REFORM OF PERSONAL PROPERTY SECURITIES LAW IN THE CER CONTEXT

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The first thing I am going to say is that Australia and New Zealand personal property securities law is a mess. It is characterised by archaism, incoherence, inefficiency and unfairness. The legal requirements differ according to the nature of the debtor, the nature of the property, and the form of documentation used. This is a recipe for chaos, and to some extent, that is what we have.

If you look at the thing from an economic point of view, the role of the law should be to facilitate exchange and the financing of transactions. Most dealings represent voluntary exchange. The law must also deal with involuntary exchange, and that is the reason why we have the rule in ***nemo dat*** and its exceptions. We have to have rules that protect bona fide purchasers. Lawyers in the past have not regarded the latter as part of securities law, but if you read more enlightened treatments of the subject like Roy Goode's lectures over the last ten years, he integrates this into the subject.

There has been very interesting debate in the last ten years in the American legal literature about the economics of secured transactions, because there is a school of thought, a rather radical school of thought, that says: why security, what is the justification, what is the economic rationality or efficiency of secured transactions? This particular line of reasoning seems to be a modified form of a theory that has been developed in connection with capital structures.

In the capital structure context the reasoning is that a firm's wealth is unaffected by its capital structure, given certain assumptions. And the theory in the secured transactions context is a kind of corollary of that, that a firm's welfare is also unaffected by its mix of secured and unsecured debt, that the firm will negotiate its way around any kind of restrictions.

Well, in that kind of context, people have tried to provide law and economics justifications for secured transactions, given that any security arrangement involves transaction costs, and there are questions of relative efficiencies of transaction costs.

One theory is the "new asset theory" that credit facilitates the acquisition of new assets by the company as a kind of adding of value. And that would certainly be true about purchase money security interests.

Another theory is linked with the idea of "monitoring" the debtor's performance; that security facilitates monitoring. Indeed, to some extent, security cuts down the need for regular monitoring of the debtor.

A further theory is signalling that the secured credit "signals" to other creditors the value of the underlying transaction.

Yet another theory is in terms of the relationship. This is a kind of relational theory explaining a kind of "joint venture" between the borrower and the lender, who are regarded as joint venturers in respect of the transaction for which the credit is made available.

Another group of theorists talk about distribution and they make the point that secured transactions achieve to some extent a "transfer of wealth" and that they really transfer benefits to the secured party at the possible expense of other unsecured providers of goods or credit.

The matter is one of continuing controversy. And there is no simple answer, there is no one theory that adequately justifies security. But everybody seems to agree that security necessarily involves transaction costs and that anything that reduces those transaction costs achieves some measure of economic rationality. And it is in that context that we must consider registration systems.

It seems to be taken as axiomatic in common law jurisdictions that to have an efficient system of security involves some registration system. It seems to be absolutely obvious and yet when we look at overseas systems, particularly in continental Europe, we find that this is not so. And indeed, when were thinking of the PPSA two or three of us spoke to somebody in the Justice Department and we were startled by the question: but what about Germany?

Well, what about Germany? Germany has no system of registration of securities over chattels, and they seem to get by without it. But they have an elaborate doctrine of good faith in their law which to me is a rather unsatisfactory basis for upholding or not upholding commercial transactions.

Registration is basic to us, but it is not necessarily basic to other people. It provides a statement of rights or a possibly definitive statement of rights. It also provides a source of information which may be of some use about the debtor's creditworthiness - although that is perhaps less convincing.

If we consider the various types of registration systems possible, one could theoretically have a system of registration of title for goods and intangibles. But really, the more you consider it, the more impractical this is. Goods are not of the same value of land, they do not have the same quality of uniqueness, they are mobile. It would be completely unreal to have a system of registration of title for all chattels, and very difficult to have such a register in respect of intangibles given the problem of what constitutes the equivalent of title in respect of those.

Some jurisdictions like the United States do, however, have title systems for motor vehicles. And indeed when we went to the United States in 1987, we found that most jurisdictions in the United States have motor vehicle title systems. This takes a lot of the load off an Article 9 system which I will talk about in a second. The bulk of transactions are handled in a motor vehicle title system. When you purchase a car in most States in the United States you get a certificate which is rather like a share certificate and there is provision for endorsement of this of what is usually described as the lien-holder's interest, if you purchase the car on credit. Everything appears on the face of the document. If you want to subsequently sell the car then you have to hand over the

certificate and if it has got the endorsement of the lien-holder, the bank's name, then obviously you would need to get the bank's consent and discharge the loan. That system works very well in the United States as far as I can see. The only question is what is the cost of that and what is the impact of that on any other system? Of course, in Australia and in New Zealand now we have the motor vehicles security legislation, not a motor vehicles title certificate system. So we have paid recognition to some extent to the distinctive quality of motor vehicles, but we have not gone the whole hog of having a motor vehicle title system.

The second type of register that one could have is a register of security interests and that is of course the type of register that we have for different types of chattel. If one looks at it again from an economic point of view, all systems of public registration should be justifiable on a cost-benefit analysis, and I think the main criteria are as follows. The costs must be less than the losses which you seek to avoid. The costs should be less than the costs of prevention possibilities open to the parties. And the net benefits of a public registration system should exceed those of any private scheme.

Well, we have not gone in for private schemes in this hemisphere. In the United Kingdom they have had a private system of registration of hire purchase agreements which is not covered by their bills of sale legislation and that has had its problems in its time.

It is very difficult in fact in both jurisdictions or in all the Australian jurisdictions and in New Zealand to get accurate information from government about the cost of running these various registries. And certainly in New Zealand one had detected a hidden tax, particularly in the charges made by the company registration system - inflated charges for the kind of system that they have and the service that we get - and this is really covert taxation. It is not an accurate reflection of the cost of providing that service with a small element of profit; there is a large element of profit which goes into the general revenue.

If we consider the systems of the world and if we accept as given the need for registration and if we think that it is impractical to go for a title registration system, except possibly in respect of motor vehicles, and in a small jurisdiction like New Zealand it may be just not affordable. And if we accept the proposition that what we have to have is an efficient system of registration of security interests, we ask the question: which is the best overseas precedent? And the answer is absolutely clear. The best overseas precedent is Article 9 of the American Uniform Commercial Code and its variants in the various Canadian provinces. It is quite interesting to look at the background of the American and Canadian experience.

In the late 1930s and early 1940s the Americans turned their attention to this project, this part of the Uniform Commercial Code which was a very elaborate, very time consuming, but ultimately very successful endeavour to provide uniform legislation and codification of the major areas of commercial law. And the secured transactions provisions became Article 9 of this.

Originally they toyed with the idea of having six separate little statutes which were transaction based. They eventually found that that was not practical. It started off as a good idea, but they found that it led to complexity and it led to duplication, and this was unnecessary. So the result was a unitary system, Article 9, where they knock together all kinds of security interests under a common concept with a common system of registration, the characteristics of which I will elaborate in a moment.

The Canadians, fairly early in the scene in Ontario, looked at this very closely and there was a very able committee under the chairmanship of a leading Toronto credit lawyer, Fred Catzman QC, and they worked on Article 9 to produce an Anglicised, if that is the right word, version of it. They then spent the next ten years before they brought it into effect. The reason for this was that they wanted, unlike the Americans, to introduce a computerised system. Computer technology at that time was in its developmental stage and they spent ten years sorting out an appropriate computer system. The object was put by Fred Catzman, whom I met in 1987, in the following terms: "The jungle of our personal property security laws has been a century in the making. From seeds planted in Victorian times the assorted statutes now in our books have grown into a tangled mess which has survived sporadic pruning and hacking. The urgent need is for a bulldozer to clear away the chaos and for its replacement by a fresh and modern statute." Well Fred and his committee thought that the answer lay in an Article 9 system and they adopted such a system in Ontario and that has spread to all the major jurisdictions in Canada now.

When the Law Commission was asked to look at the Companies Act part of the companies review included company charges. The view was taken that one should look at this as part of a larger question of personal property securities law. Mark O'Regan and I were sent by the Law Commission to America and Canada in 1987 and we had very intensive discussion with practitioners, with bank officials, and with Ford's legal department. We looked at American registries, we looked at Canadian registries, companies and personal property securities registers, and then we came back and we did an interim report. Our final conclusion in that interim report was that a committee of experts should be set up to look very closely at the latest Canadian draft as a working draft for our own Bill. That committee was set up. Geoffrey Palmer, who was then Minister of Justice, said that he would consider it if we produced a draft by the end of the year. Without fee, and working on Saturdays throughout most of that year, we produced a draft which is now in the report. He then changed his mind.

Anyway, the Law Commission produced the report. The relationship of this project to the Justice Department has always been slightly problematic yet we are now in the situation where there is quite a measure of commercial and particularly commercial legal support for this project. It has been referred to Australia under CER and this afternoon at 2:30 I had the draft documents which indicate the Australian response. In some respects there seems to be a misguided attempt to reinvent the wheel, but more about that in a second.

What are the main characteristics of the PPSA? I will just sum them up briefly in this way. First of all the PPSA unifies security interests in all personal property - goods and intangibles - irrespective of the form. It covers bills of sale, chattel mortgages, hire purchase agreements, conditional sale, Romalpa clauses, they are all security interests. It also includes certain other things that are a bit "iffy", that are marginal, that may or may not be security interests. It includes them for the sake of clarity. The Australians do not necessarily agree with some of that, but that is another matter of detail for later.

The second thing is that the statute provides for the perfection of a security interest in a definitive way, either by registration or by possession. At the moment, a number of our security interests lack the concept of perfection as opposed to attachment. But the legislation provides clearly for perfection of a security interest which is a distinct priority point for security purposes. The main means of perfection is by registration of a notice. It is not by registration of a copy of the instrument. So you do not have the terrible storage problems that you have with our present documentary type of system.

The legislation sets out distinctive priority rules instead of leaving it to that weird amalgam of statute law, common law and equity that we have at the moment with certain exceptions. All the main rules are in the statute. This will inevitably reduce transaction costs, and particularly if the system is fully computerised with on-line filing and searching from financial institutions and from lawyers and accountants' offices.

The consequences of this are that the significance of things like Romalpa clauses, the terrible problems that we have had with floating charges which to some extent have now been dealt with in Australia, but not totally by the 1981 reforms, will wither away. Floating charges will cease to be significant. We will have fixed charges over circulating assets provided by this system.

But there is a certain problematic characteristic of the PPSA and that is that there is a lack of consumer protection. The Article 9 and the Canadian counterparts have pockets, bits, of consumer protection. It was controversial how much. The New Zealand draft does not have any consumer protection. A policy decision was taken to exclude it, leaving it as a matter for the Ministry of Consumer Affairs.

The problem is that the Ministry of Consumer Affairs moves with glacial slowness and never produces anything in the way of legislation. I think the major reform promoted by the Ministry of Consumer Affairs since its inauguration was the Fair Trading Act which is a straight crib from the Australian legislation.

Speaking briefly about the CER dimension. There is a CER dimension. It is not mentioned in the basic agreement, there is nothing really terribly legal mentioned in the CER agreement. Company charges were mentioned specifically in the Memorandum of Understanding of 1988. Just thinking about the thing in context, in the case of diversity of land laws there is no great problem because land is immovable and apart from a question of foreign ownership of land you are not really going to be presented with any problem. But the subject matter of personal property is movable, that is its characteristic. So, free movement of goods is more likely to be prejudiced by diversity of personal property security regimes both within a federal system like Australia and within CER. That can, however, be exaggerated.

I think that diversity of laws in the EEC and the lack of a computerised system in the United States do not impede trade too much there. But in principle if we had uniform laws it would be a good thing. If we had laws which were basically the same as North America and the UK on this it would be a very good thing. There must be some economies in transaction costs resulting from that.

What is the position in the UK? Very briefly Professor Aubrey Diamond was commissioned by the Department of Trade to look into this and produced a report which favoured this kind of system. There has been a Law Society report on it which starts off by saying that there is no great problem and everybody knows what the law is and so on. And it says that they do not really favour a drastic solution. It then goes to the main proposals and if you sum up the conclusions of their report they support most of the major conclusions. So there is an internal incoherence in their report. But at the moment nothing seems to be going on on this as far as I can tell.

Where are we now in our part of the world? We are at the stage that the Companies Bill without charges in New Zealand is before parliament. The Personal Property Securities Bill has not been introduced, it is referred to Australia under CER. The Australians are about to produce a report which is sympathetic to the concept. It suggests some

changes of detail which we can talk about later. Some of them depart not only from the NZ draft but also the US and Canadian law. There are some real problems here. Why opt for an elaborate overseas model which has proved workable in practice and then fiddle with it? This could get Australia the worst of both worlds.

If I can conclude in this way. A Personal Property Securities Act is a good thing. It is the best system of registration. It does achieve economically rational ends. It should result in reduced transaction costs. It does favour financial institutions. It favours the initial financial institution that provides bulk finance and it means that you have constantly got to go back to them. There is a need to counter-balance that perhaps with some degree of consumer protection. But the PPSA is arguably not the proper place for that. It should be dealt with elsewhere.

The glaring omission from the New Zealand draft was remedies and it was left out largely because of this consumer protection reason. The Australian proposals that I have seen in the last hour also omits remedies. I think this is intrinsically problematic but is connected with the consumer protection reason. It would be a good thing to have uniform remedies perhaps. It may be an impediment to the implementation of legislation in both countries if this is in the PPSA itself if there has to be full consultation with the bodies interested in consumer protection. But at the end of the day we will have to sort this problem out. It may be tactically that it is a good idea at the moment to leave it out, but ultimately we will have to revisit that question.

I think it would be a good thing for Australia and New Zealand to have basically similar law. I am rather concerned that if we do not implement this law in New Zealand that we will have a gaping hole in the companies legislation or be left with our present unsatisfactory law which differs from Australian laws. We are in a bit of an unsatisfactory position under CER in that by tying ourselves to Australia on law reform questions, we are tying ourselves to a jurisdiction which is an inherently conservative and, due to its federal system, dilatory reform jurisdiction. And we may miss the opportunity if we do not enact the PPSA of introducing rational legislation which is in force in some of our major trading partners. To do that I think, will be unfortunate given what is perhaps an increasing isolation of both jurisdictions from major trading blocs.