Review of the
Personal Property Securities Act 2009

Submission of

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Supplemental to our submission of 6 June 2014 on issues affecting small business

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Review of the PPSA

1. Introduction

1.1 Who we are

We are large Australian law firms which each have significant corporate financing and insolvency practices.

1.2 Our experience

Since the inception of the reform process which introduced the Personal Property Securities Act 2009 (Cth) ("PPSA") and the Personal Property Securities Regulations 2010 (Cth) ("PPS Regs"), we have seen them operate in practice in a wide variety of transactions and have advised a wide variety of business clients on them. We regularly undertake registrations and searches on the Personal Property Securities Register ("PPSR"). Members of our firms have published numerous articles and contributed chapters to various books in connection with PPSA. We lecture on the PPSA at universities and regularly speak at industry conferences in Australia.

1.3 Our approach to this submission

This submission is supplemental to our submission of 6 June 2014 on the issues affecting small business. We have focussed in this submission on issues that are relevant to all businesses. However, these issues may also affect small businesses. Similarly, many of the issues raised in our earlier submission also affect large businesses and so should not be seen as being relevant only to small businesses.

2. Issues

2.1 Interests to which the Act does not apply – s8

| 8(1)(f)(vi) | We query why this provision does not also exclude assignments of chattel paper that are made to facilitate collection, rather than just assignments of accounts made for that purpose. |

2.2 Definitions of land and fixtures – s10

The application of the PPSA to land and fixtures should be clarified by deleting the reference to fixtures from the definition of "land" and deleting the definition of "fixtures".

We consider this is desirable for the following reasons:

a) **It will eliminate concerns that fixtures and land under the PPSA have a different meaning to the common law meaning.** The inclusion of a definition of "fixtures" raises the question as to whether it is intended to alter the common law meaning of fixtures (and land) for the purposes of the
It is our view that the definition of fixtures is intended to reflect the common law meaning. If that is the case, the simplest way to ensure that this is achieved is by deleting the definition of "fixtures" and removing the reference to fixtures from the definition of "land".

b) It will result in consistent treatment of payments in connection with land and fixtures. Under the current provisions, security interests in payments "in connection with" specifically identified land are excluded from the PPSA under s8(1)(f)(ii) but security interests in those same payments are not excluded if they are in connection with fixtures. This arises because the definition of land excludes fixtures. For example, if rights to repayments under a mortgage of land or to the rent under a lease of land are transferred, to the extent that the mortgage or lease is only over bare land specifically identified in the transfer agreement, the transfer is excluded under s8(1)(f)(ii) on the basis that they are payments in connection with an interest in land. However, if the property being mortgaged or leased includes fixtures, there is no exclusion for transfer of repayments or rent to the extent they are in connection with them. Is this difference intended? If so, what is the policy justification since at common law, a fixture is an item of tangible personal property that is annexed to land in such a way as to become a part of the land?

The legislative history of the provisions dealing with fixtures further suggests that there was no intention to alter the common law meaning of land or fixtures. The exclusion for fixtures in s8(1)(j) was a relatively late addition to make it clear that the PPSA would not apply to fixtures. It was made because it was originally intended that the PPSA would include rules to regulate priority between security interests in fixtures and interests in land but these fixtures provisions were not ultimately included in the PPSA.

Fixtures provisions were included in the Exposure Draft Personal Property Securities Bill (May 2008) ("First Bill") and they were referred to in the Commentary on the First Bill: See Personal Property Securities Bill 2008 - Commentary (May 2008) at paras 8.10 to 8.15. Personal property was defined to mean "property…other than land": First Bill, s19. Land was defined to mean land within the meaning of State and Territory real property legislation "(other than fixtures affixed to the land)" First Bill, s19. No definition of "fixtures" was included. The First Bill then set out priority rules to determine priority between an interest in land and a security in tangible property (fixture) that is affixed to the land: First Bill, see Part 8, Division 2.

The fixtures provisions were removed from the revised Exposure Draft Personal Property Securities Bill (December 2008) ("Second Bill") at the request of the States and Territories who were concerned about the impact of these provisions on State and Territory based land laws: see Personal Property Securities Bill 2008 - Revised Commentary (December 2008) at p170. However, while the fixture provisions were removed, the concept of "fixtures" was not. The Second Bill provided that land did not include "tangible property that is affixed to land": Second Bill, s26. and that the Second Bill did not apply to "an interest in tangible property that is affixed to land: Second Bill, s6(1)(j)). The substance of this approach was retained in the PPSA as enacted. The Replacement Explanatory Memorandum and the original Explanatory Memorandum to the final Bill did not refer to fixtures except to state that the Bill did not apply to interests in "goods affixed to land: see Replacement Explanatory Memorandum at pp11 and 16 and Explanatory Memorandum at pp10 and 15".

The commentary to the Exposure Draft Personal Property Securities Bill (May 2008) stated that the references in the Bill to the similar phrase "tangible property that is affixed to land" was "consistent with the common law doctrine of fixtures": see the Personal Property Securities Bill 2008 - Commentary (May 2008) at para 8.13. The commentary also stated that in some instances, a security interest in a fixture would need to be registered on both the PPSR and the relevant land titles register to have priority over certain interests in the land: at para 8.11. These comments suggest that the concept of fixtures is intended to reflect the common law definition.
2.3 Other definitions – s10

**Control**

There are two different sets of definitions: one set only relating to controllable property; the other to the concept of what is a circulating asset. This can give rise to confusion. We suggest that where additional concepts are necessary in the context of circulating assets, they are expressed in terms of restrictions, rather than control. This would make the legislation easier to follow.

**Investment instrument**

Units in unit trusts should be expressly defined as investment instruments so that a secured party can perfect a security interest in a unit in a unit trust by control. At present, in s10 under paragraph (f) of the definition of investment instrument, only an interest in, or a unit in an interest in, a managed investment scheme is an investment instrument. Units in unit trusts which are not managed investment schemes should also be included.

**New value**

It is not clear why the definition of new value should exclude value that is provided by way of reducing or discharging an existing debt or liability. What if the existing debt or liability had fallen due for payment? Alternatively, what if the value was provided by way of a partial release of an earlier debt or liability?

2.4 ADI accounts

Provisions relating to ADI accounts (other than those provisions which deal with an ADI that has a security interest in an ADI account held with it) should extend to accounts with similar financial institutions (including foreign banks).

The following provisions relating to ADI accounts are there not to benefit the ADI but the depositor and parties who take security interests in the accounts:

- s33(1)(c) under which an ADI account can be automatically covered as proceeds
- s40(5) which excludes ADI accounts from the continuous and temporary perfection rules applying to other intangible property after relocation events
- s239(4) and (5) relating to the choice of law for security over an ADI account
- s341(3)(a) and (c) requiring proceeds of receivables to be deposited into an ADI account for the receivables not to be circulating assets
- s10 - the definition of account (where ADI accounts are excluded).

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3 See ss12(4)(b), 21(2)(c)(i), 25(1) and 75.
For the purpose of these provisions, whether or not the institution with whom the account is held is an ADI is irrelevant to the manner in which the customer should be able to give security over the account. Whether an institution is an ADI or another deposit taking institution such as a foreign bank makes little or no difference to commercial parties in the context of taking security over an account with that institution. Those provisions should also apply to accounts with institutions which fulfil the function of a bank. Why, for example should an Australian corporation’s account with ANZ in Hong Kong be treated differently from its account with Standard Chartered in Hong Kong?

**2.5 Defining crops and determining when trees are crops - s10**

Paragraph (b) of the definition of “crops” provides that trees which have not been harvested will constitute crops if they are “personal property”. The definition of “personal property” excludes land. The definition of “land” excludes “fixtures”, with the result that fixtures are personal property. The definition of “fixtures” excludes “crops”. This leads to ambiguity in terms of how crops are characterised for the purposes of the PPSA. In the case of trees, it suggests that determining whether trees are “personal property” depends on whether they are considered to be part of land under the common law.

The common law on this point is unclear and can depend on a number of factors such as: (i) whether the tree was produced by labour and industry rather than spontaneously; (ii) the length of time the tree was left to grow without human intervention/harvest; (iii) whether the tree is the subject of a contract of sale and the timing of removal of the tree after sale. In order to provide certainty, the PPSA should clarify when trees are to be considered personal property for the purposes of the PPSA.

Providing clarity on the status of trees (prior to harvest) under the PPSA would be consistent with the approaches taken in other jurisdictions which have a PPS regime, such as New Zealand and the Saskatchewan province in Canada. In each of those jurisdictions, the legislation seeks to provide clarity as to when trees will be “personal property” as follows:

- **New Zealand** – trees are excluded from the definition of personal property until they have been severed. Personal property is defined as follows:
  
  "**personal property includes chattel paper, documents of title, goods, intangibles, investment securities, money, and negotiable instruments.**" The definition of goods includes “crops” and “trees that have been severed”. Trees are expressly excluded from the definition of crops.

- **Saskatchewan province, Canada** – trees are excluded from the definition of personal property until they have been severed unless they fall within the definition of “crops”. Personal property is defined as follows: "**personal property” means goods, chattel paper, investment property, a document of..."
The definition of "goods" only includes trees which are "crops" and trees which have been severed. Crops are defined as follows: "crops" means crops, whether matured or otherwise, and whether naturally grown or planted, attached to land by roots or forming part of trees or plants attached to land, and includes trees only if they:

(i) are being grown as nursery stock;

(ii) are being grown for uses other than the production of lumber and wood products; or

(iii) are intended to be replanted in another location for the purpose of reforestation."

This issue has arisen on a number of occasions in connection with tree plantation managed investment schemes. Private investment in such schemes and particularly privately owned hardwood plantations continues to increase and clarity on this issue would benefit both financiers and investors in such arrangements.

2.6 Transfer of account - s12(3)(a)

Generally

We suggest that consideration be given to deleting s12(3)(a) so that transfers of accounts (and if the concept is retained, chattel paper) are no longer deemed to be security interests.4 If this were done, such transfers would only be security interests if they were "in substance" security interests under s12(1) or (2). Transfers of accounts would be treated in the same way as transfers of other forms of personal property.

In the secondary loan market, loan receivables may be transferred numerous times. Securitisations may also involve successive transfers of receivables between trusts. Failure to register those transfers may adversely impact (or at least create uncertainty) on the chain of title and expose a later transferee to a priority and taking free risks or uncertainties. The only way the parties can try to protect against the risk is through due diligence and representations but due diligence may be impractical, time consuming and inconclusive and representations will be subject to negotiation. To entirely cover off the risk and remove uncertainty would require each transferee to register against each preceding transferor in the chain which can be difficult or impossible to achieve at a later time when an incoming transferee is seeking to protect its position.

If s12(3)(a) is retained, we suggest that it should be possible for the transferee of an account or chattel paper to perfect the security interest by giving notice to the account debtor or taking other steps as a result of which the account debtor is

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4 We have also suggested in our previous submission that the concept of chattel paper be deleted.
registration

obliged to make payments to the transferee (or another person on its behalf). This is directly analogous to possession or control of other forms of personal property which are modes of perfection and should be treated as one or the other. There seems to us to be no policy justification for requiring registration of a transfer where the debtor has become bound to treat the transferee as the creditor. This change would also be consistent with s12 of the Conveyancing Act 1919 (NSW) and its equivalents and general law priority rules.

Transfer of syndicated loans

If s12(3)(a) is retained, we also suggest that transfers of receivables to repay all or part of syndicated loans or other syndicated facilities should be excluded from it.

There is some debate as to whether loan receivables (debts owed by borrowers to lenders to repay loans and other forms of financial accommodation) are "accounts", but the general view is that they are, except where they are "debentures" as defined in the Corporations Act 2001 (Cth) ("Corporations Act"), and therefore "investment instruments", or they are "chattel paper". If they are "accounts" or "chattel paper", a transfer of a loan receivable would be a security interest under s12(3)(a), requiring perfection by registration.

We consider that transfers of loan receivables under syndicated loans and other syndicated facilities should not be deemed to be security interests for the following reasons.

• Deals are structured and documented in the syndicated loan market, with a view to them being traded regularly, like securities, or capable of being traded if they become distressed as part of a loan portfolio of such loans or individually.

• The Australian syndicated loan market is in excess of $100 billion. The syndicated loan market relies on its liquidity. Requiring the registration of transfers of loan receivables on the PPSR is an unnecessary level of red tape and cost in a secondary loans market which has developed and operates very well domestically and globally without it. Current practice with most loan transfers in the secondary loan market is not to register, exposing participants to “chain of title” risks which, in any event, are almost impossible to protect against. If that practice changes, it will be necessary to have a separate registration with virtually every transfer and as transfers are very common, that would soon clog the register with information about each participant which is largely historical.

• As we understand it, the treatment of transfers of accounts and chattel paper as security interests reflects the fact that factoring of trade receivables at a discount is a common financing technique. Loan receivables owed to financiers are not normally dealt with in this way.

When loan receivables are traded, they are usually traded at par (full face amount), except when the loan is distressed (that is the borrower is
in financial difficulty) in which case holders of the loan receivable may sell, at a discount to par, reflecting the reduced value of the asset (taking account the reduced likely recovery on the relevant loan). There is a flourishing market in the sale of distressed debt, as lenders crystallise their losses, and others buy their receivables either with a view to making a profit on trading or making a profit when the distressed loans are eventually realised.

This trade in loan receivables is not part of the factoring market, and is not a quasi-financing or secured transaction in any form. It is a disposal of the assets of the lending corporation for consideration representing the value of the traded loan receivable. It is no different from the sale of any other asset.

- There is no false apparent wealth issue. Only the total amount of loans held by a lender is apparent and only through its balance sheet in its accounts. Confidentiality rights of borrowers mean that parties dealing with a lender are not aware of individual loans. Loan receivables transferred by a lender are taken off the balance sheet of the seller.

- The definition of "account" does not include all loan receivables. Many loans to corporations are excluded from the definition of "account" because they are "debentures" as defined in the Corporations Act and are therefore "investment instruments" as defined in the PPSA.

This is because "debenture" is defined to mean "a chose in action that includes an undertaking by [a] body to repay as a debt money … lent to the body". At first sight this will include all loans made to corporations, but there is an exception in paragraph (a) of the definition of "debenture" where the loan is made in the ordinary course of a business carried on by the lender, and the borrower receives the money in the ordinary course of a business that does not include borrowing and providing finance.

Loan receivables owed by companies and other bodies are only included as accounts where they fall within the exception in paragraph (a) of the definition of "debenture" (or another exception) or they arise from financing transactions that are not strictly "loans".

In general terms this means that loans by banks and others in the business of lending are not "accounts" where they are made to other financiers or, where they are made to those holding companies or finance subsidiaries which provide intercompany loans to other members of corporate groups in such a way that they might be said to be carrying on a business of borrowing and providing finance, but are "accounts" when they are made to any other body.

For PPSA purposes this is an arbitrary and irrelevant distinction — there is no policy difference between loans by financiers which are classed as...
"debentures" and those that are classed as "accounts". They are made in exactly the same way. The only difference is the nature of the business of the borrower. As a corollary, a number of corporate bonds, which are indistinguishable from other securities which are treated as investment instruments, might not be "debentures" because they fall within the same exception to the definition of "debenture" and are therefore "accounts".

Not only is the difference for PPSA purposes between loan receivables and investment instruments often blurred or arbitrary, as a policy matter transfers of them should be treated the same.

We suggest that the PPSA provides a broad definition of what is a syndicated loan. The definitions of "syndicated loan" and "syndicated loan facility" in Part III, Div 11A of the Income Tax Assessment Act 1936 are too narrow and specialised in scope to be useful for purposes of an exclusion of the kind we propose.

We suggest that there should be a definition like "Syndicated Loan Receivable" as being a monetary obligation arising under or in connection with an agreement under which one or more loans or other financial accommodation are or are to be provided to one or more parties, and which provides that there may be more than one party providing, or entitled to repayment or payment of, such loans or other financial accommodation, whether or not at any stage there is only one such providing party.

2.7 Definition of "intermediary"- s15(2)

We suggest that the requirement that the intermediary be licensed in Australia or another jurisdiction be removed. Whether or not an intermediary is licensed to hold a securities account is irrelevant to the mechanism in which a security interest might operate and the nature of the interest subject to the security interest. The requirement gives rise to unnecessary complexities and cost in the following ways:

- It requires due diligence every time a party takes security over what may be rights in a securities account, to determine whether or not the intermediary has an Australian financial services licence or licence under a foreign jurisdiction, and if it does, whether the terms of the relevant licence permit the licence holder to maintain securities accounts.
- The due diligence may become very difficult or impossible where the intermediary is in a foreign jurisdiction.
- There are further difficulties and questions which may arise where the relevant intermediary does not need a licence in the relevant foreign jurisdiction.
It raises significant questions as to what happens if the intermediary loses or relinquishes its licence. For example, a secured party may have perfected a security interest in collateral which is an intermediated security by taking control. However, if the intermediary loses its licence, this may have the result that the collateral no longer qualifies as an intermediated security and further, it may no longer be a type of collateral that can be perfected by control under s21(2)(c) and this will have the result that the security interest is unperfected. Further, the secured party may not be aware that the licence has been lost and that its security interest may be adversely affected. As such, innocent third parties can be prejudiced by matters which they cannot control and of which they may have no knowledge.

One illustration of the difficulties that can emerge from the licence requirement is an argument put by some in the market that, in order to comply with the requirement, the licence must expressly authorise custodial or depository services, rather than simply authorising a business or activities which could include the holding of securities accounts. If for some reason it is thought necessary to retain the licensing requirements, then this at least should be put beyond argument.

2.8 Property which may be perfected by control - s21(2)(c)

We are unsure why this does not also cover performance bonds and bank guarantees.

2.9 Control by a secured party who is also an intermediary - s26(2)

The PPSA should be amended to permit an intermediary to perfect by control any security interest it takes in intermediated securities in respect of which it is the intermediary. The PPSA sets out how a secured party can take control of an intermediated security: see s26. However, it is not clear how the intermediary who takes a security interest over the intermediated security will satisfy these controls. It is not uncommon for an intermediary to take a security interest in an intermediated security in respect of which it is the intermediary (for example, custodians often take security over assets they hold in custody in the context of prime brokerage and margin lending arrangements). The control tests in s26(2) are drafted on the assumption that the secured party and the intermediary are different while the control tests in s26(3A) and 26(4) may not be practicably achievable for an intermediary. This means that an intermediary who takes a security interest in the intermediated security may not be able to satisfy any of the tests for control.
under the section. The only way the intermediary can perfect its security interest in any intermediated securities is by registration. However, this exposes the intermediary to the risk that it will lose priority to a competing secured party who has control of the intermediated securities. The section should be amended to make it clear that the intermediary can perfect by control in these circumstances.

**Control tests**

It appears that an intermediary who takes a security interest in the intermediated security will not be able to satisfy any of the tests for control under s26 for the following reasons.

a) The control tests in s26(2)(a)(i) and (ii) require that there be an agreement with the *intermediary* who maintains the securities account and this agreement must effectively require the intermediary to deal with the intermediated security only in accordance with the secured party’s instructions or consent: s26(2)(b). If the intermediary is the secured party, then it will not be possible to satisfy this test. On a literal reading, the test requires the intermediary to enter into an agreement with itself. As a practical matter, the intermediary has control as since it is the secured party, the intermediated security cannot be transferred without its consent.

b) The control test in s26(2)(a)(iii) requires that that there be an agreement between the grantor and the secured party and notice of the agreement must be given to the intermediary. However, this agreement must effectively require the *intermediary* to deal with the intermediated security only in accordance with the secured party’s instructions or consent: s26(2)(b). Again, if the intermediary is the secured party, then it will not be possible to satisfy this test. On a literal reading, the test requires the intermediary to give a notice to itself. As a practical matter, the intermediary has control as since it is the secured party, the intermediated security cannot be transferred without its consent.

c) The control test in s26(4) requires that the intermediated security be maintained in the name of the secured party (or its nominee). This effectively requires that the owner has *transferred* the intermediated security to the secured party (or its nominee) so that secured party (or its nominee) becomes the owner. It is not entirely clear how a custodian can satisfy this test. The definition of intermediated security refers to an intermediary who “*maintains*” a securities account in the name of a person: s15(1).

d) The control test in s26(3A) requires that there be an agreement under which the secured party (or a person who has agreed to act on its instructions) is able to initiate or control the sending of some or all electronic messages or other electronic communications by which the intermediated security could be transferred or otherwise dealt with. An intermediary will only be able to satisfy this control if it has established a system under which instructions must be sent electronically. This will not always be the case.
e) The control test in s26(4) requires that the securities account be maintained in the secured party’s name or in the name of another person on behalf of the secured party. It may not be possible for the securities account to be maintained in the name of the intermediary, or a person its behalf.

**Consequences of the intermediary not being able to take control**

As a result of these drafting ambiguities, the only way an intermediary can perfect its security interest in any intermediated securities is by registration. However, this exposes the intermediary to the risk that it will lose priority to a competing secured party who has control of the intermediated securities. For example, a competing secured party could obtain control simply by entering into a “control agreement” with the grantor and giving notice to the intermediary: see ss26(2)(a)(iii) and 26(2)(b).

Finally, we note that the Attorney-General's Department has indicated that the PPSA is intended to be drafted in a manner as consistent as possible with the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary. The Hague Convention recognises that an intermediary acts in more than one capacity and this is reflected in s15(4). It seems to us that enabling an intermediary who is a secured party to take control of intermediated securities would be consistent with the policy objectives of the PPSA and ensure consistency with the Hague Convention.

**2.10 Control of uncertificated negotiable instruments - s29**

It is unclear how this section deals with a negotiable instrument that is itself an instrument and is not evidenced by a certificate, for instance, a promissory note, letter of credit or a bill of exchange. Possession of that bill of exchange or promissory note should suffice. Alternatively, control could be obtained if it were endorsed in favour of the secured party.

As negotiable instruments are defined by reference to an instrument, in what circumstances would it be represented by a certificate that is not the instrument itself?

**2.11 Proceeds must be transferable – s31(3)(a)(ii)**

What is this section designed to achieve? It appears that the PPSA only recognises security interests over transferable property, and if the property is not transferable there could be no security interest under the PPSA. If it is possible to have a security interest over non-transferable property, then why should it not be possible to obtain a security interest over proceeds (eg compensation for

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5 See Article 1(1)(c).
2.12 Enforcement of security interest against collateral and proceeds – s32(2)

The rights of the secured party in proceeds of original collateral should not be limited to the market value of the collateral immediately before the collateral gave rise to proceeds.

2.13 Consensual transactions; impact on efficacy of takeovers – s50

This section gives a mechanism by which purchasers of investment instruments take free of security. It is limited to "consensual" transactions - by doing so it limits the ability of parties completing a takeover through compulsory acquisition or a scheme of arrangement to get full ownership. This could have a significant dampening effect on the efficacy of takeovers. The PPSA should treat takeover transactions (including schemes of arrangement) as consensual.

We note that the PPS Regs seek to address the limitations of the rule in the context of schemes of arrangement and compulsory acquisitions by providing that s32(1)(a) does not apply to them: see reg 7.1. However, this does not resolve the issue under s50 because s50 only applies where there is a consensual transaction.

2.14 Operation of s59

It is not clear in which circumstances s 59 is intended to operate. We suggest that the PPSA should include a practical example as to how the section operates or otherwise remove it.

Such an example may take the following form:

For example, (subject to satisfaction of the requirements of s64) an accounts receivable financier’s security interest takes priority over an earlier PMSI over inventory in so far as the PMSI relates to an account (s64). The PMSI over inventory takes priority over an earlier ALLPAAP in so far as it relates to the same proceeds, being an account (s63). The earlier ALLPAAP takes priority over the accounts receivable financier's security interest by the operation of s55.

Could the PPSA specify which is the first security interest, the intermediate security interest and the last security interest for purposes of determining such a priority dispute?
2.15 Priority of creditor who receives payment of debt - s69

Our concern is that the person making the payment may not be a "debtor" as defined in the legislation (which is the person that owes the secured obligation and not the person that owes the debt being discharged). It may be the grantor or another person that owes the obligation. Further, the recipient of the payment may not be a creditor. Can this section be amended as marked below?

Priority of creditor who receives payment of debt

(1) The interest of a creditor person (the payee) who receives payment of a debt owing by a debtor through a payment covered by subsection (3) has priority over a security interest (whether perfected or unperfected) in:

(a) the funds paid; and

(b) the intangible that was the source of the payment; and

(c) a negotiable instrument used to effect the payment.

Example: A bank account from which the funds were paid is an example of an intangible that was the source of the payment.

(2) Subsection (1) does not apply if, at the time of the payment, the creditor payee had actual knowledge that the payment was made in breach of the security agreement that provides for the security interest.

(3) Payments made by a debtor are covered by this subsection if they are made through the use of:

(a) an electronic funds transfer; or

(b) a debit, transfer order, authorisation, or similar written payment mechanism executed by the debtor person making the payment when the payment was made; or

(c) a negotiable instrument.

2.16 Priority of execution creditors - s74

Under s74, the interest of an execution creditor in collateral will have priority over any security interest in the same collateral which is not perfected at the times set out in s74(4). Those include the time an order is made by a court in respect of a judgment in relation to the execution creditor. Section 74 applies to both security interests which are the subject of the PPSA as well as some that are excluded under s8 (such as liens and other security interests arising under general law): see s8(1), s8(2) item 6 and reg1.4(5)(b) of the PPS Regs. This provision has particular implications for the following:

- The holder of a lien, charge or other interest arising under general law which would not otherwise need to be perfected under the PPSA.
Example:

John takes his car to XYZ mechanics for repairs. The mechanic’s bill unpaid, XYZ mechanics exercise an equitable lien over the car and refuse to release the car to John until full payment of the account has been made. A week later, default judgment is entered against John by FinCorp from who John leases the car. The court issues a writ against the against the car and FinCorp subsequently discovers that the car is at currently at the premises of XYZ mechanics who are claiming an equitable lien on the basis of John’s unpaid account. If XYZ mechanics has not perfected its lien, the execution creditor will have priority.

This provision should be amended so that the holder of the lien, charge or other interest has priority (as was the case under pre-PPSA law). Most holders of such interests will not perfect their interests under the PPSA because, apart from s74, the PPSA does not apply the interests. The current provision thus will almost always result in execution creditors taking priority over such interests.

- The priority of security interests in after acquired property.

This provision should be amended so that security interests which are not perfected at the time of the court order only because they attach after the court order (because the asset is acquired after the court order), do not lose priority to the execution creditor. This would reflect the pre-PPSA position. That is, the execution creditor should not get priority over a perfected security interest over after-acquired property. We consider that this is an extremely important weakening of the value of a security, and unprecedented in the sense that it means that unsecured execution creditors get priority over perfected security.

### 2.17 Delimitation of rights on transfer of account and chattel paper – s81

This provision should only invalidate the provision to the extent that it relates to the account or chattel paper, not to the extent it relates to other contractual rights. Under the current drafting, if a term in a contract prohibits transfers of a broader class of property that happens to include accounts or chattel paper, for example all contractual rights under the relevant contract, then s81(2) may defeat the whole term, not just the term as it applies to accounts or chattel paper.

Example:

A contract requires payments by X for services by Y, but also X must provide services to Y. If the contract restricts assignment, the sub-section provides that the whole term is unenforceable against third parties, not just in relation to accounts that arise when X has to pay Y for services.
In our submission on small business, we raised issues about the operation of Part 3.4 in relation to issues arising where goods which are fungibles are commingled with other indistinguishable fungibles, for example, wheat in a silo, coal in a stockpile, oil in a tank.

In brief we said that they should be dealt with under a separate and simpler regime. We said in effect that the existing Part 3.4 should be confined to the situation where different goods are blended or affixed together in a manufacturing or mixing process: for example, wheat in mixed grain bread, duco on a car, oil in salad dressing, resin in chipboard.

On further reflection, we consider that the suggested new part dealing with commingling of indistinguishable tangibles should not only apply to goods, but also to other forms of fungible personal property including intangibles.

If Part 3.4 is narrowed in the manner we suggest, there are a number of issues that need to be addressed to cover the situation where different goods are mixed. They are set out below.

**Relationship of Part 3.3 and 3.4**

The relationship of Parts 3.3 (dealing with accessions) and 3.4 (dealing with commingling) should be clarified.

For example, both parts on their terms could apply where paint is sprayed on a reconditioned car body: Part 3.3 because, the paint is affixed to the car body (and it is therefore an "accession"), and Part 3.4 because it is not commercially practical to restore the paint to its original state (see s99(2)). However, Parts 3.3 and 3.4 are inconsistent. Part 3.3 gives priority to the security interest in the paint and allows its removal. Part 3.4 provides that the security interest in the paint continues in the painted car, subject to certain limits.

We suggest that Part 3.3 make clear that it does not apply when Part 3.4 applies. In broad terms, if the identity of the accession is lost or it is not commercially practical to separate it, then Part 3.4 should apply to the exclusion of Part 3.3.

**Section 101 - priority over unperfected security interests**

Example:

$40,000 worth of woodchips is mixed with $10,000 worth of resin to make $100,000 worth of chipboard. There is a security interest over the woodchips securing $70,000 and there is an unperfected security interest over the finished chipboard, securing $80,000.

Section 101 limits to $40,000 (the value of the woodchips) the priority given to the security interest which was initially over the woodchips. But it only limits the priority over other security interests, it does not limit the amount recoverable, nor does it affect the priority against other interests. If there are no other security interests, then the secured party can recover the full $70,000 against the
chipboard. However, if it is not clear how the priority will be resolved between the perfected security interest and the unperfected security interest. Section 102(1) states that the perfected security interest has priority over the unperfected security interest. However, s101 limits that priority to the value of the goods on the day which they became part of chipboard which is $40,000. The provisions displace the application of the general priority rules in s55. Beyond that, it is not clear whether the provisions when read together have the result that:

a) the unperfected security interest has priority over the perfected security interest in respect of any amount secured after the first $40,000 (the more likely result);

b) the perfected and unperfected security interests rank equally in respect of any amount secured after the first $40,000.

c) some other result.

We suggest that the perfected security interest should still rank ahead of the unperfected security interest in all respects. An unperfected security interest should not have an advantage against a perfected security interest solely as a consequence of commingling and as such, s101 should not apply.

Section 101 - continuing security interest affects above or whole as original collateral

On a literal reading of the wording of the section, the above result might also be said to follow even where the woodchip security interest on its terms also applies to the chipboard as original collateral. We suggest that the section make clear that the limit does not apply when the security interest would apply to the product or mass as original collateral, that is when it would have applied to the product or mass without the operation of Part 3.4.

Timing for section 101

Significant issues of unfairness can also arise under s101 with commodities that fluctuate in value. For example, if $300,000 in gold subject to a security interest is used in the manufacture of jewellery then the priority of the holder of the security interest would be limited to that $300,000 even if the gold subsequently became worth $500,000 and the value of the jewellery fluctuated as a result.

Reversal of priority of PMSIs – s103

Section 103 currently gives priority to a perfected PMSI even where the perfected PMSI would not have been entitled to priority under s62 (because registration was not done correctly or within time).

This could have strange results.

**Example:**

A registered security interest over woodchips is registered in 2013. A PMSI is registered over the woodchips in 2014, but in insufficient time to gain priority.
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over the first security interest under s62. Before the chips are mixed with resin to form chipboard, the first security interest ranks ahead of the PMSI. After they are mixed, s103 has the effect of reversing that priority – it gives priority to the PMSI.

We suggest that s103 should only give priority to PMSIs which would have priority under s62.

Relationship of s102 and s103

The relationship of s103 and s102 also needs to be made clear. For example, in the above example, if the woodchips on mixing were worth $10,000, but secured $50,000, and the chipboard was worth $40,000, would the PMSI have priority limited to the $10,000 of woodchips that was contributed, or would it have priority for its full $50,000?

Section 102 sharing between more than one continuing security interest

Section 102 has a complex sharing procedure depending on two variables: the amount secured by the respective security interests and the value of the respective contributed goods. There are different reference times for the respective variables: the first is determined at the time that priority is determined, the second at the time of mixing. Significant unfairness can result if the value of the contributed goods fluctuates between those periods.

It is inappropriate that sharing between security interests over different contributed goods should be principally according to the amount secured rather than the respective value of the contributed goods. And the use of the obligation secured as a measure has no application where the security interests are "deemed" security interests under s12(3) which do not secure any obligation., like a PPS Lease or a commercial consignment. What should occur in that circumstance? Is the amount secured by such security interests for the sharing formula nil, or is it somehow deemed to be the value of the contributed collateral?

A more appropriate model is to follow the Ontario legislation and simply say that the parties share according to the value of the contributed goods, but go further and make that value determined at the time of determination of priority.

Section 102 - subsequent security interests in contribution

The effect of s102 is also not clear where there are two security interests (one ranking after the other) in one of the contributions to the product or mass. If the above model (the modified Ontario model) is adopted it should be clarified so that second-ranking security interests only share in the product or mass to the extent the share represented by their contributed portion exceeded the amount secured by the prior ranking security interest, in the example:

$40,000 worth of woodchips is mixed with $20,000 of resin to make $72,000 worth of chipboard. The woodchips are subject to two security interests: the first-ranking securing $30,000, the second ranking securing $50,000. The resin
is subject to a security interest securing $20,000.

On a literal reading of the section, the sharing is in the respective proportions of the amounts secured (as limited under s102(4)) 30,000:40,000:20,000, or 3:4:2.

There is nothing to say that the security interests in the woodchips don’t both share to the full extent of the amount secured (subject to the limit of the value of the goods under s102(4)) without regard to their ranking, so the resin security interest receives a smaller share than it might otherwise. If the woodchips were sold for $72,000, that would give the respective secured parties $24,000 for the first-ranking woodchip security interest, $32,000 for the second, and $16,000 for the resin security interest.

The sharing as between the resin and woodchip secured creditors should reflect the relative portions of value of the resin and woodchip (2:1), and as between the woodchip secured creditors should reflect their pre-mixing priority. That is, if the chipboard is sold for $72,000 $48,000 at most should be available for the woodchips secured parties (subject to any limits on priority under s101 should there be any further security interests in the chipboard) and $24,000 to the resin.

In the absence of subsequent security interests in the chipboard, $30,000 should be received for the first ranking security interest and $18,000 for the second, with $20,000 paid for the security interest in the resin. The provision should provide that in the absence of subsequent security interest holders the surplus from the resin ($4,000) after paying the resin secured party could be paid to the second ranking security interest holder in the woodchips.

2.19 Contracting out of enforcement provisions – s115(2)

This appears to take away from the ability to contract out of giving notice because the parties cannot contract out of obligations in relation to person who are not parties to the security agreement: for example, requiring notice to be given to other parties in relation to disposal. This removes much of the benefit of being able to contract out, and imposes duties and restrictions in relation to the enforcement of security interests that are not found in general law. In relation to 115(2) sub-section (5) is not adequate to deal with the issue. The secured party has no control over who may have an interest in the property. It cannot ensure that it contracts with everyone. Also it does not deal with any other rights that other holders of interest of the property may have by virtue of the provisions.

The general law in relation to mortgagees’ duties should be sufficient to protect other parties with interests in the property. If the grantor is able to contract out, then all parties claiming through the grantor (including transferees of the collateral) should be affected by that contracting out.
2.20 Enforcement of liquid assets – s120

This entire s120 seems over-prescriptive. A better provision would be simply one that was general, and said that the secured party can exercise any of the rights of the grantor in relation to the collateral.

- Section 120(3) can put the account debtor in a difficult position, if it is unsure as to the efficacy of the security, or the validity of the notice. The timing is also interesting. Why should an account debtor get five days grace of payment simply because it needs to pay it to another party? Does this give an automatic statutory stay of 5 business days? This may be the one provision in the PPSA where the 5 business day period is too long.

- Section 120(4) seems to be inconsistent with sub-section (5).

2.21 Power to remove accessions - ss92 and 123

Section 123 provides for the seizure of collateral generally but it does not specifically provide for the removal of accessions as is contemplated by s92.

We suggest that s123 be amended to include the following wording as a new subsection (2) before the sub-heading “Seizing intangible property”:

(2) Subject to section 92, a secured party may remove an accession over property over which the secured party has first priority by any method permitted by law if the debtor is in default under the security agreement.

2.22 Secured party may seize collateral – s123

We note that there is an apparent gap relating to the seizure of shares and any other property excluded from the definition of intangible property.

2.23 Apparent possession of collateral – s126(2)

In our view, the “necessarily incidental” test is a harsh one, particularly by comparison with other tests which relate to reasonableness. We suggest that “reasonably incidental” be replaced with “reasonably required”.

2.24 Seizure by higher priority parties – s127

127(1) It is not uncommon in corporate financing arrangements for secured lenders to agree that a junior-ranking lender is to have control (or no control) of any enforcement proceedings. Section 127(1) does not allow the secured parties to enter into an agreement of this type. The "contracting out" list in s115(1) should
be extended to include this section as well. We query whether this should require a notice in all circumstances. If the higher ranking party is entitled to possession as against the other parties, it should be able to take it.

The provisions for seizure by higher ranking parties should not be limited to security interests – if another party with a prior claim to a secured party is entitled to possession of the property they should be able to take it.

127(4) This seems to be drafted so as to always require a longer period than 5 business days. If the collateral is immediately deliverable, and the higher ranking secured party is entitled to it, then it should be immediately delivered. There is no reason why a lower ranking secured party should have any longer grace period in delivering possession than the grantor.

127(6) This provision should be deleted.
A higher priority party should not be obliged to pay costs incurred by a lower ranking party: such a rule seems to give a blank cheque to a lower ranking party. There are no tests in relation to the incurring of costs by the lower ranking party, and they could be incurred in a way that would not have been incurred had the higher priority party acted, and may have been incurred before the higher priority party knew that action had been taken. The pre-PPSA rules should apply, namely that a lower ranking security holder should take its chances. If it thinks the seizure would justify the costs and be able to pay out the higher ranking creditors, then it could do so. If not, it wears the risk that there is insufficient money to pay its costs and the higher ranking party.

This provision significantly tilts the balance in favour of lower ranking secured parties.

127(9) If s127(6) is deleted, this provision will no longer be required.
If s127(6) is retained, this timing limit seems unduly restrictive, given that the higher priority party needs to receive and check through invoices.

The pre-PPSA general rule was that a higher priority party is entitled to immediate possession as against lower priority parties.

The pre-PPSA law position should be reinstated, which is that a holder of a security interest only has to compensate grantors of security interests and lower ranking owners of security interests if it breaches its duties as mortgagee.

The provision also gives undue leverage to lower ranking parties to put commercial pressure on higher ranking parties who may want to have a work-out or leave a business running in the interests of overall recoveries.

### 2.25 Secured party may dispose of collateral – s128

128(1) Seizure should not be necessary for the secured party to sell collateral. It may be that control and possession is not necessary for sale: it might be sold “as is, where is”, or the secured party may have sufficient possession or control to be
able to sell the asset without having sufficient control or possession to have perfected the security interest. There may be circumstances in which the secured party may or not wish to control or possess the collateral, for example, because of the risk of incurring liability as a result (eg environmental liability).

128(3) We wonder what the purpose of this section is. The collateral is not entirely disposed of, because the owner still retains ownership: it is merely subject to a lease. This would be particularly concerning if that was held in some way to extinguish the security interest, which would still bite in relation to the collateral. We wonder whether this section is necessary.

<table>
<thead>
<tr>
<th>2.26 Secured party to give statement of account – s132</th>
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<td>132(1),(2)</td>
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<th>2.27 Limit reinstatement right to grantors – s143</th>
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<tr>
<td>Can s143 be amended to provide that the grantor (rather than other persons) may reinstate a security agreement? If this is not changed, it should be amended to provide that if the grantor has waived its rights under this section, this should also apply to everyone else.</td>
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2.28 Governing law rules for intermediated securities - Part 7.2

Part 7.2 does not address the position in relation to intermediated securities because it was decided such legislation should be deferred until the conclusion of the UNIDROIT Convention on Substantive Rules Regarding Intermediated Securities. Pending Australia becoming a signatory to the UNIDROIT Convention, an interim solution is necessary to avoid unintended outcomes which result from the current uncertainty. For example, the PPSA currently applies if Citibank NY (which is registered in Australia as a foreign company) grants security over an intermediated security in Euroclear to JP Morgan in London.

2.29 Location of certificated investment instruments, chattel paper and negotiable instruments - s235

When read together, s235(1) and 235(2)(a) suggest that the location of chattel paper, a negotiable instrument and a certificated investment instrument which is evidenced by a physical instrument, could be determined by the location of the physical instrument evidencing the personal property in each case. As the law relating to the location of shares and contractual rights already operates to determine “the particular jurisdiction in which the personal property is situated” (regardless of whether the relevant property is evidenced by a physical instrument or by an electronic record) the inclusion of s235(2) appears unnecessary and raises the question as to what is intended where the relevant property is evidenced by a physical instrument.

Adding to the uncertainty is the fact that the location of the physical instrument evidencing investment instruments, chattel paper and negotiable instruments determines the governing law in a number of circumstances under the Saskatchewan, Ontario and New Zealand PPS legislation.

This provision should be clarified so it is clear that the location of investment instruments, chattel paper and negotiable instruments evidenced by physical instruments is not affected by the location of the physical instrument.

2.30 Location of individual grantor - s235(5)

The PPSA applies to a security interest if the grantor of the security interest is an Australian entity: s6. An Australian entity includes an individual who is located in Australia: see definition in s10. An individual is located at the individual’s principal place of residence: s235(5).

An individual's place of residence may change. When a security interest is granted by an individual, the grantor’s principal place of residence may be outside Australia. If the grantor’s principal place of residence changes to

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Norton Rose Fulbright Australia
Australia, this means that the PPSA will apply and the governing law rules in Part 7.2 may have the result that the law of Australia govern the validity and perfection of the security interest. If that is the case, and the secured party acquires actual knowledge of the relocation event, the secured party only has 5 business days after the grantor becomes located in Australia to perfect the security interest: see s40(3)(b).

These provisions expose secured parties to risks whenever they deal with an individual grantor who resides outside Australia. The PPSA does not define what a “principal place of residence” means (eg where is the principal place of residence of an individual who works outside Australia but regularly visits his family who resides in Australia?). As a result, a secured party may take the view that it is prudent to register against an Australian citizen who appears to be resident outside Australia in case the person may be found to principally reside in Australia or may do so in the future.

2.31 Vesting on execution of a DOCA - s267 and CA 588FL

Both s267 of the PPSA and s588FL of the Corporations Act provide three trigger events in the case of a company or a body corporate, upon which unperfected security interests will vest in the grantor. Those are:

a) the making of an order, or the passing of a resolution for the winding up of the company or body corporate;

b) the appointment of an administrator to the company or body corporate; and

c) the execution by the company or body corporate of a deed of company arrangement (“DOCA”).

The test for whether the security interest vests upon execution of a DOCA includes a requirement that the security interest be unperfected at the s513C day. Since the s513C date will be either the date of administration, or the date the winding up is taken to have commenced, any security interest which was unperfected on the s513C day would already have vested on the s513C day as a result of the administration or winding up trigger events.

Accordingly, the inclusion of the execution of a DOCA as additional trigger event is unnecessary as it will never operate. Further, it is capable of generating considerable confusion in circumstances where: (a) a security interest is perfected at the time of administration, but for some reason becomes unperfected between administration and the execution of a DOCA; and (b) a security interest is created by the company whilst it is in administration (for example, by the administrator in order to finance the continued trading of the company).

The review should consider removing the reference to the execution of a DOCA
as a trigger event under sections 267 and 588FL.

2.32 Subordination trusts not successfully excluded from vesting provisions - s268(2)

This section is designed to cover turnover trusts in subordination arrangements, but may not cover any of them. As currently drafted, these provisions will very rarely apply because turnover trusts will not usually satisfy all the requirements, in particular because such arrangements are not a security interest in an "account" and because of the cumulative requirements in paragraph (2)(c). For the section to apply, it should be sufficient that there is a subordination trust – it should not be necessary that the subordination agreement also provides for subordination amounts to be paid to the senior creditor or for an express security interest.

(2) This subsection covers a security interest in collateral if all of the following conditions are satisfied:

(a) a person (the obligor) owes money to another person (the senior creditor);

(b) the obligor also owes money to a third person (the junior creditor);

(c) an agreement between the senior creditor and the junior creditor provides (in substance):

(i) for the postponement or subordination of the obligor’s debt to the junior creditor, to the obligor's debt to the senior creditor; and

(ii) in the event of the obligor's debt to the junior creditor being discharged (whether wholly or partly) by the obligor transferring personal property to the junior creditor--for the junior creditor to transfer the property, or proceeds of the property, to the senior creditor to the value of the amount owed by the obligor to the senior creditor; and

(iii) in the event of the obligor transferring personal property to the junior creditor that the property or proceeds are not transferred--for the junior creditor to hold the property, or proceeds of the property, on trust for the senior creditor to that value; and

in the event of such a trust arising--for a security interest to be granted by the junior creditor to the senior creditor over the personal property or proceeds securing payment of the obligor's debt to the senior creditor;

(d) the security interest is a security interest granted under the agreement, in the circumstances described in subparagraph (c)(ii).
2.33 General cross references to other regulatory requirements and legislation

The complexity and opacity of the PPSA is only increased by the large number of references to other regulations and legislation. They make it extremely difficult to follow and can have some counterintuitive, arbitrary or unintended effects. They should be reduced. For example:

- There are a large number of terms defined by reference to terms defined in other legislation, particularly the Corporations Act. To determine the meaning of terms like "derivative" and "financial product" requires a workable knowledge of the Corporations Act, and an ability to explore the definition of the term in the Corporations Act, and the exclusions and inclusion in the Corporations Regulations which can be labyrinthine. Usually those exclusions and inclusions are for purposes related to the policy of the Corporations Act. They have nothing to do with the workings of the PPSA. It can mean that quite similar arrangements can be treated as entirely different types of collateral for the purposes of the PPSA. As an example, see the discussion of the definition of "debenture" in paragraph 2.6. They can change, again for reasons that have little relevance to the policy of the PPSA, amending the PPSA by stealth or inadvertence. The PPSA should be largely self-sufficient in definitions, so that the relevant defined term should be defined in the PPSA, usually without reference to many of the exclusions in the definitions where they appear in other legislation

- There are a number of places where the PPSA only refers to entities which comply with other legislation or regulations, or on some other regulatory act, again which have nothing to do with the policy of the PPSA. Examples include the reference to intermediaries having to have an Australian financial services licence discussed in paragraph 2.7 and the requirement that an account being held with an ADI, that is an entity licensed by APRA as discussed in paragraph 2.4.

2.34 Meaning of motor vehicle – PPS Regs

We are concerned that the changes to the definition of "motor vehicle" under the PPSA which took effect from 1 July 2014 may result in some unintended adverse consequences for secured parties with registrations made before 1 July 2014.

Under the previous definition, a motor vehicle included personal property that was capable of a speed of at least 10km/h or had 1 or more motors that have a total power greater than 200W. From 1 July 2014, the definition was narrowed...
to personal property that is capable of a speed of at least 10km/h and has 1 or more motors that have a total power greater than 200 W.\textsuperscript{7}

A “motor vehicle” registration made before 1 July 2014 will no longer perfect a security interest in collateral that ceases to be motor vehicle from 1 July 2014. If the collateral is not within the collateral class described in the registration, there is a risk that, in respect of that collateral, there is no effective registration (or alternatively, that the registration does not satisfy s153 or the registration is defective under s164). This exposes the secured party to priority, taking free and vesting risk. Set out below are some examples which illustrate the effect that the change may have on a secured party with a “motor vehicle” registration before 1 July 2014.

It is not clear to us from the Australian Financial Security Authority fact sheet on the change what policy outcome the change is intended to have on existing registrations.\textsuperscript{8} The fact sheet suggests that, as a matter of policy, the change to the definition of motor vehicle:

- is not intended to prejudice the rights of secured parties and not alter priority and taking free outcomes, under pre 1 July 2014 registrations to the extent of collateral to which the security interest has attached before 1 July 2014; and

- is intended to prejudice the rights of secured parties, and to alter priority and taking free outcomes, under existing registrations to the extent of collateral to which the security interest attaches after 1 July 2014.

If that is the intended policy outcome, the effect of the change on registrations made before 1 July 2014 should be as follows:

- A “motor vehicle” registration made before 1 July 2014:
  - will continue to protect a security interest to the extent it attached to specific “motor vehicle” collateral before 1 July 2014, even though that collateral will no longer be properly described as a “motor vehicle” after 1 July 2014;
  - will not protect a security interest to the extent it attaches to collateral on or after 1 July 2014 where that collateral will no longer be properly described as a “motor vehicle” (even though at the time the registration was made that collateral would have been properly described as a motor vehicle).

- An “other goods” registration made before 1 July 2014 should not advantage a secured party who had an attached security interest before 1 July 2014 in collateral that was a “motor vehicle but which on or after 1

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\textsuperscript{7} Personal Property Securities Amendment (Motor Vehicles) Regulation 2014 (Cth).

\textsuperscript{8} See Changes to the definition of Motor Vehicle under the PPS Act.
July 2014 is “other goods”.

To ensure that these policy outcomes are achieved, we consider that it would be beneficial if regulations were passed to preserve the effectiveness of registrations made before 1 July 2014 using the “motor vehicle” collateral class for a lengthy transitional period and preserve the existing priority and taking free rules that applied before 1 July 2014.

**Impact of change**

If a “motor vehicle” registration made before 1 July 2014 ceases to be effective to perfect a security interest in collateral that is no longer a motor vehicle from 1 July 2014, the priority and taking free rules can result in unfair outcomes and windfall gains to other secured parties. The following are some examples.

**Example 1**

Crackerjack Coal mines and sells coal and it owns dozers to move that coal. On 1 June 2014, Crackerjack Coal grants security over its dozers to Bank A and Bank A registers its security interest using the “motor vehicles” collateral class. On 15 June 2014, Crackerjack Coal grants security over all its goods to Bank B and Bank B registers a security using the “other goods” collateral class.

From 1 July 2014, the dozers no longer fall within the definition of a “motor vehicle” because they are not capable of a speed above at least 10km.

As a result, Bank A will not have a perfected security interest in the dozers either because there is on registration in respect of the collateral or the registration does not satisfy s153 (because the wrong collateral class has the effect that there is no effective registration) or is defective under s164 (because the wrong collateral class is a seriously misleading defect which renders the registration ineffective). Bank B will have a perfected security interest in the dozers and thus will take priority over Bank A: s55 (5). This will be the case even though Bank B registered after Bank A.

Further, Bank A will be required to register a financing change statement to end the effective registration of the collateral within 5 business days of the “unperfection time” if the dozer is registered with a serial number: s167. Failure to do this exposes Bank A to an action for damages under s271.

Bank A will have lost a right all parties intended it to have, and Bank B will have received an unexpected benefit that no party expected it to receive.

**Example 2**

Infinity Iron mines and sells iron ore and it owns dozers to move that iron ore. On 1 June 2014, Infinity Iron grants security over all its goods to Bank A. Bank A registers a security interest using the “other goods” collateral class but does not register against the “motor vehicles” collateral class because Bank A did not consider the dozers to be material in the context of the transaction.

On 15 June 2014, Infinity Iron grants security over its dozers to Bank B and Bank B registers its security using the “motor vehicles” collateral class. Bank B advanced funds to Infinity Iron on the assumption that there was no prior ranking security over the dozers as Bank B had conducted a search of the PPS Register.
and found no registrations against motor vehicles owned by Infinity Iron.

From 1 July 2014, the dozers no longer fall within the definition of a "motor vehicle" because they are not capable of a speed above at least 10km.

As a result, Bank A will have a perfected security interest in the dozers because the dozers are now within the definition of "other goods" and are covered by Bank A’s registration. Bank A’s security interest in the dozers will take priority over Bank B: s55(5). This will be the case even though before 1 July 2014, Bank B had registered its security interest and Bank A had not.

Further, Bank A will be required to register a financing change statement to end the effective registration of the collateral within 5 business days of the "unperfection time" if the dozer is registered with a serial number: s167. Failure to do this exposes Bank A to an action for damages under s271.

Bank B will have lost a right all parties intended it to have, and Bank A will have received an unexpected benefit that no party expected it to receive.

Example 3

Platinum Platforms manufactures and sells elevator platforms to wholesalers who then distribute to hardware retailers.

On 1 June 2014, Platinum Platforms grants security over the elevator platforms to Big Bank.

From 1 July 2014, the elevator platforms no longer fall within the definition of a "motor vehicle" because they are not capable of a speed above at least 10km.

As a result, Big Bank’s security interest will not continue in the elevator platforms because the taking free rule in s46 will now apply. The wholesalers will take free of the security interest because the exception in s46(2)(a) will no longer apply to the elevator platforms.

Preserving existing rights of secured parties

It seems to us that the desired policy outcome is that any alteration of existing rights of secured parties which would prejudice the secured parties should be avoided as far as possible in relation to property to which the security has attached before 1 July 2014.

It also seems to us that in relation to property to which the security attaches on or after 1 July 2014, people are entitled to assume that the law in effect as at that date governs the situation.

To ensure this outcome, we consider that it would be beneficial if regulations were passed to preserve the effectiveness of a registration made before 1 July 2014 using the "motor vehicle" collateral class by providing that for collateral which was a "motor vehicle" before 1 July 2014 and to which the security interest attached before 1 July 2014:

(a) the registration in respect of that collateral is effective for a temporary transitional period (eg 5 years);

(b) if the security interest the subject of the registration extends to property
which is no longer a motor vehicle, the secured party should be required to make a further registration before the end of transitional period to cover that property (eg an “other goods” registration); and

(c) priority and taking free rules that applied before 1 July 2014 continue to apply to that collateral.

The regulations should also confirm that:

- a registration made before 1 July 2014 using the “motor vehicle” collateral class is not effective to perfect a security interest to the extent it attaches to collateral on or after 1 July 2014, if that collateral is not then properly described as a “motor vehicle”; and

- a registration made before 1 July 2014 using the “other goods” collateral class is not effective to perfect a security interest to the extent it attaches to collateral on or after 1 July 2014, if that collateral was not properly described as “other goods” at the time of registration.

This issue has been raised with the Personal Property Securities Registrar and has been referred to the Attorney-General’s Department. We consider the regulations should be passed as matter of urgency as the changes to the definition of motor vehicle have been in effect since 1 July 2014 and secured parties remain exposed to the risks outlined above.

We also note that whenever a there is a change in the definition of a collateral class (whether under the PPSA or the PPS Regs), similar issues may arise. It would be beneficial if the PPSA included a provision that preserved the effectiveness of registrations that were within the collateral class at the time they were made.