PERSONAL PROPERTY SECURITIES LAW REFORM

THE NATIONAL REVS SCHEME, THE ARTICLE 9 PROPOSAL AND THE LAW REFORM COMMISSIONS

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INTRODUCTION

There are three main scenarios in which a third party claim to personal property might arise. The first scenario is where property owned by A is misappropriated by X and sold to B.[1] This kind of case involves competing claims to ownership. If A wins, the consequence is that B

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1 For example:
(1) X steals the property from A;
(2) X tricks A into giving up possession of the property (*Ingram v Little* [1961] 1 QB 31; *Lewis v Averay* [1972] 1 QB 198);
(3) X is a bailee (having legitimately obtained possession from A), but the sale to B occurs without A's authority.

In Case (3), the agreement between A and X whereby X obtains possession from A might be, for example, a:
(a) warehousing arrangement
(b) contract of carriage
(c) repair or maintenance agreement
(d) consignment for sale
(e) conditional sale or hire-purchase agreement.

Case (3)(e) is different from the others, because in substance the contract between A and X is equivalent to a security transaction. A is only nominally the owner of the subject property. Therefore, Case (3)(e) is really an example of the second kind of third party claim described in the text, rather than the first.

will be treated as never having obtained title, whereas if B wins A's title will be extinguished. The second scenario is where A holds a security interest and X (the debtor), without A's consent, sells the asset to B who buys it without knowing of the security arrangement. This kind of case involves a claim to ownership by B in competition with A's security interest. If A wins, the consequence is not that B gets nothing (as in the first scenario), but that B takes the asset subject to A's security interest. Conversely, if B wins, the consequence (as in the first scenario) is that A's security interest is extinguished. The third scenario is where A holds a security interest and X (the debtor) without A's consent creates another security interest in the asset in favour of B who transacts without knowing of A's prior entitlement. This kind of case involves competing claims to priority. If A wins, the consequence is that (as in the second scenario) B takes the asset subject to A's security interest. If B wins, the consequence is not that A gets nothing (as in the second scenario), but that A's security interest is postponed to B's. Whoever wins gets first claim to the asset. The other party gets any surplus after the winner's debt has been satisfied.

In each of these scenarios, the dispute between A and B is not of their own making in any direct sense. The wrongdoer is X, but often X is likely to be judgment-proof. Accordingly, the law is faced with the dilemma of having to choose between two innocent parties. The intractability of the problem is reflected in the fact that the law has fluctuated down the centuries between two opposing principles:[2]

> "[t]he first is for the protection of property; no-one can give a better title than he himself possesses. The second is for the protection of commercial transactions; the person who takes in good faith and for value without notice should get a better title".

The first principle is embodied in the Latin maxim, *nemo dat quod non habet*. It favours A. The second principle is known to civilian law as *possession vaut titre*. It favours B. The conflict of principle means that there can never be an entirely satisfactory *ex post* solution to these kinds of problems. In certain circumstances, registration may be an appropriate form of *ex ante* solution. The purpose of registration is to give B a means of discovering the existence of A's interest before B transacts with X. If A's interest is registered, B should discover it by searching. Then, assuming B is honest, the transaction with X will not go ahead and the problem of conflict is avoided. This will not be the outcome if A fails to register or B fails to search, but then, in either case, there is a clear principled basis for arriving at an *ex post* solution.

Different forms of register are needed to deal with the three scenarios just mentioned. In the first scenario, what is required is a register of title, similar to the Torrens system of registration applicable to land dealings. A title register for ships has been established pursuant to the *Shipping Registration Act* 1981 (Cth), but there are few other examples of this kind of registration system in Australia. In the United States, there is in many jurisdictions provision for the registration of title to motor vehicles but there is no corresponding legislation in this country.

In the second scenario, what is required is a register of security interests indexed against the asset in question. The best local example of this kind of scheme is the provision in all States for the registration of security interests in motor vehicles (this is the so-called "REVS scheme"). This kind of registration scheme (as with title registration) is only possible in the case of property that is capable of being individually identified, by means such as a serial number. Examples include cars, caravans, trailers, motor boats, ships, aircraft, patents, trademarks and insurance policies.

In the third scenario, what is required is a register of security interests indexed either against the asset or the name of the debtor. Neither alternative is perfect. A debtor's name-indexed

2 *Bishopsgate Motor Finance Corporation v Transport Brakes Ltd* [1949] 1 KB 332 at 336-337 per Denning LJ.

registration system provides information about prior security interests in an asset created by a particular person. However, it will not necessarily provide information about security interests in an asset created by a prior owner.[3] Furthermore, the system is vulnerable to the use of false names. An asset-indexed system is subject to neither of these limitations. On the other hand, what this kind of system will not disclose is information about all the security interests a particular person has created. This information may be of value to intending creditors, and it can only be generated by a debtor's name-indexed registration system. A further limitation of an asset-indexed system is that it does not enable the recording of information relating to unascertained goods until they are ascertained. This is because registration depends upon the asset being capable of precise identification.[4] An example of an asset-indexed registration scheme directed to the third scenario is the *Chattel Securities Act* 1987 (Vic), section 10 of which deals with competing claims between the holders of registered security interests in motor vehicles.[5] An example of a debtor's name-indexed registration scheme directed to the third scenario is the registration of charges provisions set out in Part 3.5 of the *Corporations Law*.

The purpose of this paper is to discuss recent developments in the use of registration systems in the three scenarios described above, and also proposals for reform. Particular attention will be given to:

(1) the moves to establish a national REVS scheme (these moves are relevant to scenario (2)); and

(2) proposals for legislation based on Article 9 of the United States *Uniform Commercial Code*, including the establishment of a comprehensive debtor's name-indexed register of security interests at the national level (these proposals are relevant to scenario (3)).

The conflicting views of the Queensland and Victorian Law Reform Commissions and the Australian and New South Wales Law Reform Commissions concerning the Article 9 solution will also be discussed.

SCENARIO (1): TITLE REGISTERS

The need to choose between A and B in the case of a dispute about a misappropriated asset is a product of imperfect information. In a world of perfect information, B would know about A's interest in advance of contracting with X so that (assuming B was honest) the transaction would not take place.[6] One way of improving the information available to parties at the time of transacting is to establish a system of title registration. If A's title is registered, B has an easy means of discovering it, and if B does make this discovery then the transaction with X is unlikely to take place.[7] If A fails to register, then as a general rule, B should win but

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3 Cf *Corporations Law*, section 264 which provides for registration in the case where a company acquires property subject to a charge that would have been registrable if it had been created by a company in the first place. However, this provision is only relevant where the company contracts for title in the property subject to the encumbrance. It does not apply where the debtor (fraudulently) purports to transfer an unencumbered title to the property.

4 See Begg, "The Registration of Security Interests in Chattels" (1981) 55 *Australian Law Journal* 649 at 651-652.

5 See also *Chattel Securities Act* 1987 (WA), section 10; *Motor Vehicles Securities Act* 1986 (Qld), section 12; *Goods Securities Act* 1986 (SA), sections 11 and 12.

6 Baird and Jackson, "Information, Uncertainty and the Transfer of Property" (1984) 13 *Journal of Legal Studies* 299 at 300.

7 Another alternative is to base claims to ownership on possession. Then the fact of A's (or X's) possession is a signal to B of ownership. However, possessory rules are

otherwise A should prevail. These simple rules act as incentives for A to register and B to search so that the loss is avoided.

On the other hand, registration systems generate their own costs, including:

(1) the cost of establishing and maintaining the register; and

(2) the cost to the parties of registration and search.

Whether the benefits of registration outweigh the costs depends on the kinds of property involved.[8] Baird and Jackson argue that registration is likely to be a viable option if the following conditions are satisfied:

(1) the property is valuable and is not transferred often;

(2) it is important to share ownership of the property among several individuals, such as creating a future interest or a security interest;

(3) the physical use of the property is important, or the underlying property right is abstract or unembodied;

(4) the subject property is capable of precise identification;

(5) the asset has a long life; and

(6) the property is unlikely to move.[9]

Conditions (1) and (5) are important, because otherwise the costs of registration are likely to be high relative to the benefits. If conditions (2) and (3) are not satisfied, then a rule which bases claims to ownership on possession of the asset is likely to be a cheaper alternative than registration. Conditions (4)-(6) reflect the fact that an effective system of title registration is dependent on the establishment of an asset-indexed register. A's interest must be registered against the asset, and B must be able to search for interests registered against the asset. In the absence of a unique identifier, this kind of register will not be feasible.

Real property is the paradigm of property for which a system of title registration is superior to other kinds of rule.[10] At the other extreme, money provides the clearest example of property that is not amenable to a registration system.[11] Other kinds of property fall between these two extremes. In most cases, the benefits of a system of title registration will not outweigh the costs.[12] However, there are two exceptions. The first relates to goods such as

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inferior to registration because: (1) they impede temporal divisions of ownership of property; (2) they make the tracing of claims for more than one generation difficult, and therefore increase the risks of a thief in the chain of title; and (3) they inhibit commercial transactions which are dependent on a separation of ownership and possession (including hiring agreements, non-possessory security transactions, warehousing arrangements, contracts of carriage, repair and maintenance agreements, and consignment sales): *ibid* 301-303.

8 *Ibid* 303-304.

9 *Ibid* 304.

10 *Ibid.*

11 *Ibid* 306.

12 *Ibid.*

aeroplanes, motor vehicles and ships. In these cases, condition (1) is, on balance, satisfied. While it is true that the assets concerned are, on average, probably less valuable than land and are likely to be transferred more often, they compare favourably with other classes of goods in these respects. Furthermore, the costs of title registration are reduced because of licensing and registration laws (introduced for other purposes) that require the gathering and recording of information relating to these kinds of property in any event.[13] Conditions (2) and (3) are obviously satisfied, and serve to distinguish these kinds of property from many other classes of asset. Condition (4) is also capable of being satisfied, whether by means of registration number, engine number or a composite serial number such as the VIN system ("Vehicle Identification Number"). Condition (5) is satisfied: the property in question is obviously less durable than land, but it has a longer life than many other kinds of asset. Condition (6) is not directly satisfied, but it is capable of being addressed indirectly by:

- the establishment of a single national register or separate computer-linked State registers (so that movement of the goods within national boundaries becomes immaterial);
- the States making reciprocal arrangements for the recognition of interstate registration;
- an administrative rule making production of a valid certificate of title a prerequisite to the registration in State 2 of goods that have been moved from State 1; or
- the enactment of uniform conflict of laws rules in State registration statutes.[14]

The second exceptional case relates to items of intangible personal property such as patents, copyrights and trademarks. In the case of a patent, for example, without a special rule B will have no way of confirming whether or not A is the inventor or a transferee of the inventor's entitlement. There are two kinds of rule capable of dealing with this problem. The first assimilates abstract rights to a possession-based regime (as where the entitlement becomes embodied in a piece of paper, with possession of the paper signifying the locus of the entitlement). The alternative is a registration system, under which A's entitlement depends on whether it is properly noted. The advantage of registration over a paper-based title system is that it facilitates the creation of partial ownership interests, such as security interests.[15]

In Australia, there are systems of title registration covering ships,[16] as well as patents, designs and trademarks.[17] In contrast to the position in the United States, there is no system of title registration for motor vehicles. On the basis of a study concluded in 1967, Peden concluded that the introduction of a system of title registration for motor vehicles at that time was "probably unjustifiable".[18] However, his conclusion was an equivocal one, and it was in any event reached in pre-computerisation days. Registration systems are capable of being delivered more cheaply today, in the wake of the dramatic technological advances that have occurred since the date of Peden's study. The issue of title registration for motor vehicles deserves fresh consideration in the light of modern conditions, with particular reference to:

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13 *Ibid* 310.

14 *Ibid*; Peden, "Title Problems in Relation to Chattels - Proposals for a Registration System for Motor Vehicles in Australia" (1968) 42 *Australian Law Journal* 239 at 249; QLRC/VLRC Discussion Paper, para 2.1.3(b).

15 Baird and Jackson, *op cit* 311.

16 *Shipping Registration Act* 1981 (Cth).

17 *Patents Act* 1990 (Cth); *Designs Act* 1906 (Cth); *Trademarks Act* 1955 (Cth).

18 *Op cit* 250. See also United Kingdom, *Report of the Committee on Consumer Credit*, Cmnd 4596 (1971), paras 5.7.17-5.7.20 ("Crowther Committee Report").

(1) the extent of the problem (the incidence of motor vehicle misappropriation); and

(2) the likely costs of extending existing motor vehicle registers to record title details.[19]

In New South Wales and Victoria, the REVS legislation provides for inclusion on the register of information relating to stolen vehicles.[20] This is an embryonic version of title registration. However, a fully fledged title registration system is superior because under a title registration system, B will be alerted to any deficiency in A's title as a matter of course (it will appear on the certificate of title), whereas under the present law the system will break down if:

(1) a theft is not recorded; or

(2) B fails to search the register.

SCENARIO (2): ASSETS-INDEXED REGISTERS OF SECURITY INTERESTS

The Function of Registration

As in the case of stolen goods, the need to choose between A (the secured party) and B (the third party purchaser) where X (the debtor) wrongfully disposes of a secured asset is a result of B's imperfect information at the time of transacting with X.[21] A partial solution to this information problem would be for the law not to recognise transfers of property without possession. If A took possession of the asset by way of security, then B would be on notice of A's entitlement. Correspondingly, if X remained in possession, B could transact safe in the knowledge that there had been no secret transfer.[22] At one time, it was the law that a valid security interest in real or tangible personal property could be created only by the transfer of possession.[23] However, there are difficulties with this approach:[24]

(1) the rule offers no protection to B where A gives possession to X but retains title, or where X gives possession to A by way of security, and A purports to transfer unencumbered title in the asset to B; and

(2) it means that a debtor who wants to be able to use an asset cannot offer it as security.

Particularly for the latter reason, in an advanced economy the possession rule is impracticable.

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19 See Queensland Law Reform Commission and Law Reform Commission of Victoria, *Personal Property Securities Law: A Blueprint for Reform* (QLRC Discussion Paper No 39 and VLRC Discussion Paper No 28, August 1992), Chapter 3.6 ("QLRC/VLRC Discussion Paper"). See also Committee of the Law Council of Australia, *Report to the Attorney-General for the State of Victoria on Fair Consumer Credit Laws* (1972), para 5.10.2 ("Molomby Committee Report").

20 *Registration of Interests in Goods Act* 1986 (NSW), section 5(3); *Chattel Securities Act* 1986 (Vic), section 24(2)(b).

21 See text at n 6, above.

22 Baird and Jackson, *op cit* 302-303.

23 *Twyne's Case* 3 Coke's Reports 80b (1601).

24 Baird and Jackson, *op cit* 307-308.

Registration is an alternative to possession as a means of solving the information problem. If A's security interest is registered, B has an easy way of discovering it, and it does not matter that X is in possession. The bills of sale legislation represented an early and regrettably long-lived attempt to substitute registration for the possession rule. The bills of sale legislation was deficient in three main respects:

(1) like the possession rule it replaced, it applied only to transfers, and the most important consequence of this came to be that it gave no protection to B in cases of hire-purchase;

(2) under the legislation, registration was required in order for the transfer to be valid, and this was an excessively heavy-handed approach (it would have been sufficient to make A's entitlement against B dependent upon registration); and

(3) transfers were registrable against the name of the transferor (X), rather than against the asset.

The drawback of a name-indexed register is that, while it enables B to discover all the transfers X has made, it provides no information about interests in a particular asset that may have been transferred to a third party by previous owners. A prospective purchaser (B) will be less interested in knowing about X's asset dealings at large, than about the dealings by X and others in the particular asset to be purchased.

An asset-indexed register of security interests is subject to more or less the same policy considerations as title registers.[25] A register of security interests is likely to be less expensive than a title register because there would be fewer registrable dealings. But even allowing for this, in most cases, the benefits of establishing such a register are unlikely to outweigh the costs.[26] The exceptional cases are the same as for title registers.[27]

The REVS Scheme

One of the exceptional cases is motor vehicles, and this case has been provided for in all Australian jurisdictions by the enactment of motor vehicle security statutes.[28]

The substance of this legislation is the same from one jurisdiction to another. It provides for the establishment of an asset-indexed register of security interests in motor vehicles. Like Article 9, it is not limited to security interests in the strict sense, but extends to all transactions that are in substance security transactions including title retention arrangements. Registration is not compulsory, but as a general rule an unregistered security interest will be extinguished in the event of a *bona fide* third party purchase. Correspondingly, as a general rule, a registered security interest prevails over a *bona fide* third party purchaser. These rules confront A with the incentive to register and B with the incentive to search. If both parties respond appropriately, then X's fraud will be discovered before any transaction with B takes place. One consequence of the registration scheme should therefore be a substantial

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25 See text at nn 8-9, above.

26 Baird and Jackson, *op cit* 306.

27 See text following n 12, above.

28 *Registration of Interests in Goods Act* 1986 (NSW); *Registration of Interests in Goods Act* 1990 (ACT); *Registration of Interests in Motor Vehicles and Other Goods Act* 1990 (NT); *Motor Vehicle Securities Act* 1986 (Qld); *Chattel Securities Act* 1987 (Vic); *Chattel Securities Act* 1987 (WA); *Goods Securities Act* 1986 (SA); *Motor Vehicle Securities Act* 1984 (Tas). For a comprehensive description of this legislation, see Duggan, Begg and Lanyon, *Regulated Credit: The Credit and Security Aspects* (1989), Chapter 7.

reduction in the incidence of fraudulent dealings by debtors in motor vehicles that are the subject of existing security interests.

In most jurisdictions, there are two main exceptions to the rule that a registered security interest prevails over a *bona fide* third party purchaser. The first relates to the case where X is a dealer and gives A a security interest over its stock-in-trade ("inventory security interest"). It is a feature of inventory security interests that the financier (A) agrees to allow the dealer (X) to continue to trade its stock in the ordinary course of business. If a registered security interest were to prevail over a *bona fide* third party purchaser, A would obtain a benefit that had not been bargained for and, if such a rule were to be applied systematically, it would preclude dealers from offering their stock-in-trade by way of security. The second exception relates to the case where a vehicle is purchased from a dealer by a private buyer.[29] In New South Wales and Victoria, a compensation fund has been established to assist the victims of a motor dealer's misconduct. Failure by a dealer (X) to discharge a registered security interest before selling a vehicle to B amounts to misconduct. If the registered security interest were to prevail in these circumstances, B would have a claim against X for breach of contract (failure to transfer clear title), and if X were judgment-proof, B would have a claim against the fund. The end results would be that:

(1) the financier (A) took the vehicle; and

(2) B obtained a monetary payment.

This represents the reverse of the parties' likely preferred outcomes. A swap would then have to be negotiated, involving transactions costs on both sides. These transactions costs can be avoided by giving A the money claim and B the vehicle in the first place, and this is what the legislation seeks to achieve. The rationale for this special rule only holds if there is a compensation fund to which A is given access in cases where the rule applies. If a registered security interest is routinely extinguishable without A having ready access to compensation, the likely consequence will be an appreciable increase in the cost of motor vehicle finance. Furthermore, such a rule would reduce the incentive for A to register, so diminishing the capacity of the registration system to achieve loss avoidance objectives. Regrettably, this consideration has been ignored in some of the States where the rule has been adopted: in Western Australia, there is no compensation fund, while in New South Wales, access to the motor dealers' compensation fund has not been granted to financiers in the circumstances under consideration. By contrast, in Victoria, statutory provision has been made for financiers to claim against the fund,[30] although the amount allowable in respect of any one claim is limited to $20,000.

The National REVS Scheme Proposal

Consider the following case:

A holds a security interest in a motor vehicle. A's security interest is registered in New South Wales. X (the debtor), without A's consent, moves the vehicle to Victoria and sells it privately to B. B has no knowledge of A's security interest.

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29 See: *Registration of Interests in Goods Act* 1986 (NSW), section 9; *Chattel Securities Act* 1987 (Vic), section 7(2); *Chattel Securities Act* 1987 (WA), section 7(2). The legislation in the Territories is the same as in New South Wales: *Registration of Interests in Goods Act* 1990 (ACT), section 9; *Registration of Interests in Motor Vehicles and Other Goods Act* 1990 (NT), section 9.

30 *Motor Car Traders Act* 1986 (Vic), section 76(2).

There are two possible variants:

(1) X has the vehicle re-registered in Victoria, so that when it is sold to B it carries Victorian number-plates; and

(2) the vehicle still carries New South Wales plates at the time it is sold to B.

Under previous Victorian law, this difference did not matter: either way, B was likely to win and A's security interest would be extinguished.[31] The governing provision is *Chattel Securities Act* 1987, section 7(1), which provides in relevant part as follows:

> "if a secured party has -
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> (a) an unregistered security interest (whether or not over registrable goods); or
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> (b) a registered inventory security interest -
>
> in goods but is not in possession of the goods and a purchaser purchases or purports to purchase an interest in the goods...for value in good faith and without notice when the purchase price is paid...of the security interest from a supplier being -
>
> (c) the debtor; or
>
> (d) another person who is in possession of the goods in circumstances where the debtor has lost the right to possession of the goods or is estopped from asserting an interest in the goods against the purchaser -
>
> the security interest of the secured party is extinguished".

In the case under discussion:

- A's security interest is not "registered" within the meaning of the Act.[32]
- B did not have "notice", within the meaning of the Act, of A's security interest at the time of the purchase.[33]

Therefore, B wins.

This outcome is in principle the right one in the case where the vehicle is sold with Victorian plates, but the wrong one in the case where it is sold still carrying New South Wales plates. It is the wrong outcome in the second case because the New South Wales plates should alert B to the possibility that the vehicle might be subject to a security interest registered in New South Wales. A legal outcome which favours B acts as a disincentive to search the New South Wales register.

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31 The dispute between A and B will be subject to Victorian law because the vehicle was situated in Victoria at the time of the conversion: see Duggan, Begg and Lanyon, *op cit* para 7.3.90.

32 "Registered" means registered under Part 3 of the Act: *Chattel Securities Act* 1987 (Vic), section 3(1).

33 For the purposes of the Act, "notice" is limited to actual notice and deliberate abstention from inquiry, and it does not extend to constructive notice: *Chattel Securities Act* 1987 (Vic), section 3(5).

Consider the mirror-image case:

> A holds a security interest in a motor vehicle. A's security interest is registered in Victoria. X (the debtor), without A's consent, moves the vehicle to New South Wales and sells it privately to B. B has no knowledge of A's security interest.

This time, the dispute between A and B will be governed by New South Wales law. In contrast to the position under previous Victorian law, in New South Wales until recently it probably did make a difference whether the vehicle carried domestic or interstate plates at the time of the sale. If it carried New South Wales plates, then the likely outcome was that B would win under the New South Wales statutory version of the *bona fide* purchaser rule.[34] However, if the vehicle still carried Victorian plates, then the likely outcome was that A would win. This is because, for the purposes of the New South Wales Act, "notice" includes constructive notice,[35] and if the vehicle still carried Victorian plates B would arguably be on notice of any security interest that was registered in Victoria.

It follows from the foregoing that there were at least two deficiencies in the previous law:

(1) the benefits of registration to financiers were limited, in the sense that registration of a security interest in one State would not necessarily give protection against the risk of conversion in another State; and

(2) there was a potential for different legal outcomes on the same set of facts, depending on whether Victorian or New South Wales law applied.

The optimal solution would have been to replace the various State registers with a single national register of motor vehicle security interests, and to enact uniform State laws. In 1991, the finance and motor industries, in conjunction with State and Territory governments, commissioned Ernst and Young to carry out a feasibility study for the development of a national register. The study found compelling technical, operational and financial reasons for the establishment of a central data base to support a national register. It recommended that customer services should continue to be provided by individual States, but using the national data base. The national data base would be operated, as a commercial venture, by a limited liability company formed for the purpose, in which shares would be held by the participating States and Territories. The study also recommended that, in the first instance, only minimal legislative changes should be made to existing State laws so that the national registration scheme could be put into place as quickly as possible. It foreshadowed the introduction of uniform State legislation further down the track. The national REVS proposal received endorsement from the meeting of State Premiers and Chief Ministers of the Territories held in Adelaide in November 1991[36]

Unfortunately, notwithstanding these promising beginnings, the project subsequently became stalled. One of the reasons, apparently, was that Victoria and New South Wales could not agree on the location of the national register. This is a depressing, if familiar enough, outcome. Fortunately, the project did not break down completely. In due course, a compromise was reached. It was agreed that there should be two "national" data bases - one located in Sydney, and the other in Melbourne. The New South Wales data base would service the requirements of New South Wales and Territories users, while the Victorian data base would service Victoria and possibly Tasmania and South Australia. At this stage,

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34 *Registration of Interests in Goods Act* 1986 (NSW), section 9.

35 *Registration of Interests in Goods Act* 1986 (NSW), section 8; see Duggan, Begg and Lanyon, *op cit* para 7.3.49.

36 The foregoing history of the national REVS proposal derives from Holloway, "National Register of Encumbered Vehicles" (paper presented at the Business Law Education Centre Third Annual Credit Law Conference, Gold Coast, 8-11 September 1993).

Western Australia and Queensland plan to persevere with their own separate data bases, but to exchange summary data with the two "national" registers. The idea is that a person searching the register in, say, New South Wales will be alerted to any possible problems affecting the vehicle in Queensland or Western Australia and a detailed search of the relevant register should then follow.

The Victorian and New South Wales registers operate on the basis of identical and interlinked computer systems. Within 24 hours of a security interest being registered in one State, details of the entry are transmitted to the other State and entered on the register there. The entry will thereupon be treated as registered for the purposes of that State's legislation. The impact of these changes can best be explained by reference to the two mirror-image case studies, discussed earlier. In the first case, under the new arrangements, A will defeat B because under section 7(1) of the *Chattel Securities Act* 1987 (Vic), the *bona fide* purchaser rule does not apply if A's security interest is registered in the relevant sense. It is immaterial whether the vehicle carries Victorian or New South Wales number-plates at the time it is sold to B. In either circumstance, this is in principle the correct outcome, given that the existence of A's security interest should be readily discoverable by B from a search of the Victorian register. In the second case, A will again defeat B because A's security interest will be treated as registered for the purposes of the *Registration of Interest in Goods Act* 1986 (NSW) once details of the Victorian entry have been incorporated into the New South Wales data base. In short, at least in the case of those States and Territories subscribing to one or other of the Victorian or New South Wales data bases, the system replicates the advantages of a single national register (though at a higher cost). One incidental consequence of this is to eliminate non-uniform outcomes from State to State which arise out of different statutory approaches to the concept of "notice" (as in the above case studies).

What if there is a system error so that, for example:

- in case study (1), A's New South Wales-registered security interest is not entered on the Victorian register; or
- in case study (2), A's Victorian-registered security interest is not entered on the New South Wales register?

The compensation provisions in the Victorian legislation have been amended to deal with this problem,[37] and corresponding changes to the New South Wales statute are contemplated. The basic scheme is that compensation for system errors will be payable in the first instance by the State whose law governs the dispute between the security holder (A) and the third party purchaser (B). (For example, in case study (1) above, compensation for any system error would be payable by Victoria.) Two main kinds of system error are possible under the new arrangements:

- transmission errors
- reception errors

Victoria and New South Wales will enter into an arrangement to deal with the sharing of responsibility for system errors. The gist of the likely arrangement is as follows. If Victoria is liable to compensate A, but the case is one of transmission error (in other words, the fault lies at the New South Wales end), then Victoria will be entitled to an indemnity from New South Wales. On the other hand, if the case is one of reception error (in other words, the fault lies at the Victorian end), then Victoria will be left to bear the compensation cost. There will be a mirror-image set of provisions to cover the case where compensation is payable to A in the first instance by New South Wales.

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[37] *Chattel Securities Act* 1987 (Vic), sections 25 and 26.

SCENARIO (3): DEBTORS' NAME-INDEXED REGISTER OF SECURITY INTERESTS

The Function of Registration

In the case of a dispute between competing security holders, policy considerations strongly favour a first in time priority rule. A rule favouring the later security interest would mean that no prospective creditor could be confident at the outset that its security would end up being worth anything.[38] In other words, if a debtor could dilute a security interest by granting unsubordinated rights in the same property to later creditors, security interests would be made worthless and no-one would take them.[39] At common law, the general priority rule is first in time, but there are exceptions. Where the exceptions apply, A will often attempt to protect its priority status by resort to negative pledge covenants in the loan agreement with X. The floating charge is an obvious case in point.

The first in time priority rule means that, at the time of transacting with X, A does not need to be concerned about later security interests. However, it does need to worry about earlier ones. The conventional justification for a registration requirement is that registration is one method of making the required information available to prospective creditors. In this connection, a registration system for security interests coupled with a first to file (register) priority rule has been likened to the law governing mineral claims, because it makes the existence of property rights public in a clear and unambiguous way:[40]

> "[a] prospector in the Old West could explore land, confident that no-one else had a claim to it that could be superior to his as long as no markers indicated it belonged to someone else. Similarly, a creditor can lend money to a debtor with confidence because he knows (by looking at the files) that no other existing creditor can claim an interest in the property superior to his own".

Current Registration Requirements

Where X is a company, the common law priority rules will be displaced in favour of the priority rules set out in Part 3.5 of the *Corporations Law* (assuming that A's and B's security interests are both registrable charges for the purposes of the legislation).[41] In summary, the statutory priority rules are as follows:[42]

(1) where both security interests are registered, priority is determined according to the order of registration, except where B's security interest is registered first and B had notice of A's security interest at the time when B's security interest was created;

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38 Jackson and Kronman, "Secured Financing and Priorities Among Creditors" (1979) 88 *Yale Law Journal* 1143 at 1161-1164.

39 Schwartz, "A Theory of Loan Priorities" (1989) 18 *Journal of Legal Studies* 209 at 216. A possible precaution might be to include a negative pledge covenant in the loan agreement. However, this is a deficient solution in two respects: (1) as the law presently stands, a covenant would be enforceable by A against X, but its enforceability against B is problematical; and (2) if parties are likely more often than not to contract around a rule which gives priority to B, then it is cheaper to change the rule so that priority is given to A in the first place.

40 Baird, "Notice Filing and the Problem of Ostensible Ownership" (1983) 12 *Journal of Legal Studies* 53 at 63.

41 *Corporations Law*, section 262.

42 *Corporations Law*, Part 3.5, Div 3.

(2) where B's security interest is registered, but A's is not, priority goes to B, subject to the notice exception just mentioned;

(3) where A's security interest is registered, but B's is not, priority goes to A; and

(4) where neither security interest is registered, priority is determined according to the order of "creation" of the security interest (A wins).

There are special provisions applicable to the case where A's security interest is a floating charge,[43] and also to deal with tacking for further advances.[44]

Where the subject-matter of the security transaction is a motor vehicle, A's and B's security interests will both be registrable under State motor vehicle securities legislation. In some States, there is a priority rule to the effect that the first registered security interest wins.[45]

The Article 9 Proposal

The *Corporations Law* establishes a debtors' name-indexed register of security interests. It is designed for the protection of intending creditors of the debtor company. UCC Article 9 has a similar purpose. The main differences are as follows:

- Article 9 is not limited to the case where X is a company
- it is not limited to security interests in the strict sense (mortgages and charges), but also applies to arrangements which are functionally indistinguishable from security transactions (for example, conditional sales or Romalpa agreements, certain kinds of hiring agreement and outright assignments of receivables ("book debts") and chattel paper[46]
- under Article 9, priority as between two registrable security interests (A and B) is generally determined by reference to the order of filing for registration, and notice is irrelevant[47] (this general rule is subject to displacement by a series of particular rules covering designated kinds of priority dispute and which have been developed with functional or policy considerations in mind)

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43 *Corporations Law*, section 279.

44 *Corporations Law*, section 282. See further, text at n 57, below.

45 Eg: *Chattel Securities Act* 1987 (Vic), section 10. The rule is expressly subordinated to the *Corporations Law* priority rules in cases where both statutes apply.

The *Goods Securities Act* 1986 (SA) contains a similar priority rule, but there is no statutory direction as to the outcome in a case of conflict with the *Corporations Law*. However, it has been judicially determined that the *Corporations Law* takes precedence: *Australian Central Credit Union v Commercial Bank of Australia* (1991) ASC 56-037 (F S Ct of SA).

46 Article 9 lays down special rules with regard to chattel paper. In the United States, a common method of financing the acquisition of expensive consumer durables, such as motor vehicles, is for the retailer to enter into a credit sale contract with the customer together with a written security agreement that gives the retailer a lien on the asset to secure payment of the purchase price. The credit sale contract and the security agreement together constitute chattel paper (see Article 9.308(b)). The retailer, having concluded the agreement with the customer, will usually assign the chattel paper to a third party financier.

47 See further, text at n 55, below.

- under the *Corporations Law*, registration entails lodgment of the security document itself, whereas under Article 9 registration is effected by filing a short abstract of the security transaction ("financing statement")

- as a consequence of the Article 9 system of notice filing

  - registration by electronic means is facilitated (at least until recently, computer systems would have had difficulty coping with a requirement for document registration)

  - a security interest can be registered before the security transaction has been formally concluded (in such a case, the security holder's priority dates from the time of registration, not the time when the agreement is concluded)

- under Article 9, there is no penalty for failure to register (the risk of postponement to B is regarded as being a sufficient incentive for A to register its security interest).

Adoption in Australia of legislation based on the Article 9 model would involve repeal of the provisions in the *Corporations Law* governing registration of charges, and other statutory registration schemes, such as the bills of legislation, and requirements for the registration of assignments of book debts. These, and all other existing debtors' name-indexed registers of security interests in personal property would be subsumed under the new arrangements. However, asset-indexed registers of security interests (such as the REVS register) would be retained, because these serve discrete functions. They are directed mainly to scenario (2), above, whereas Article 9 is directed to scenario (3). The new Article 9 register should be interlinked with the existing asset-indexed registers so as to maximise the benefits of both registration and search.[48] Careful attention would need to be given to the avoidance of overlapping rules in cases where the Article 9 statute and legislation establishing an asset-indexed register of security interests both apply.[49]

Adoption of the Article 9 solution would have two particular advantages for Australia:

- it would avoid the overlapping registration requirements that characterise the present law

- it would replace the patchwork of statutory, common law and equitable rules that govern priority disputes with a set of principles that are functionally based, not arbitrary.

A third advantage is that if an Article 9 solution is adopted on a national basis, or at least a uniform State basis, the kinds of conflict of laws problem that tend to crop up in a federal system can largely be avoided.

The Article 9 solution has been widely adopted throughout the United States, and also in a number of Canadian provinces. Adoption of an Article 9 solution was recently recommended in the United Kingdom by Professor Aubrey Diamond in a report to the Department of Trade and Industry.[50] Professor Diamond's report builds on recommendations made some 20 years previously by the Crowther Committee on consumer credit.[51] Article 9 reforms were recommended for Australia by the Molomby Committee as long ago as 1971,[52] but these

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48 QLRC/VLRC Discussion Paper, para 3.3.8.

49 *Ibid* paras 3.4.1-3.4.5.

50 Diamond, *A Review of Security Interests in Property* (HMSO, 1989), Chapter 4.

51 Crowther Committee Report, Chapter 5.7.

52 Molomby Committee Report, Chapters 5.9 - 5.14.

proposals were never adopted. In 1988, the New Zealand Law Commission produced a report recommending the adoption in New Zealand of personal property securities legislation based on Article 9.[53] A draft bill was prepared, and for this purpose the text of the British Columbia version of the Article 9 model was used as a starting point.[54]

Race Statutes and Notice Statutes

As already mentioned, one difference between Article 9 and the registration of charges provisions in the *Corporations Law* has to do with the priority rules: under the *Corporations Law*, as a general rule, B will obtain priority over A if:

(1) A's security interest is not registered, or is registered after B's; and

(2) B has no notice of A's security interest at the time of transacting with X.

By contrast, under Article 9, knowledge gained outside the filing system is irrelevant, and priority between competing security interests is determined solely by reference to the order of filing for registration. The *Corporations Law* is an example of a "notice" statute, whereas Article 9 is an example of a "race" statute.[55] Race statutes incorporate a pure first to file rule, whereas notice statutes employ a qualified first to file rule.

From a policy perspective, there are reasons for suggesting that race statutes are superior to notice statutes. Notice statutes necessarily entail higher administrative costs, because any inquiry into knowledge is likely to be expensive and time-consuming. These increased costs are probably not matched by the benefits.[56] The issue arises in cases where A forgets to register its security interest or A's registration is defective. In these circumstances, there are two possible arguments in favour of a knowledge requirement:

(1) it takes away the benefit B might otherwise derive from the information, and therefore confronts B with an incentive to disclose it (either by correcting the register, or by telling A); and

(2) it prevents B from taking advantage of A's mistake.

Neither argument is persuasive. The first assumes that a knowledge requirement will improve the information in the registration system. However, it overlooks the fact that, under a notice statute, non-disclosure will be penalised only if B proceeds to transact with X. A knowledge requirement is just as likely to drive B away, as it is to induce B to disclose the information to A or the register. Disclosure is costly, and it does not guarantee B priority. On the contrary, the most likely result of disclosure is that B will end up being subordinated to A. Moreover, if B is driven away, A will be no better off. Its security interest will still be at risk of postponement in the event that X can find a substitute for B who does not have knowledge of A's interest.

The second argument in favour of a knowledge requirement assumes that B's superior information provides it with opportunities for exploitation. This is not necessarily the case. If B knows about A's security interest, three alternative courses of action are open to it:

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53 New Zealand Law Commission, *A Personal Property Securities Act for New Zealand* (Report No 8, 1989). The NZLC report built on work previously done for the Commission for two consultants: Farrar and O'Regan, *Reform of Personal Property Security Law: A Report to the Law Commission* (NZLC Preliminary Paper No 6, 1988).

54 *Personal Property Security Act* 1989, 5 BC 1989, c 36.

55 Baird and Jackson, *op cit* 312-313.

56 *Ibid* 314.

(1) to disclose;

(2) not to transact with X; or

(3) to transact with X without disclosing.

If option (1) or (2) is adopted, B obtains no advantage. If option (3) is adopted, B is likely to demand a higher interest rate by way of compensation for the risk of being postponed to A pursuant to the knowledge rule. However, this will immediately make B uncompetitive in relation to other financiers who, without knowledge of A's security interest, may be prepared to deal with X. B might respond by sharing the information with its competitors, but once the information is out, B loses whatever advantage it might otherwise have conferred. Therefore, the most likely outcome is that B will reject option (3). That leaves options (1) and (2), and the choice between them will be shaped by the considerations already discussed.

Priority for Further Advances (Tacking)

There are many matters of detail relating to Article 9 that cannot be canvassed in a general discussion of this nature. However, one issue worth mentioning is the vexed question of tacking.

In Australia, the rules relating to tacking for further advances are in an unsatisfactory state. The position varies according to both the status of the debtor and, in some States, also the nature of the secured asset. Where X is a company, and A's and B's security interests are both registrable charges, the statutory priority rules set out in Part 3.5 of the *Corporations Law* apply. These give priority in respect of a further advance if there is provision in the agreement between A and X for the making of further advances and any one or more of the following conditions is satisfied:

(1) A has no actual notice of B's security interest at the time of making the further advance;

(2) A and X have agreed upon a specified maximum amount for further advances which is noted on the register, and this limit has not been exceeded; or

(3) the agreement between A and X obliges A to make the further advance.[57]

Where X is not a company, a different set of rules applies. A's security interest will take priority over B in respect of A's further advance in any one of three cases:

(1) if an arrangement to that effect is made between A and B;

(2) if A had no actual notice of B's security interest at the time of making the further advance; or

(3) where the agreement between A and X obliges A to make the further advance.[58]

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[57] *Corporations Law*, section 282. Similar rules applied in some American states before the enactment of Article 9: see Jackson and Kronman, *op cit* 1181-1182.

It is common practice for parties to rely on condition (2), and in this connection to specify an artificially high maximum amount. This secures for A the full protection of registration, while at the same time preserving flexibility with respect to future lending decisions. It also results in the information disclosed on the register being virtually meaningless so far as B is concerned.

[58] See, eg, *Property Law Act* 1958 (Vic), section 94.

Both sets of rules stand in contrast to the equitable rules governing tacking. In equity, tacking is not permissible if A had notice of B's security interest at the time of making the further advance,[59] and this rule applies even if the agreement between A and X obliges A to make the further advance.[60]

Under Article 9, the priority which A obtains by registering its security interest extends to all further advances, subject to any subordination agreement that may be entered into between A and B.[61] The rule applies regardless of whether:

(1) A is obliged to make the further advance; or

(2) there is any provision in the agreement between A and X for further advances.[62]

The supposed justification for the Article 9 rule is that where A and X contemplate a series of transactions over a period of time, it saves transactions costs if A is required to search and register once only.[63] However, the rule has been criticised.[64] Schwartz argues that the rule should be limited to the case where A is obliged to make the further advance. In that case, the transaction between A and X is the same as an ordinary single loan contract, except that the loan proceeds are to be advanced or drawn down either in stages or at X's discretion. If the priority rule applied only in respect of the first advance, then in respect of all later advances A effectively would be in the same position as if the basic priority rule were last in time. It has already been seen that a last in time priority rule would undermine the value of security interests and no-one would take them.[65] In the present context, the effect of such a rule would be to make A unwilling to enter into (for example) a revolving credit transaction with X except at an unsecured rate.

However, the considerations are different where A is not obliged to make the further advance. In that case, the second transaction between A and X is effectively a separate loan contract. The application of the priority rule to this case means that B is in effect subjected to a last in time priority regime. B can avoid this outcome by entering into a subordination agreement with A, but subordination agreements are costly. Under the alternative rule (where A's priority is limited to the first advance), if A wanted priority in respect of the further advance it would be necessary to negotiate a subordination agreement with B. It follows that, whatever the rule, there are likely to be circumstances where the parties will want to contract around it. However, the alternative rule is preferable because it reflects the parties' likely preferences in the majority of cases, so that the incidence of contracting out will be lower than under the present Article 9 rule. The consequence is a reduction in transactions costs.

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59 *Hopkinson v Rolt* (1861) 9 HLC 514; 11 ER 829.

60 *West v Williams* [1899] 1 Ch 132. See generally *Matzner v Clyde Securities Ltd* [1975] 2 NSWLR 293; *Mercantile Credits Ltd v ANZ Banking Group Ltd* (1988) 46 SASR 407.

61 UCC Article 9.204 and 9.312(5) and (7).

62 A similar rule has been adopted in some of the Australian State motor vehicle security registration statutes, eg: *Chattel Securities Act* 1987 (Vic), section 10; *Chattel Securities Act* 1987 (WA), section 10.

63 Jackson and Kronman, *op cit* 1180.

64 Schwartz, *op cit* 252; see also Jackson and Kronman, *op cit* 1178-1182.

65 See text at n 39, above.

ARTICLE 9 AND THE LAW REFORM COMMISSION

The References

In May 1990, the Australian Law Reform Commission ("ALRC") was given a reference on the topic of personal property securities by the Commonwealth Attorney-General. The reference included the object of harmonising the law with respect of personal property securities between Australia and New Zealand, and it directed the ALRC to take account of the New Zealand Law Commission's report. The Law Reform Commissions of New South Wales, Victoria and Queensland were also given references on the topic by their respective Attorneys-General, and it was contemplated that the four Commissions would work co-operatively towards the production of a joint report.

Initially it was agreed that the ALRC should have prime carriage of the work. However, as the project developed, the QLRC and VLRC began to have misgivings about aspects of the ALRC's thinking on the topic. The issues were debated between the Commissions frequently and at length, but the differences could not be resolved. Eventually the VLRC and QLRC decided to publish their own discussion paper on the topic. This appeared in August 1992.[66] A week later, the ALRC (in conjunction with the NSWLRC) produced its own discussion paper.[67]

In May 1993, the ALRC (this time without the NSWLRC) published a report.[68] The report is described as being an "Interim Report", but it reads like a final report and it is unlikely that significant changes will be made to any of the recommendations it contains. There is a draft Bill appended to the report, and this reinforces the view that the reference to the document being an interim one is not intended to be taken seriously.

From the outset, the QLRC/VLRC regarded the ALRC's approach as being fundamentally flawed, for two main reasons:

(1) it departs radically from the Article 9 model

(2) it envisages separate statutes to govern corporate and non-corporate securities.

In a number of relatively minor respects, the ALRC in its Interim Report has moved closer to the position advocated in the QLRC/VLRC Discussion Paper, but on the two key issues just mentioned it has not budged.

The ALRC Proposals and the Article 9 Approach

The ALRC proposals represent a significant and unjustified departure from the North American (Article 9) model. Professor Ronald Cuming, who is one of Canada's leading experts in this field, said in relation to the proposals contained in the ALRC/NSWLRC Discussion Paper, that the system proposed was so different from the North American model that it was inaccurate to describe it as being based on Article 9 at all.[69] Professor Jacob Ziegel made similar observations.[70] Nothing has changed in this regard.

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66 See n 19, above.

67 *Personal Property Securities* (ALRC Discussion Paper No 52, NSWLRC Discussion Paper No 28).

68 *Personal Property Securities* (ALRC Report No 64).

69 Letter to ALRC dated 17 November 1992.

70 Letter to ALRC dated 25 November 1992.

In its Interim Report the ALRC still describes its proposals as being "based on the Article 9 approach", but "adapted to meet the needs of Australian jurisdictions".[71] This statement is quite misleading. A glance at the draft Bill appended to the Interim Report is enough to demonstrate the force of Cuming's point: the ALRC proposed regime is nothing like Article 9. It is therefore inappropriate to claim legitimacy for the proposed regime, as the ALRC implicitly does, by reference to the Article 9 experience.

It is also suggested in the Interim Report that just as "other jurisdictions have modified the detail of the original Art. 9 to suit their own conditions, so should Australia".[72] Taken by itself, this proposition is unexceptionable. In its particular context, however, it is misleading because it invites direct comparison between the adaptations made in Canada to the Article 9 model and the ALRC proposals. There is no comparison. The differences between the Canadian and the United States versions of Article 9 are differences of detail. The differences between the ALRC's draft Bill and Article 9 are fundamental. There is no serious attempt made in the Interim Report to justify Australia taking such a radically different tack. The New Zealand Law Commission's approach was to take the text of the British Columbia personal property securities statute and to modify it, but only in so far as was necessary to reflect differences in local conditions and requirements. This is what the ALRC should have done. Instead, it elected to reinvent the wheel.

The costs of reinventing the wheel are high. They include:

- duplication of effort (to the cost to the taxpayer)
- loss of the opportunity to key in to the considerable volume of North American case law and literature on Article 9
- the increased likelihood of error.

There are significant errors in the draft Bill, which would not have occurred if the ALRC had adopted the NZLC's methodology. Moreover, the prospects for improvement are bleak. In one form or another, the draft Bill has been around since very early in the history of the reference. This is the third version, and if anything, the draft is getting worse. For example, one of the ongoing areas of difficulty has been the definition of "security interest". This is a key issue, because it determines the transactions to which the legislation applies. There is a tried and tested definition of security interest in Article 9 (which, incidentally, has been adopted in Australia in the credit legislation and the motor vehicle securities statutes), but the ALRC has chosen to ignore it. Instead, the expressions "security interest" and "security arrangement" are defined in clause 94A(1) of the draft Bill as follows:

> "If:
>
> (a) a person other than the company has an interest in property that is:
>
> (i) property of the company; or
>
> (ii) in the possession of the company and apparently property of the company; and
>
> (b) under an arrangement between the company and the person the person has a right to take possession of or otherwise deal with the property if:
>
> (i) the company contravenes or fails to comply with a provision of the arrangement; or

[71] Para 4.7.

[72] Para 3.22.

(ii) another person contravenes or fails to comply with an obligation specified in the arrangement; or

(iii) an event or state of affairs specified for the purpose in the arrangement occurs;

then, for the purposes of this Law:

(c) the interest is a **security interest** and

(d) the arrangement is a **security arrangement**; and

(e) the property is **property of the company.**

The secured party's interest may amount to ownership of the property".

This is an absurd provision. It is both too wide and too narrow. It is too wide in the sense that it catches all kinds of transactions that have nothing to do with security. For example:

- a contract for the sale of goods by the company to the other person
- a warehousing agreement pursuant to which the company is entrusted with goods by the other person for storage purposes
- a contract of carriage pursuant to which the company undertakes to transport goods for the other person.

The application of the proposed legislation to cases such as these would be likely to produce bizarre commercial outcomes.

The proposed definition is too narrow because it leaves out of account security interests in future property. One of the great advantages of Article 9 is that it allows a security interest to be registered prior to attachment, and in such a case, priority dates from the time of registration, not the point of attachment. This facility would not be available under the ALRC's proposal, because there is no "security interest" until the company has either property in or possession of the asset, and it is only "security interests" that are registrable.

There are all sorts of other problems with the draft Bill, but it will be sufficient to mention just one more. Two key expressions in Article 9 are "attachment" and "perfection". "Attachment" describes the point at which the security interest becomes enforceable as between the immediate parties. (In order for a non-possessory security interest to attach:

(1) there must be a security agreement;

(2) the creditor must have given value; and

(3) the debtor must have rights in the secured asset.)

"Perfection" describes the point at which a security interest becomes enforceable against third parties (the basic methods of perfection are registration and possession). The ALRC has abandoned these expressions, for reasons that have not been publicly stated. This decision is misguided. In particular, the lack of any reference to attachment (or an equivalent expression) means that the draft Bill is left with no way of describing the relevant concept. Instead, it is forced back upon references to:

(1) "crystallisation" (in the case of a floating charge); and

(2) (for other security interests) the time at which the security arrangements became "binding and enforceable" as between the parties (clause 264(4)).

With regard to (1), crystallisation is an artificial and cumbersome concept, and there should be no need for it in a properly drafted Article 9 statute. With regard to (2), in the absence of any statement about when security arrangements become "binding and enforceable" the law is left in a state of considerable uncertainty. Particular difficulties are likely to arise in cases where future property is involved. The meaning of the expression can only be determined by reference back to common law and equitable principles, and in particular, cases such as *Tailby v Official Receiver*[73] and *Holroyd v Marshall.*[74]

According to Article 9, in the case of a contest between two unregistered (but registrable) security interests, priority is determined according to the order of attachment. According to the draft Bill, priority in such a case is determined according to the order in which the competing security interests become "binding and enforceable". However, according to the ALRC's actual recommendation as set out in the Interim Report, priority should be determined by reference to the time at which value is given in respect of each security interest.[75] The discrepancy between the draft Bill and the Interim Report results from a failure to think through the application of the proposed legislation to cases involving future property. The definitions of "security interest" and "security arrangement" are affected by the same problem.

The ALRC's Proposed Legislative Framework

The ALRC proposal is for the new personal property security laws to be enacted by way of amendment to Part 3.5 of the *Corporations Law*, and the Bill appended to the Interim Report is drafted on this basis. As a necessary consequence of this method of proceeding, the Bill is limited to security interests given by corporate debtors. It therefore leaves out of account the substantial minority of cases involving security interests given by unincorporated commercial enterprises. This is a deficiency of the present law, and it was one of the factors that led to calls for reform in the first place. The ALRC has effectively duck-shoved the issue.

It is envisaged in the Interim Report that individual States and Territories might enact their own laws, based on the ALRC model, but directed specifically to security interests given by non-corporate debtors. In that way, the gaps in coverage could be filled.[76] However, what would be required is uniform legislation enacted simultaneously in all States and Territories. There is no method suggested in the Interim Report as to how Commonwealth and State efforts might be co-ordinated with a view to achieving this goal. In the absence of some kind of co-operative arrangement, the goal is likely to prove elusive as recent experience in the areas of consumer credit and the national REVS scheme clearly demonstrates. In short, if the matter is left where the ALRC proposes to leave it, it is highly unlikely that a comprehensive personal property securities regime will ever be achieved.

Legislation limited to corporate debtors is only a partial reform. Article 9 is not limited in this way, nor are any of the Canadian versions of the Article 9 solution. The Molomby Committee in Australia, the Crowther Committee and the Diamond Report in the United Kingdom and the New Zealand Law Commission all envisaged the enactment of a single personal property securities statute that applied regardless of whether or not the debtor happened to be incorporated. In the United Kingdom, it was recommended that the new legislation should be limited to security interests given by business (non-consumer) debtors, but that is a different issue. There is no justification for the different application to enterprises of general commercial regulations depending on the form of business organisation which happens to

[73] (1888) 13 App Cas 523.

[74] (1862) 10 HLC 191; 11 ER 999.

[75] Para 6.8.

[76] Para 11.5.

have been chosen. This is yet another respect in which the ALRC proposals differ radically from the Article 9 model.

The only sensible way to proceed is by a co-operative agreement between the Commonwealth and the States, based on the model that led to the enactment of the *Corporations Law*. There should be a single *Personal Property Securities Act* covering security interests given by corporate and non-corporate business debtors alike, and this should be adopted by each State and Territory as its own law. There should be a single national register of security interests registered against the debtor's name, and this would act as the register for the purposes of each State and Territory law. Under such a system, it would not be necessary for a security holder to register more than once in order to secure national protection, nor would it be necessary for a searcher to search more than once. The result should be a substantial reduction in the incidence of third party disputes involving security interests. Furthermore, to the extent that such disputes did still occur, they would be subject to the same rules no matter where in Australia the dispute arose or where the action was brought. Uniform legislation is the only way of achieving uniform outcomes. The ALRC's proposed regime does not offer these benefits. The alternative proposal outlined above necessarily involves the repeal of Part 3.5 of the *Corporations Law* (a step which, inexplicably, the ALRC from the outset has been reluctant to consider). However, it does not necessarily involve the abolition of the Australian Register of Company Charges, because one option would be to use this as the basis for the new register.

CONCLUSION

Third party disputes involving personalty can arise in three main ways:

(1) where an asset is misappropriated from the owner before being sold to a third party;

(2) where a secured asset is sold to a third party without the consent of the holder of the security interest; and

(3) where a security interest is created in an asset that is already encumbered in circumstances where both security holders have contracted for first ranking.

At common law, the rules for the resolution of these conflicts vary from one class of dispute to another.

The purpose of this paper has been to explore the use of registration as an alternative solution to each of the three classes of dispute. The main conclusions are as follows:

- in relation to scenario (1), there is at least a *prima facie* case for expanding the existing asset-indexed registers of security interests in motor vehicles to cover ownership (similar reforms in relation to aircraft are also worth considering)

- in relation to scenario (2), the next stages in the national REVS project should be to: (1) collapse the Victorian and New South Wales data bases into a single (genuinely) national register of motor vehicle security interests; and (2) introduce uniform State motor vehicle security legislation

- in relation to scenario (3), there is significant potential for improvement in the law through adoption of the Article 9 model in Australia (a properly drafted Article 9 statute would facilitate the process of secured lending, bringing substantial cost savings to lenders and flow-on benefits to borrowers).

On this last score, there was no disagreement at all between the QLRC/VLRC and the ALRC/NSWLRC. All four Commissions subscribed to the case for reform. In the end, the differences between them had more to do with matters of implementation than with substantive policy. Nevertheless, there is considerable cause for concern in that the case for reform has not been well presented. As matters presently stand, it would be surprising if

legislation were to result. The challenge remains to secure government and industry support for the Article 9 solution. The issue deserves to be reopened. Regrettably, in jurisdictions outside North America, when personal property security law reform proposals are made, there is a marked tendency for industry to cling to the frying pan, and for governments to gravitate to the back burner. A vacancy exists for a creative chef who is prepared to rearrange the stove.