SECURITIES OVER ESOTERIC PROPERTY

QUESTIONS AND ANSWERS

Question - Simon Begg (Corrs Chambers Westgarth, Melbourne):

Last year I addressed the conference in Adelaide on the subject of security and title registers. I put forward a proposal for an integrated registration system covering title and security interests.

My proposal was for the establishment of a comprehensive debtor's named indexed register of security interests. This would be based on Article 9 of the Uniform Commercial Code. However, unlike Article 9 and the recommendations of the ALRC in its Interim Report on *Personal Properties Securities*, my proposed register would cover not just personal property security interests, but security interests in land as well. It would, however, be limited to business debtors. This scheme would replace Part 3.5 of the *Corporations Law* and also all existing specialist name-indexed registers (for example, bills of sale, wool, livestock and crop liens, etc).

I also proposed the establishment of a network of asset-indexed registers covering assets which are capable of separate identification. Obvious examples include land, motor vehicles, ships, aircraft, some kinds of intellectual property and - most relevantly for present purposes - shares. Such registers already exist in some areas (for example, land, motor vehicles, ships). However, my proposal was that the relevant legislation should be re-written so that it was based on a common set of principles, the basic concepts to be derived in part from Article 9 of the Uniform Commercial Code, and in part from the Torrens system schemes. Each registration scheme would cover not just security interests (as is presently the case in relation to motor vehicles) but title as well (as in the case of land and ships). Each register would be fully computerised using a database that was compatible with the debtor's name-indexed register. The objective would be to facilitate one-stop registration and search of title and security interests in every kind of property that was subject to the scheme.

Title to property would be registered title. Security and other interests in property could be perfected only by registration (except, perhaps, where the security holder takes physical possession of the asset). Each statute would contain a detailed set of rules for resolving:

- competing claims to ownership;
- disputes between purchasers and prior holders of security interests;
- priority disputes between competing security holders.

The approach would be to make the register determinative. So, for example, in the case of competing claims to ownership, the party with registered title would prevail; as a general rule, the holder of a registered security interest would prevail over a later purchaser; and priority between competing security holders would be determined according to the order of registration. Registration would confer immediate indefeasibility of title, but the register would be subject to rectification if

title was obtained by fraud. These rules would be complementary from statute to statute; they would be based on common concepts and framed using common terminology. There would be clear and principled provisions to identify which set of rules took precedence in cases of overlap (eg: a dispute involving a security interest in an aircraft, which would be registrable in both the debtor's name-indexed register and the aircraft register).

Greg Hammond's paper does not attempt to deal with the relationship between CHESS and wider proposals for personal property security law reform (in particular the ALRC's *Interim Report*) though footnote 1 notes the existence of the wider proposals. Nevertheless, I believe this issue to be critical. The point is that the laws and regulations governing CHESS pay no regard to the case that has been made for personal property security law reform at large. They are quite inconsistent with my own proposal. In particular, they make no proper provision for security interests, or for public search of the register. I know the ASX is concerned about potential liability for system error. However, this need not be an issue. There could be an insurance scheme to cover system error losses, based on the motor vehicle securities register model. This is a user pays scheme. It is funded out of registration and search fees. The motor vehicle security registers, far from being risky ventures, have proved to be highly profitable for governments. There is no reason why a reformulated CHESS scheme should not also be profitable.

Would the speakers care to comment?

Response - John Stumbles (Speaker):

Simon, I agree with you on CHESS. The attempt described in the paper, as to how one takes a security interest over securities on the CHESS system reveals the practical difficulties and deficiencies associated with this type of security. A thorough-going review of the area is necessary. The commercial problem however is that the clearing house is unwilling, as I understand it, to take any commercial risk whatsoever in respect of this issue and I think we have got to deal with that first, before we can move on. Bob Austin has written a report on securities and CHESS and the fundamental point he comes back to is that CHESS is not a guarantee of title. It is a facilitator for dealing with title, but no more.

Response - Michael Pattison (Speaker):

Simon, your point would seem at this stage to be already met with respect to security interests over patents, to a degree. With respect to trade marks and design, it is not met at all, for the reasons stated in my paper. I think it would be very good if the position on securities in trade marks and designs were brought into line with the principles in your paper. It would be a real challenge, though, to apply your principles to copyright, which has historically under Australian and English Law not been subject to any registration requirement at all. Indeed, under international convention now Australia would be in breach of its international obligations if it were to make subsistence of copyright subject to some registration requirement.

Response - Alan Millhouse (Speaker):

Simon, I think as regards contractual choses in action the principal problem is in identifying priorities which I referred to. The other issue that flows in taking assignments in securities and joint venture financings is the problem you are no doubt already aware of about security type Queensland problems still to be resolved in the commercial property review.

Comment - David Clifford (Allen Allen & Hemsley, Sydney):

I want to make a rather more prosaic point in relation to CHESS. I think it perhaps follows on from what John Stumbles said about the inadequacies of the system. It seems to me that the banks are responding to overseas issues with uncertificated holdings under CHESS by requiring certificates

or certificated holdings to be maintained. It seems to me that an interesting problem arises particularly with long term securities and that is there is, well it is not a mandatory requirement eventually to turn to uncertificated holdings, at least there is a promotion of that, and it is within, as I understand it, the control of the issuer of the securities as to whether they move to uncertificated holdings. That being the case, if that occurs whilst the bank is holding the certificated security, it seems to me that the only way to get notice of that occurring is by being a holder of a marketable parcel and under the ASX rules the issuer is required to give notice to a holder of the shares the fact of the change from a certificated to an uncertificated holding in the security. Perhaps John could comment on that.

Response - John Stumbles (Speaker):

I agree with that David. I think there is a real risk at the moment in holding certificated securities and my preference would be to go via the sponsorship route and get a HIN number. At least have some reliability upon whom you can rely other than the issuer.

Question - Cam Johnston (Blake Dawson Waldron, Melbourne):

I would just like to add one further complexity or competing interest to the list of complexities that Alan gave us in taking securities from joint ventures. It arises particularly, I think, in a case where a joint venture is being used to purchase or operate infrastructure. The government of course will always be concerned to ensure that the relevant infrastructure continues to operate whether it continues to generate electricity or if it is a tollway, continues to be available for use as a road. And government of course will always, in my experience, be looking for a right to step in and operate that facility, whatever it is, if the joint venture should fall over. And that competing problem of the step in right that the government is looking for with the priorities that the banks are seeking on their security and the joint venture cross charge, creates a great deal of difficulty and all sorts of complexities when negotiating those arrangements. It is really just an observation rather than a question.

Response - Alan Millhouse (Speaker):

I agree when you are negotiating risk sharing and allocation in those types of projects, it is a nightmare. And no doubt you are experiencing that in Melbourne at the moment.