

REFORM OF PERSONAL PROPERTY SECURITIES LAW IN THE CER CONTEXT

THE AUSTRALIAN EXPERIENCE

JUDE WALLACE

**Law Reform Commissioner
Law Reform Commission of Victoria**

THE LAW REFORM COMMISSION REFERENCES

The Federal Attorney General gave the Australian Law Reform Commission a reference on Security Interests in Personal Property on 8 June 1990. The reference grew out of the desirability of harmony between trade laws of Australia and New Zealand. Parallel references were given by their respective Attorneys General to the Victorian Law Reform Commission and to the New South Wales Law Reform Commission.

The references have a tight schedule. Extensive consultation has been undertaken by the ALRC which has had the major resources for work on the reference. The research and writing team is in the Australian Commission, with co-operation of the State Commissions.

Generally the Commissions work on references by appointing a team of consultants to represent the various interest groups. The consultants provide advice. They do not make decisions. Consultants generally attend preliminary meetings to work out policy on the reference, review the research, and comment on drafts of discussion papers. Because consultants are drawn from the various interested groups, they are not expected to provide a single view on any issue of substance: like the community at large, they tend to be more divided over the major issues. However, the processes of discussion and comment often draw a consensus of view, or at least a reduction of the range of views.

Decisions of the Commissions are made by the Division that is appointed by the Chairpersons in accordance with the legislative structure.

In a joint reference, each Commission is independent of the others. The Commissions work out a common view by discussion, comment and consensus. To the extent that persuasion is possible, a common paper is presented by each Commission to its Attorney General. The Attorney receives the paper in the local political context. The Government of the day is not bound to adopt a Commission Report, although the work of most commissions is actually tabled in the relevant Parliament. In the case of the VLRC, tabling is a statutory requirement. The Commissions do not involve themselves in implementation once their reports are tabled. However, they do undertake an educative and advisory role, rather than an implementation role, that tries to ensure that the work is not overtaken by more pressing political legislative agendas.

Typically Commissions are given work that is too commercially or socially sensitive to be sourced in the corridors of a single government department, or too technical for even a group of departments to provide sufficient resources to conduct a review that will withstand the divergent opinions of the affected constituencies.

Personal Property Security law both technical and commercially significant. It cannot be done by amateurs. It cannot be done without a broad agreement from the affected constituencies.

Now you see why the occasion of this Conference is so important to the Commission's work. It is a welcome opportunity to explain and inform. On behalf of the three Commissions, I thank the Association for the invitation to discuss the major issues in reform of personal property security law.

To put the Discussion Paper in context, I have four comments about the philosophy of the Commissions.

1. **Uniformity.** The Commissions work together because we preach the value of uniform law. Australia is not served well by diversity in local jurisdictions. Australian law is far too complex. Local distinctions are frequently unjustifiable, except for bureaucratic convenience. We therefore strive to produce a single voice in the (sometimes faint) hope that we will induce a common approach in the three Parliaments, a tiny antidote to the persistent process of changing law to increase local differences.
2. **Plain English legislation.** All the major reports have legislation attached. The legislation format and content is pioneer. It attacks shibboleths of legal formalism, and often draws fiercely traditional lawyers into a red-faced pontification that judges will not like the result. Our belief in the role of law, particularly legislation, in a democracy remains unshaken. Law is only good if it can work. It can only work if it can be understood by those who must use it. It can only be understood by users (even sophisticated corporate users who are used to digesting a finance facility of 40 closely printed pages) if it is written in clear language. Judges are not negative about good drafting. Our legislation, like any other, will receive critical review. No drafting can contain all possible futures. We believe it will survive the tests better than traditional legislation.

In the context of this reference, the determination to write plainly has led us to disown lawyers' games - Is it property or is it contract? Is it a Romalpa clause, or is it a sale? Is it a Unless the question has a point other than revealing adeptness in the construing of esoteric nouns for hidden legal results, our drafting makes it irrelevant. We hope, in the process, we have highlighted important questions - Who is agreeing with whom to do what? Should third parties know about this arrangement? and What simple information processes should we create?

3. **Action.** Publications are written for action, understanding and the future. The Commissions have abandoned the Ph D thesis model of law reform reporting in favour of "action documents". This is especially sensible if the work builds on exhaustive reports and research products of other Commissions. We acknowledge our debt to Sir Ken Keith, President of the Law Commission of New Zealand, and his Commission and compliment its excellent and very thorough Report, Personal Property Securities Act for New Zealand No 8 (1989).

We will publish shortly a Background Issues Paper, a Draft Bill and an Explanatory Memorandum. The documents are short. We have abandoned the survey of the past 100 years and the analysis of how we got to the present mess. We have not detailed the lumbering amounts of existing decisions and legislation. We have even been very economical (perhaps too economical) in explicating the policy support for the very worthwhile recommendations that we have produced. We believe that good ideas speak for themselves.

4. **Government Efficiency.** While an unclear line separates the proper role of the private and public sectors, there is no debate about the principal that enterprises should be run efficiently. A registration system is an enterprise. It can be run efficiently even if it is run by the public sector. The LRCV has particular expertise in these systems. We have worked on subdivision of land systems, mining title systems, land title systems and registers of government decisions about and interests in land. We know the pitfalls of reform proposals which cut into administrative arrangements. The trick is to get in at the beginning of the bureaucratic design, and to embed accountability and risk management principles in the enterprise.

Reform of personal property security law in Australia has been delayed. The running of time has, however, had its compensations. We have the benefits of reforms in other jurisdictions, and high tech efficiencies in data capture and management.

The Fundamental Principle

The work of the Commission in personal property law reform has had one single overriding policy: to make personal property securities transparent and visible.

We have not followed Article 9 of the Uniform Commercial Code because it was intended to rationalise rather than reform. Substantial underlying changes to the law were not made. It was a substantial step forward because it defined "securities" according to the purpose of the arrangements, and not their formal cloth. Subsequent legislation has relied on definitions which eschew the form and regard the substance of the security arrangement.

Since then, various personal property security schemes have been introduced: some contain priorities rules, some have limited priorities rules (for instance, they might protect insolvency situations), and others leave the priorities for general law. All these schemes have had one thing in common, however. They all demand registration. Some schemes have a complex conceptual structure built around registration, writing and possession, and even create an artificial concept of "perfection" as a legal shorthand.

The Commissions have reviewed this history and decided that the fundamental reform needed is to improve transparency. Given computer technology, the time is appropriate to have a complete, workable and effective registration system. Registration offers to the world publicity, information and transparency of security interests. It solves priority problems, and consigns antiquated law to history.

Once this policy is stated, it is relatively easy to follow our line of thinking.

Important Recommendations

The important recommendations include:

- Clear statement of the policies of the legislation. Existing pps law and proposals have an unclear set of priorities which cover:

protecting innocent purchasers
resolving priority disputes
increasing information.

- To increase information available, everything goes on the register. Lending and security-taking are made transparent and public.

All personal property is covered. In this we are slightly different from New Zealand which excludes certain property. We do not exclude rights to wages or damages: these are rarely used as security, and if they are, there is no reason why the public should not be informed. Negotiable instruments ARE excluded. Otherwise they would cease to be negotiable. Insurance policies, ships etc which are covered by other legislation were excluded in NZ and are covered in the Australian proposals in the interests of a comprehensive and accurate register. We have enough divergence: anything to remove inexcusable complications.

- The definitions are very straightforward. Like NZ we take a purpose approach to the transactions that are covered by the scheme. NZ calls them "security interests". We call them "security rights" and "security transactions". A security right is a right over property that secures the performance of a particular obligation (whether it arises from a contract or a property interest). We cover title retention arrangements, where rights are reserved on sale of property and only transferred when the balance of the purchase money is paid (Romalpa clauses). The test is a purpose test: does the right secure the performance of a particular obligation.

We are not interested in whether a right is a proprietary right rather than a contractual interest: title retention provisions, negative pledges and contractual rights of set-off are covered.

We are not concerned about whether the right arose through an agreement or by operation of law. However, rights (such as workers' liens) which arise by operation of law are usually possessory and do not require registration.

We are not concerned about the form of the transaction, or the legal character of the security right.

To help the reader, we provide a list of transactions by which rights are created, and we also exclude interests in land. Unlike New Zealand, we do not expressly include transfers of accounts receivable or chattel paper (except factoring transfers), leases for more than one year and commercial consignments because these are not security rights. If they have a security purpose, they should be registered. If they do not, they should not be.

We have excluded the minimum of specific transactions. New Zealand excludes liens created by statute, factoring agreements, assignments for the general benefit of creditors, sale of accounts receivable and chattel paper. We do not because these do not have a security purpose.

Rights which do not have to be registered are simple: rights protected by possession (not as a result of enforcing the security), and securities for \$1,000 or less.

We say what is capable of registration, and make all security rights capable of being registered, even if they need not be.

■ Registration is encouraged in four ways:

by conferring priority,

by making an unregistered right void against a liquidator or official receiver,

by criminal sanctions of \$500 to cover situations where no one suffers a loss in failing to register and perhaps only the ASC is interested

by giving a civil action for damages parallel with the Trade Practices Act and other civil liability claims under Corporations Law. Damages are the appropriate incentive under the policy because they tailor the risk of non-registration to the potential loss of a person disadvantaged.

Priorities

The simplest priority scheme is often the best. Currently, we assess priorities on a messy common law versus equity basis, plus the myriad of individual registers that exist in the commonwealth.

Our scheme is different from the earlier schemes. The earlier schemes provide a series of rules to cover particular situations, and then a general or residual rule to cover the remaining cases.

Ours proposes a series of rules, or step by step instructions, which cover all cases in a logical and ordered way. The rules start by establishing an initial priority order from which the priority of any security right can be seen in relation to all other security rights. The rules can be applied to any number of competing security rights; that is, they can be applied to determine a dispute between two competing rights, or to determine the ranking of all security rights, including those not in dispute.

ATTACHMENT 1**PLAIN ENGLISH LEGISLATIVE INITIATIVE****PRIORITY RULES IN A FLOW CHART**

The basis provision is in 282D **Priorities of security rights**.

- (1) The priority order of security rights as between themselves in respect of the same property is to be worked out in accordance with the rules set out at the end of this section.

RULES FOR WORKING OUT THE PRIORITY ORDER OF SECURITY RIGHTS

- A1 Where all financing statements registered.** Are all the security rights registered?
- (a) If yes, the initial priority order is the order in which the financing statements were lodged. Go to rule A2.
 - (b) If no, go to rule B1.
- A2 Floating charges and the like.** Do any of the relevant security transactions provide (expressly, impliedly or because of the nature of the transaction) for later security rights to take priority over the security rights arising under the transactions?
- (a) If yes, vary the priority order so that those later rights, if any, rank ahead of the rights arising under the transaction. Then go to rule A3.
 - (b) If no, go to rule A3.
- A3 Effect of possession.** Does one of the secured parties have possession of the property?
- (a) If yes, vary the priority order so that the security right of the secured party with possession ranks ahead of all the other priority rights except those for which financing statements were lodged before the secured party acquired possession. Then go to rule C.
 - (b) If no, go to rule C.

- B1 Where not all financing statements registered.** Are some (but not all) of the relevant security rights registered?
- (a) If yes, work out the initial priority order of the security rights using the following rules:
- (i) all the registered security rights rank ahead of all the other security rights;
 - (ii) the priority order, as between themselves, of the registered security rights is to be worked out by applying rules A1, A2, A3 and C as if they were the only relevant security rights; and
 - (iii) the priority order, as between themselves, of the other security rights is the order in which the security transactions under which they arose were entered into.
- Then go to rule B2.
- (b) If no, the initial priority order is the order in which the security transactions under which they arose were entered into. Go to rule B2.
- B2 Effect of possession.** Does one of the secured parties whose security right is unregistered have possession of the property,
- (a) If yes, vary the initial priority order so that the security right of the secured party with possession ranks ahead of all the other security rights except those for which financing statements were lodged for registration before the secured party acquired possession. Then go to rule C.
- (b) If no, go to rule C.
- C Powers to make further advances.** Does the amount outstanding under one of the security transactions include an amount advanced under a power (not an obligation) provided for in the transaction to make further advances?
- (a) If yes, vary the priority order so that security rights of later secured parties rank ahead of the security right so far as the further advances were made after the financing statements for the late security rights were lodged or the later secured party acquired possession of the property. Then go to rule D.
- (b) If no, go to rule D.
- D Agreements to vary priority order.** Have some or all of the secured parties agreed (otherwise than in a security transaction) to vary the priority order,
- (a) If yes, vary the priority order, so it affects those parties' security rights only, in accordance with the agreement. Then go to rule D.
- (b) If no, go to rule D.