ships

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## *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 ships, motor vehicles, 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 and nature of the collateral; the nature of the security interest; and the legal personality of the debtor (for example, 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,

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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);

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>

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>

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*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*.

<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)>.

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 Attorney-General’s 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.

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).

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<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.

<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.

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 commercial lenders are corporations. And, regardless of the nature of the lender, 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.

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.

There has been some suggestion that the proposed new scheme will be more complex than the existing arrangements.<sup>16</sup> This is incorrect. 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

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<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.

<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.

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 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 legal 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 coming to 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.

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 is the priority rules that are proposed to apply to investment property.<sup>19</sup>

### ***PPS reform and ships***

#### ***Registering ships***

The registration of Australian ships is currently governed by the *Shipping Registration Act 1981* (Cth). State and Territory legislation imposes various registration requirements, but these relate to the use of ships rather than to their ownership.<sup>20</sup>

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

<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.

<sup>19</sup> James Popple, 'Personal Property Securities Reform', paper presented to the 17th Annual Credit Law Conference, Gold Coast, 19–21 September 2007.

<sup>20</sup> For example, the *Transport Operations (Marine Safety) Act 1994* (Qld), the *Marine Safety Act 1998* (NSW) and the *Marine Act 1988* (Vic).

The Act provides that every Australian-owned ship shall be registered under the Act,<sup>21</sup> but exempts from this requirement ships that are less than 24 metres in tonnage length, Government ships, fishing vessels and pleasure craft.<sup>22</sup> But Australian-owned ships may be registered even if registration is not required.<sup>23</sup> An offence is committed under the Act if an unregistered ship departs from an Australian port<sup>24</sup> or, with some provisos, leaves a foreign port.<sup>25</sup>

The Australian Maritime Safety Authority (AMSA) operates the register, and a list of registered ships is accessible on the web.<sup>26</sup> More than 93% of ships currently registered are not required to be registered.<sup>27</sup> The accessible list includes each ship's name, type, length, year of completion, home port and registration status. To ascertain the registered owner of a ship, or whether there is a mortgage or caveat over a ship, an application must be lodged with AMSA.

### *Registering a security interest in a ship*

Part III of the Shipping Registration Act makes provision for transfers, transmissions and mortgages in relation to registered ships.<sup>28</sup> It also provides that '[a] ship or a share in a ship may be made a security for the discharge of an obligation by way of a mortgage' under the Act and that, as soon as practicable after the lodgement of a mortgage instrument, the Registrar shall register the mortgage on the register and endorse the mortgage instrument with the date and time of its registration.<sup>29</sup>

Mortgages are to be registered in the order of their lodgement<sup>30</sup> and the priority of mortgages in the same ship, or share of a ship, is determined by the order of their registration 'notwithstanding any express, implied or constructive notice'.<sup>31</sup>

Creditors looking to take a security interest in a ship are still very much reliant on paper-based search requests and registration. And a cautious secured lender would have to make an application to search the shipping register, lodge their mortgage instrument, and perform a further search to ensure that another mortgage over the same ship had not been lodged before theirs. If another interest had been lodged during that time, it would have priority.<sup>32</sup>

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<sup>21</sup> *Shipping Registration Act 1981*, section 12.

<sup>22</sup> Section 13. The terms 'Government ship', 'fishing vessel' and 'pleasure craft' are defined in section 3.

<sup>23</sup> Section 14, which also provides for the registration of other specified craft which are Australian-owned or on demise charter to Australian-based operators.

<sup>24</sup> Section 68.

<sup>25</sup> Section 69.

<sup>26</sup> <[http://www.amsa.gov.au/Shipping\\_Registration/List\\_of\\_Registered\\_Ships/](http://www.amsa.gov.au/Shipping_Registration/List_of_Registered_Ships/)>.

<sup>27</sup> As at 13 September 2007, 9758 ships were listed as registered. Of these, 9136 were less than 24 metres in length, fishing vessels or pleasure craft.

<sup>28</sup> See section 34.

<sup>29</sup> Section 38.

<sup>30</sup> Subsection 38(4).

<sup>31</sup> Section 39.

<sup>32</sup> As explained below, the new PPS register will simplify this process.

### *Ships under a PPS register*

The Shipping Registration Act meets Australia's obligations, under Article 94(2) of the United Nations Convention on the Law of the Sea, to maintain a register of ships. Although the Act also allows the registration of mortgages on that same register, the Convention does not require that it do so.

As explained above, the strategy behind PPS reform is to treat all security interests the same as far as is possible, with all PPS interests registered in one place, and subject to one Act. If security interests in ships are treated as not being an exception to this approach, then those interests would be registrable on the new PPS register only, and not on the shipping register. Obviously, this could cause inconvenience for those searchers that need to search both registers. But this inconvenience could be minimised by providing links between the shipping register and the PPS register so that people searching one could be directed seamlessly to the other. And there will be an advantage for some searchers in all security interests in ships, and in their associated equipment, being on one register.

If security interests in ships are treated no differently from interests in other property, then the current restrictions on the sorts of interests that can be registered would not apply. Currently, only mortgages<sup>33</sup> and caveats<sup>34</sup> can be registered. Under the proposed PPS Act, other forms of security interests in ships could also be registered: for example, a lease of more than 12 months. And, because it will be possible to register an interest on the PPS register before it *attaches* (for example, before the security agreement is entered into) the cautious secured lender can be assured of the priority of their interest before taking that interest: once the security agreement is entered into, its priority will date from its registration. It would even be possible to register a financing statement in relation to a ship while it is under construction, so that the security interest would remain attached during construction and beyond completion.

### ***Duration of registration***

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. Of these, the issue of most relevance to security interests over ships is the question of the duration of registration.<sup>35</sup>

In New Zealand, a financing statement is effective for up to 5 years. The rule is the same in the USA, though some exceptions apply there (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).

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<sup>33</sup> *Shipping Registration Act 1981*, sections 38–44A.

<sup>34</sup> Sections 47A–47E.

<sup>35</sup> Other issues are set out in James Popple, 'Personal Property Securities Reform', paper presented to the 17th Annual Credit Law Conference, Gold Coast, 19–21 September 2007.

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.

### *Next steps*

In April 2007, COAG asked SCAG to prepare an inter-governmental agreement on referral of powers for COAG's consideration.<sup>36</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 Department will go to tender, probably before the end of 2007, for systems integration services to build the new PPS register.

This paper has explained some of the possible effects of PPS reform upon the law relating to security interests in ships. As the new national PPS system is developed, the Department welcomes comments on these reforms.

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<sup>36</sup> COAG communiqué, 13 April 2007, supplementary information: *COAG regulatory reform plan*, p. 4.