PERSONAL PROPERTY SECURITIES: A COMPARISON OF THE CURRENT AUSTRALIAN POSITION WITH THE REFORMS MADE IN CANADA

by

Craig Wappett
Partner, Mallesons Stephen Jaques

1 INTRODUCTION

Personal property, including intellectual property and ideas, now accounts for most of the wealth generated in advanced economies. Australia must have modern and flexible laws to encourage business and consumers effectively and conveniently to raise finance and creditors to provide finance on the security of such property.

It seems, from the perspective of someone who has been a strong supporter of personal property security law reform, that the biggest obstacle to change is "reform fatigue". The financial services sector has confronted enormous regulatory changes in recent years including the Consumer Credit Code, the Managed Investments Act and the CLERP 6 proposals.

In this context the reform of personal property security law has been seen as "unnecessary" or just "too hard". Several points should be made in response to this view:

- first, present laws are outdated, inflexible and stifle product innovation;
- secondly, unlike the Consumer Credit Code which imposed huge costs on financial institutions, North American style personal property security legislation should result in cost savings and promote efficiency;
- thirdly, new legislation need not require financiers to change all the forms of documentation they currently use; and
- finally, assuming New Zealand proceeds with its reforms, Australian banks which own New Zealand banks and other financiers which operate in both countries will have to confront change in any event.

2 OVERVIEW OF THE CURRENT AUSTRALIAN POSITION

Australia has a vast array of laws dealing with security over personal property. The more significant legislation appears in the table below.

COMMONWEALTH	*Air Navigation Act* 1920 *Circuit Layouts Act* 1989 *Designs Act* 1906 *Life Insurance Act* 1995 *Patents Act* 1990 *Plant Breeder's Rights Act* 1994 *Plant Variety Rights Act* 1987 *Shipping Registration Act* 1981 *Trade Marks Act* 1995
NEW SOUTH WALES	*Bills of Sale Act* 1898 *Consumer Credit Code* *Corporations Law* *Factors (Mercantile Agents) Act* 1923 *Liens on Crops and Wools and Stock* *Mortgages Act* 1898 *Registration of Interest in Goods Act* 1986
VICTORIA	*Chattel Securities Act* 1987 *Consumer Credit Code* *Corporations Law* *Goods Act 1958* *Hire-purchase Act* 1959[1] *Instruments Act* 1958
QUEENSLAND	*Bills of Sale and Other Instruments Act* 1955 *Consumer Credit Code* *Corporations Law* *Factors Act* 1892 *Hire-purchase Act* 1959[2] *Liens on Crops of Sugar Cane Act* 1931 *Motor Vehicles Securities Act* 1986
WESTERN AUSTRALIA	*Bills of Sale Act* 1899 *Consumer Credit Code* *Corporations Law* *Chattel Securities Act* 1987 *Factors Act* 1842 (UK) *Factors Act Amendment Act* 1878 *Hire-purchase Act* 1959

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[1] This legislation is subject to a staged repeal: *Hire Purchase (Further Amendment) Act* 1997 (Vic). The Act will continue to apply to agreements written before 1 April 1998. Also, hire purchase agreements with farmers will continue to receive until 1 April 2000 access to remedies to set aside unconscionable agreements and to postpone the repossession of farm machinery.

[2] Amendments are currently proposed so that this Act will not apply to transactions involving goods with a market value greater than $40,000,000.

SOUTH AUSTRALIA	*Bills of Sale Act* 1886 *Consumer Credit Code* *Corporations Law* *Goods Securities Act* 1986 *Liens on Fruit Act* 1923 *Mercantile Law Act* 1936 *Stock Mortgages and Wool Liens Act* 1924
TASMANIA	*Bills of Sale Act* 1900 *Consumer Credit Code* *Corporations Law* *Factors Act* 1891 *Hire-purchase Act* 1959[3] *Motor Vehicle Securities Act* 1984 *Stock, Wool and Crop Mortgages Act* 1930
AUSTRALIAN CAPITAL TERRITORY	*Consumer Credit Code* *Corporations Law* *Instruments Act* 1933 *Mercantile Law Act* 1962 *Registration of Interest in Goods Act* 1990
NORTHERN TERRITORY	*Consumer Credit Code* *Corporations Law* *Instruments Act* 1935 *Registration of Interest in Motor Vehicles and Other Goods Act* 1989

This table does not list all of the legislation relating to security interests in personal property. There are many other Acts dealing with worker's, contractor's, warehouseman's and other statutory liens and charges as well as security interests in things such as mining tenements. Also, legislation such as the *Financial Intermediaries Act* 1996 (Qld) adopts the *Corporations Law* charges regime for State based financial institutions. Similar legislation exists for other types of entities established under State legislation. In addition, there are many other laws which impact on the taking and enforcement of security over personal property[4].

Broadly speaking existing Australian laws focus on the form of a security rather than its effects.

There is specific legislation directed to company charges, bills of sale, liens over particular crops and other property, security interests in motor vehicles, ships, aircraft,

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[3] This Act only applies to hire purchase agreements entered into before 1 March 1997 or where the offer to enter into such an agreement was made before that date.

[4] For example, *Bankruptcy Act* 1966 (Cth), *Property Law Act* 1974 (Qld) and equivalent legislation in other jurisdictions; *Stamp Act* 1894 (Qld) and equivalent legislation in other jurisdictions; *Credit (Rural Finance) Act* 1996 (Qld); *Farm Debt Mediation Act* 1994 (NSW).

mining tenements and various forms of intellectual property rights and also hire purchase legislation.

There is no specific legislation concerning the registration of a lessor's interest under a lease or licence of personal property, although there is an ability to register a lessor's interest in motor vehicles and other prescribed goods under the motor vehicles and chattels securities legislation.

Unless it can be characterised as a "charge" or "bill of sale", a retention of title arrangement is generally not capable of being registered. Nor does it have to comply with any particular legislation relating to security interests.

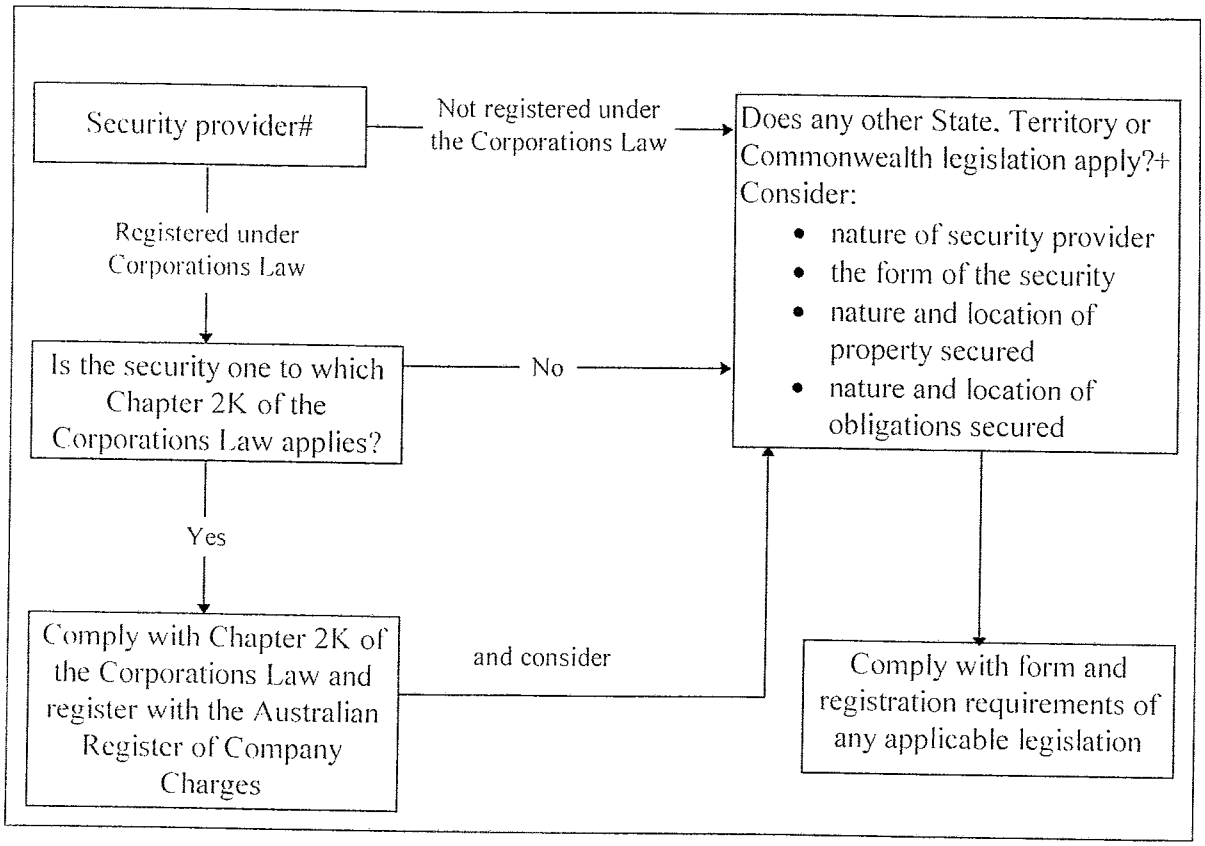
There are several key questions which must be answered to determine:

- the legislation which must be complied with;
- where the security interest should be registered (if it is capable of registration).

The key questions are:

- Is the security provider a company which is registered under the *Corporations Law*? If the answer to this question is yes then it will be necessary to consider whether the proposed security is a security which is required to be registered under Chapter 2K of the *Corporations Law*.
- Irrespective of the answer to the preceding question, it will be necessary to consider whether any other State, Territory or Commonwealth legislation applies to the security. In doing so it will be necessary to take account of:
  - the nature of the security provider;
  - the form of the security (eg. charge, bill of sale, lease, hire purchase, conditional sale, retention of title);
  - the nature and location of the property secured; and
  - the nature and location of the obligations secured.

A diagrammatic representation of this process appears below:



ie chargor, mortgagor, lessee or hirer, as the case may be.

+ Examples: Bills of sale legislation
Chattel securities/motor vehicle securities legislation
Crop lien or stock mortgages legislation
Trade mark, patents, designs legislation
Hire purchase legislation
Consumer Credit Code
Shipping and aviation legislation
Legislation establishing or regulating the entity granting the security
Legislation creating or giving effect to the property being secured

In addition to these factors, if the location or situs of personal property shifts from one jurisdiction to another it may be necessary to reperfect any security interest in that property.

3 BACKGROUND TO REFORM PROPOSALS[5]

The idea of reforming personal property security laws in Australia is not new. The Molomby Committee reporting in 1972 noted that there should be a complete reform of the law relating to security interests in chattels.[6]

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[5] The case for reform is discussed in detail in CC Wappett, "Reforming Personal Property Security Law in Australia", Journal of Banking and Finance Law and Practice, Volume 7, Number 3, September 1996, page 189.

More recently, the New South Wales Law Reform Commission (NSWLRC), the Law Reform Commission of Victoria (LRCV) and the Queensland Law Reform Commission (QLRC) have been asked to carry out reviews of the state of personal property security law in Australia and suggest reforms. In 1990 the Commonwealth Attorney-General also requested the Australian Law Reform Commission (ALRC) to review federal and other Australian laws relating to the creation and enforcement of security interests in personal property. It was envisaged that the four Commissions would co-operate with each other and produce a joint report. However, as the review developed, the QLRC and the LRCV began to have concerns about the approach being taken by the ALRC. Eventually, the QLRC and the LRCV decided to publish their own discussion paper (QLRC/LRCV Paper).[7] This was published in August 1992 and soon after the ALRC (in conjunction with the NSWLRC) produced its discussion paper.[8] Following a number of submissions on this paper the ALRC (this time without the NSWLRC) released its Interim Report No. 64, Personal Property Securities, in May 1993 (ALRC Report).[9]

Although there was broad agreement between the four Commissions, and they all agreed on the necessity for reform, there were a few significant areas of conflict between the ALRC Report and the QLRC/LRCV Paper. These disagreements related to:

- the degree of reliance to be placed upon the concepts and drafting style of the various North American personal property security laws;
- whether reform in Australia should aim to codify the law relating to personal property securities as has occurred in North America or alternatively be limited to broadening the concept of a "security" and addressing the registration and priority shortcomings which presently exist; and
- the most appropriate vehicle for introducing effective reform given the constitutional limitations which exist in the Australian federal system.[10]

In January 1995 the Commonwealth Attorney-General issued a discussion paper based on the ALRC Report[11] and this was followed in December 1995 by a workshop convened at Bond University and attended by representatives of the ALRC, various State governments

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6 EI Sykes and S Walker, The Law of Securities, 5th Edition, The Law Book Company Limited, Sydney, 1993, pages 548-600.

7 Queensland Law Reform Commission, Discussion Paper 39 and Law Reform Commission of Victoria, Discussion Paper 28, Personal Property Securities Law: A Blueprint for Reform, August 1992.

8 Australian Law Reform Commission, Discussion Paper 52 and the Law Reform Commission of New South Wales, Discussion Paper 28, Personal Property Securities, 1992.

9 AJ Duggan, "Personal Property Security Law Reform: The Australian Experience To Date", paper presented at the Annual Workshop on Commercial and Consumer Law, University of Toronto, October 1995, page 4.

10 Ibid.

11 Attorney-General's Department Discussion Paper, Personal Property Securities: A National Approach, January 1995.

and the finance industry and leading academic and practitioner experts from Australia and overseas[12].

This paper does not detail the alternative methods of implementing reform in Australia.[13]

4 WHY REFORM IS NECESSARY[14]

Form over substance approach

As noted in part 1 of this paper, Australia has many laws dealing with securities over personal property. Many of these laws are derived from legislation which originated in 19th Century England. This legislation focuses on the form of a security or the nature of the entity giving the security rather than the rights of the security provider and the security holder to the property in which those parties have an interest.[15]

Some of the legislation requires the inclusion of certain information in security agreements to make them effective,[16] regardless of whether that information has any real significance to the objective of obtaining priority for a particular security interest.

Overlapping legislation

The result of all this is that some forms of security are regulated by two or more pieces of legislation and in some circumstances require registration in more than one registry whereas other forms of security interest may not require registration at all[17].

The overlap between legislation also gives rise to priority problems which are not easily resolved. Specific priority problems can arise when there is a direct conflict between the provisions relating to a debtor-name indexed security register such as that maintained under Chapter 2K of the *Corporations Law* and an asset-indexed security register such as those maintained under the State legislation dealing with security interests in motor

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12 Report of the Personal Property Securities Law Workshop, Bond University, December 14-17, 1995.

13 These are discussed in Wappett, Op. Cit. n.5

14 This section draws on part 2 of the QLRC/LRCV Paper and part 2 of the ALRC Report. See also Attorney-General's Discussion Paper.

15 Because existing legislation focuses on the form of security interests the courts have found it necessary to extend traditional security concepts to include a broader range of security interests. Perhaps the best example of this has been the plethora of case law about whether title retention clauses constitute "charges"; see B Collier, "Retention of Title Clauses", Law Society Journal (NSW), October 1994, page 50; S Christensen, "Reservation of Title in Goods Attached to Personalty or Realty", Journal of Banking and Finance Law and Practice, December 1993, page 264 and K Walker, "All-Moneys Retention of Title Clauses: An Update", Law Institute Journal, August 1993, page 725.

16 See for example the form and content requirements in Part 3 of the *Bills of Sale and Other Instruments Act* 1955 (Qld) and the form requirements in section 3 of the *Hire Purchase Act* 1959 (Qld).

17 For example, a charge or mortgage over a motor vehicle which is given by a company in Queensland must be registered under both the *Corporations Law* and the *Motor Vehicles Securities Act* 1986 (Qld) because the latter Act is not a "specified law" for the purposes of section 273 of the *Corporations Law*.

vehicles. In *Australian Central Credit Union v Commonwealth Bank of Australia* [18] the Full Court of the Supreme Court of South Australia held that an earlier registration of a security interest under the *Goods Securities Act* 1986 (SA) was not sufficient to defeat a later charge registered under the *Corporations Law*.

Anomalies arise because legislation such as Chapter 2K of the *Corporations Law* only seeks to regulate priority as between security holders while other chattel security legislation seeks to also regulate priority as against subsequent purchasers.

The status of the security provider, the subject matter of the security interest and the form of the security interest currently determine which law will apply to the security interest and the registrations which will be necessary to protect that interest.

Gaps in the legislation

While there is a high degree of overlap in the existing legislation there are also gaps so that some security interests do not require registration at all. On the authority of *A.J Smeman Car Sales v Richardsons Pre-run Cars*[19] and *Kay's Leasing Corporation Proprietary Limited v Fletcher*[20] neither the *Bills of Sale and Other Instruments Act* 1955 (Qld) nor the *Hire Purchase Act* 1959 (Qld) would apply to instruments entered into outside of Queensland in respect of goods subsequently brought into Queensland.[21]

Some forms of security may require registration in respect of some types of property subject to the security but not other property and the benefits of registration only apply in respect of the former. Chapter 2K of the *Corporations Law* is a good example of this. Section 279(4) of the *Corporations Law* provides that where a charge relates to property of a kind or kinds to which section 262(1) applies and also relates to other property, the priority provisions in sections 280 to 282 only apply to affect the priority of the charge insofar as it relates to property specifically referred to in section 262(1) and not any other property.

Another good example of gaps in the current legislation is provided by the strict limits on the ability to secure future property under section 21 of the *Bills of Sale and Other Instruments Act* 1955 (Qld). These restrictions are particularly troublesome to inventory financiers.

Where there is no applicable statutory regime for determining priority between competing interests in personal property the common law rules will prevail. Because of this the form of the security interest is often crucial to the determination of priority.[22]

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[18] (1991) ASC 56 - 037.

[19] (1969) QJPR 150. See also *LM Ericsson Pty Ltd v Douglas-Brown (Liquidator)* (1991) 4 WAR 218.

[20] (1964) 116 CLR 124.

[21] Note however the unreported decision of Young J. in the Equity Division of the Supreme Court of New South Wales in *Re State Rail Authority of New South Wales* No. 3709 of 1994.

[22] QLRC/LRCV Paper, paragraph 2.2.7.

Compulsory registration

Under many of the existing statutes registration is compulsory for a security interest to be effective or to be effective as against parties other than the security provider and the security holder[23]. There is no sound policy basis for such a compulsory registration requirement. Registration of a security interest should be left to the parties to determine on the basis that if the security holder wishes to protect its priority position then it should register its interest. A modern personal property security law should be designed to facilitate commerce rather than being regulatory in character.

Cumbersome registration procedures

The registration process itself is unnecessarily cumbersome, confusing and outdated under many of the existing statutes. Instrument rather than notice filing remains the norm under the *Corporations Law* and many other personal property security laws.

The necessity of filing the instrument evidencing a security interest has a number of disadvantages:

- It is commercially impracticable where the secured property is of a kind which is constantly changing such as accounts receivable or inventory (unless the security is in the form of a floating charge).
- It precludes the security holder from obtaining registration until the security provider has actually signed a security agreement.
- The length of documentation can involve unnecessary time delays and reproduction of paper records and in many circumstances it is unnecessary for another party to read the entire text of the document.
- The security agreement may contain provisions which are confidential to the parties and which they do not want included on a public record.
- Instrument filing is administratively inconvenient and costly and impedes the computerisation of records.[24]

The concept of notice

Under the *Corporations Law* and some other personal property security statutes the basic priority rule is that the first party to register obtains priority for their interest. However, this rule is displaced where the holder of a charge which is executed later in time is registered before an earlier executed charge but where the holder of the charge executed later in time had notice of the earlier charge[25]. Notice includes constructive notice. This rule detracts from the paramountcy of the register and reduces the effectiveness of registration. There should be no place for the concept of constructive notice in a modern

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[23] See for example, the *Bills of Sale and Other Instruments Act* 1955 (Qld).

[24] QLRC/LRCV Paper, paragraph 2.1.4.

[25] Section 280 *Corporations Law*.

registration system. Priority between competing security interests should be determined in accordance with the register except where there are clear policy reasons for preferring the unregistered or subsequently registered security interest, for example, where fraud has occurred.[26]

Further advances and prospective liabilities

The law with respect to tacking further advances to the priority of the first registered security holder and also the concept of prospective liabilities under the *Corporations Law* produce unnecessarily complicated rules in relation to determining priorities for further advances[27]. A much simpler rule would be one which gave priority upon registration in respect of all future advances. This basic rule could obviously be varied by agreement between competing security holders.

Receivables financing

Where property the subject of a security interest is a debt or other chose in action, the rule in *Dearle v Hall*[28] means that priority as between competing security holders will depend on the order in which those security holders have given notice of their interest to the party obliged to make any particular payment which is subject to the security interest.[29] However, the classification of a creditor's security over receivables, as an assignment, fixed charge or floating charge, can affect the creditor's priority as well as its remedies.[30] These distinctions are archaic and they reduce the effectiveness of securities over receivables and the willingness of financiers to lend against this type of collateral.

Purchase money security interests

"The purchase money security interest is a security interest taken by the seller of goods to secure payment of the price, or by the lender of the money which is used to pay for them. Examples of a purchase money security interest in the Australian context would include the interest of the owner of goods under a hire-purchase agreement, the interests of a lender pursuant to a mortgage taken to secure repayment of a car loan (the mortgage

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[26] QLRC/LRCV Paper, paragraph 2.2.3.

[27] The complexity of section 282 of the *Corporations Law* is made worse by the uncertainty placed on maximum prospective liability clauses as a result of *Linter Group v Goldberg* (1992) 7 ACSR 580 and *Muirlands (No. 4) Pty Ltd v The Commissioner of Stamp Duties* 89 ATC 5241.

[28] 38 ER 475. The rule in *Dearle v. Hall* has been given statutory recognition throughout Australia. In Queensland this is found in section 199(1) of the *Property Law Act* 1974.

[29] The rule in *Dearle v Hall* will determine who the debtor has to pay to legally discharge the obligations over which security has been granted and, in the absence of an applicable statutory priority regime such as Chapter 2K of the *Corporations Law*, determine priority.

[30] For examples of the issue and its consequences see *Equus Financial Services Ltd v Glengallon Investments Pty Ltd* No. 1688 of 1991, unreported decision of White J in the Supreme Court of Queensland: *Siebe Gorman v Barclays* [1979] 2 Lloyd's Rep. 142 and *Re New Bullas Trading Ltd* (1994) 12 ACLC 3.

being taken over the car), and the interest of the supplier pursuant to a Romalpa agreement".[31]

The descriptive phrase "purchase money security interest" is derived from North America. However, recent English and Australian decisions have clarified earlier authority that a financier advancing money to enable the debtor to acquire a specific asset should be entitled to priority with respect to any security interest it may obtain at the time the debtor acquires that asset.[32] This result has been achieved by the Courts viewing the acquired asset as being subject to the purchase money financier's security interest before or contemporaneously with its acquisition so that there is no moment in time ("scintilla temporis") in which the asset is unencumbered by the purchase money financier's security interest.

Notwithstanding that the weight of Australian authority now appears to recognise that priority should be afforded to a purchase money security interest it has been commented that the evolution of the common law in this manner, driven as it has been by policy reasons, may ultimately have created more problems than the benefits achieved. While such policy reasons may be able to be rationalised, it has been suggested that if changes in the law are considered necessary for policy or other reasons then it is perhaps best that this be achieved by statutory reform.[33]

The problem with floating charges

There is considerable debate among academics and conflicting legal authority about whether the holder of a floating charge has an equitable interest in the property the subject of the charge or a mere contractual equity prior to crystallisation. The decision at first instance and on appeal in *Wily v St. George Partnership Banking Ltd* includes a useful summary of the conflicting views on this issue.[34] While the practical consequences of this distinction may not be all that significant it is troubling that such a fundamental issue is not certain.

Uncertainty also surrounds the priority position between a chargee and a subsequent purchaser for value of the charged assets without notice of the prior charge.[35]

It is submitted that the codification of the law relating to personal property securities is desirable to create a conceptually consistent framework regulating the substantive rights

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31 QLRC/LRCV Paper, paragraph 3.1.7.

32 See *Abbey National Building Society v Cann* [1991] 1 AC 56; *Composite Buyers Ltd v State Bank of New South Wales* (1990) 3 ACSR 196; *Sogelease Australia Ltd v Boston Australia Ltd* (1991) 26 NSW LR 1; *North Western Shipping & Towage Co Pty Ltd v Commonwealth Bank of Australia* (1993) 118 ALR 453. These cases clarified the earlier conflicting authority of *Re Connolly Brothers Ltd (No 2)* [1912] 2 Ch 25 and *Security Trust Co. v Royal Bank of Canada* [1976] AC503 on the one hand and *Church of England Building Society v Piskor* [1954] 1 Ch 553 on the other.

33 B Dixon, "Purchase Money Security Interests", Queensland Law Society Journal, Volume 25, February 1995, page 1 at page 15.

34 Federal Court of Australia, New South Wales District, BC 9707068; (1999) 161 ALR 1.

35 *Vibex Industries Pty Ltd v Gaylor* (1997) 15 ACLC 750.

and priorities not only as between secured parties but as between secured parties and third party purchasers for value without notice.

Reform to assist business

Because of the difficulties posed by current personal property securities laws for financiers when taking security over receivables and inventory, financiers have tended to demand security in the form of real property, non-inventory personal property and guarantees from company directors.

Many small business find it difficult to obtain finance based on the security of personal property. One of the reasons for the reluctance of financiers to take and rely on this form of security is the lack of certainty and complexity in the existing law. Experience in North America has shown that financiers are far more inclined to place reliance upon personal property as security when they can obtain clear rights in relation to that property.

For some considerable time the relative value of personal property compared with real property has been increasing and the primary generation of wealth in advanced economies today is derived from personal property including information and ideas. A modern competitive economy must have the ability of harnessing these types of property for the purposes of raising debt capital. Also, innovative financing techniques, including securitisation, would be encouraged by more modern and flexible personal property security laws.

5 THE ARTICLE 9 MODEL

Both the ALRC and the QLRC/LRCV claim that the reform of personal property securities laws in Australia should be modelled on Article 9 of the United States *Uniform Commercial Code*.[36] The *Uniform Commercial Code* represents a comprehensive reform of almost the entire commercial law of the United States. Article 9 of the *Uniform Commercial Code* relates to secured transactions.

Article 9 gained rapid acceptance in the United States because of the lack of an adequate inventory financing device in that country. Unlike England where the courts had given life to the floating charge in the latter part of the 19th century[37], the American courts generally took a hostile attitude towards transactions under which a lender was given a security interest in assets in respect of which the debtor was free to deal in the ordinary course of business. While the English courts had recognised the inappropriateness of having a fixed charge over shifting assets such as inventory and receivables while at the same time allowing the debtor to carry on business without being required to account for

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[36] ALRC Report, paragraph 4.7 (but note the ALRC supports "a regime based on the Article 9 approach but adapted to meet the particular needs of Australian jurisdictions") and QLRC/LRCV Paper, paragraph 3.1.

[37] J Chandler, "The Modern Floating Charge" in M Gillooly (Ed.), Securities Over Personalty, Federation Press, Sydney, 1994; D Everett, The Nature of Fixed and Floating Charges as Security Devices, Centre for Commercial Law and Applied Legal Research, Faculty of Law, Monash University, 1988; and WJ Gough, Company Charges, Butterworths, London, 1978.

the proceeds of disposition or to hold them on trust for the secured party[38], the American courts imposed a much more severe regime on secured creditors. Under the principle laid down in *Benedict v Ratner*[39] there could be no security interest in shifting assets vis-a-vis a third party unless the secured party closely supervised the debtor's disposition of the proceeds. The restrictiveness of *Benedict v Ratner* was significant in leading to the adoption of Article 9.[40]

Before looking at the adoption of Article 9 type legislation in Canada it is worth considering the fundamental concepts which underpin Article 9.

The uniformity and flexibility principles

With the exception of certain excluded transactions, Article 9 applies:

> "(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also
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> (b) to any sale of accounts or chattel paper."[41]

Furthermore, the Article applies to:

> "... security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's liens, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security."[42]

This broad application of the legislation is known as the *uniformity principle*.

Subject to specified qualifications, a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors.[43] This is known as the *flexibility principle*. It does not abolish traditional forms of security but it does make the distinctions between them redundant.

Under Article 9 a generic form of security agreement can be used which does not need to satisfy any particular form or content requirements. The flexibility principle eliminates the need for differing types of security documentation based on the type of property to be secured or the nature of the security provider. This allows all forms of security interests

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38 See *Re Yorkshire Wooloombers Association Ltd* [1903] 2 Ch 284 and *Re Florence Land and Public Works Company: Ex parte Moor* (1878) 10 Ch D 530.

39 268 US 353 (NY 1925).

40 JS Ziegel, "Floating Charges and OPPSA: A Basic Misunderstanding", (1994) 24 Canadian Business Law Journal, page 470 at page 477.

41 Section 9-102(1) *Uniform Commercial Code*.

42 Section 9-102(2) *Uniform Commercial Code*.

43 Section 9-201 *Uniform Commercial Code*.

created by the security provider to be incorporated in one document. Under Article 9 it is enough for the parties to grant "security" over property rather mortgaging, assigning, charging or pledging it. "The kinds of formal variable that dominate Australian security law play no part in the American scheme".[44]

Categorisation of secured property

Article 9 classifies security not according to its legal form but according to the purpose for which the asset given in security is held by the security provider. One category is inventory, that is, goods held for resale or raw materials held for processing into finished products. Special rules apply to security in inventory to reflect the fact that it is constantly changing and being turned over. Since the life of an item of inventory is short-lived, the financier needs to be able to extend his security interest to proceeds. A security interest in inventory cannot in general be allowed to prevail against a buyer in the ordinary course of business, for the security holder knows that the goods are to be resold and that it is only from the proceeds of resale that he can be repaid.

Another category of security is equipment, which includes goods held by the end user for business purposes. Separate rules apply to security in equipment since the security holder has no reason to suppose that it will be resold and can legitimately expect to assert his filed security interest over the claims of subsequent third parties.

A third category is consumer goods, that is, goods used or bought for use primarily for personal, family or household purposes. These constitute a separate category primarily in order to exclude security interests in consumer goods from the filing system. Consumer secured transactions are typically one-off affairs not involving large amounts, and the American view is that it is undesirable to clutter up the register with them.[45]

The filing system

Article 9 of the *Uniform Commercial Code* provides for a simple and effective filing system based on the concept of "notice filing" in a debtor name indexed register.[46] The general idea is to confine the particulars that need to be filed to a minimum, leaving the searcher to obtain any further details he needs from the security holder shown on the register.[47] A "financing statement" is filed against the name of the security provider. It is not necessary to have a separate financing statement for each item of property or transaction. A single financing statement can be used for any number of security interests and the security holder can, with the consent of the security provider, file a financing statement indicating merely an intention to take security. If the security agreement is later concluded and value is given priority dates from the time of filing and not the time of the transaction.

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44 QLRC/LRCV Paper, paragraph 3.1.2.

45 Section 9-302(1)(d) *Uniform Commercial Code*.

46 Article 9 registries have not, unlike their Canadian counterparts, been able to be searched by reference to an index of serial numbered property.

47 This can be time consuming, but it does have the advantage of ensuring that up to date information is obtained.

A financing statement need only contain a general description of the secured property.

Priorities

Article 9 also adopts a set of priority rules based not on the location of the legal title or on equitable rules of tracing but on what is most likely to produce a fair result in the typical case. Filing is a priority point, so that the first to file wins. This precludes a later purchaser or encumbrancer from being subordinated to a prior interest of which he had no notice.

A perfected security interest in inventory carries through to proceeds, but to avoid third parties being misled the secured party is required to reperfect his interest in those proceeds within a very limited period if they are not of a kind covered by his original financing statement. For example, a party filing as to inventory would have to reperfect his security interest in proceeds in the form of accounts within ten days of disposition of the inventory producing accounts receivable. He would not need to do this if his original financing statement had covered accounts as well as inventory. This reperfection requirement avoids most of the problems associated with the equitable right to trace into proceeds which exists under the current Australian law.

Special priority is given to the holder of a purchase money security interest. Since it is the advance that has enabled the security provider to acquire the asset, the holder of the purchase money security interest is given priority even over a previously filed security interest. Although the common law in Australia and England now seems to accommodate the concept and priority of a purchase money security interest, it would be desirable if this were to be cast in a comprehensive statutory framework.

The concepts of attachment and perfection

The central concepts of Article 9 are *attachment* and *perfection*. Together these concepts establish the existence of security interests and the rights and priorities of secured parties in the same property of a debtor.

Attachment is the time when the security interest comes into existence. A security interest will attach upon the satisfaction of the following three tests:

- Value is given. Value means any consideration sufficient to support a simple contract, including a prior debt or liability.
- The security provider must have rights in the property.[48] The extent of the security provider's rights in the property may range from full legal and beneficial ownership of the property to some lesser form of right such as the right of possession.
- The security interest must become enforceable against third parties. This means that the secured party either obtains possession of the property or the security provider signs a security agreement.[49]

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[48] Section 9-203(1) *Uniform Commercial Code*.

[49] Section 9-102(1)(a) *Uniform Commercial Code*.

While a security interest will attach upon satisfaction of the above three tests, the parties may also agree in the security agreement to postpone the time of attachment. Once the security interest attaches to property, it will continue in the property until the security interest is discharged or until the security provider disposes of or otherwise deals with the property in a manner which the secured party has authorised, either expressly or by implication.

A security interest is perfected when it has attached and when the security holder has taken all steps required for perfection under Article 9. These steps include the filing of a financing statement or taking possession of the collateral.[50] The perfection of a security interest places it in a position of priority with respect to third parties who may claim an interest in the same property.

Under Article 9 the order of occurrence of attachment and the steps required for perfection is not important so long as they all occur.

6 ADOPTION OF THE ARTICLE 9 APPROACH IN CANADA[51]

The most enthusiastic adoption of Article 9 of the *Uniform Commercial Code* in another country has occurred in Canada.

The reasons for reform in Canada

Prior to the adoption of Article 9 type legislation the laws throughout Canada resembled those which currently exist in Australia. Indeed, as one Canadian academic has observed:

"In all common law legal systems, a century and more of ad hoc response to commercial demands for an ever expanding cushion of assets to secure loan and purchase credit produced inevitable fragmentation in the legal doctrine and theories."[52]

The availability of floating charges and equitable mortgages over after acquired property in the common law provinces of Canada meant that parties wanting to obtain security over inventory were not faced with the same difficulties as their neighbours in the United States. More or less uniform *Conditional Sales Acts*, *Bills of Sale Acts*, *Assignment of Book Debts Acts* and *Corporations Securities Registration Acts* were in existence in most of the common law jurisdictions and, in many of the provinces, central registries had been established under these Acts. As a result, most provinces had a legal framework within which the traditional types of secured financing devices, including inventory financing devices, could function.

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[50] Sections 9-302, 9-304 and 9-305 *Uniform Commercial Code*.

[51] This section draws on the chronology of Canadian developments prepared by Professor RCC Cuming of the University of Saskatchewan appearing in attachment J to the Conference Papers for the Personal Property Security Law Reform Workshop, Bond University, December 14-17, 1995. See also the synopsis of Canadian developments in JS Ziegel and RCC Cuming, "The Modernisation of Canadian Personal Property Security Law", (1981) 31 University of Toronto Law Journal, page 249 and C Walsh, An Introduction to the New Brunswick Personal Property Security Act, Faculty of Law, University of New Brunswick, 1995.

[52] Walsh, Op. Cit. n 51, page xxi.

The overriding deficiency in personal property security law in these provinces was that it contained no systematic or conceptually consistent approach. The law was drawn from the common law, equity and statutes. Superimposed on these concepts were complicated, disparate and overlapping registry requirements. Priority structures were an anomalous mixture of legal doctrine and statutory rules. Not only did this law substantially ignore the needs of the persons affected by it but, in addition, it lacked a conceptual basis for further development and was poorly equipped to accommodate new business practices and new approaches to business financing. The attractiveness of Article 9 was that it swept away this tangle of established legal doctrine and put in its place a single conceptual basis for all personal property security transactions.[53]

The chronology of reform in Canada

In 1959 the Attorney-General of Ontario asked a committee of the Canadian Bar Association to put forward recommendations for the improvement of Ontario's personal property security laws. One of the major concerns was that the regional registry system for security arrangements, other than those governed by the *Corporations Securities Registration Act*, were outdated and inadequate. The committee decided to examine the feasibility of adopting in Ontario a system modelled on Article 9. The result was that in 1963 the committee recommended a *Personal Property Security Act* for Ontario that contained the same conceptual approach and many of the detailed features of Article 9. The proposal was then reviewed and modified by the Ontario Law Reform Commission. In 1967 the Ontario Legislature enacted the first *Personal Property Security Act* for the province but this Act was not fully proclaimed until 1976.[54]

In 1964 the Canadian Bar Association established a special committee to determine whether or not it was feasible to adapt the then proposed Ontario legislation so that it could be used as a model for similar legislation in the other provinces. The committee decided to prepare a model *Personal Property Security Act* that would serve as the basis for reform of personal property security law throughout Canada. The committee published the *Uniform Personal Property Security Act* in 1969. This was adopted by the Canadian Bar Association in 1970 and provided the model for Manitoba's *Personal Property Security Act* (1973). While the Uniform Act adopted most of the features of the 1967 Ontario Act, it differed in some important respects. The weaknesses of the Ontario Act and the 1969 Uniform Act along with the substantial changes made to Article 9 of the *Uniform Commercial Code* in 1972 prompted the committee to work on a second draft of the Uniform Act. In the meantime the Saskatchewan Law Reform Commission published a report in 1971 proposing a *Personal Property Security Act* for that province based in part on the Uniform Act, but containing a number of significant new features. The Saskatchewan Legislature enacted its *Personal Property Security Act* in 1980. In 1982 a revised version of the *Uniform Personal Property Security Act* was adopted by the Canadian Bar Association and the Uniform Law Conference of Canada. This revised Uniform Act contained many of the features of the 1980 Saskatchewan Act.

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[53] Cuming, Op. Cit. n 51.

[54] The delay in proclaiming the legislation was mainly due to the technological difficulties of establishing a computerised registry.

When it became clear in 1984 that Ontario was not particularly interested in using the 1982 *Uniform Personal Property Security Act* as a model for further reform in that province or in cooperating with the other provinces in having inter-jurisdictional uniformity of personal property security legislation, the Western Canada Personal Property Security Act Committee was formed. The goal of this committee was to develop a model law for adoption by jurisdictions in western Canada (Western Canada Model Act). This committee was reconstituted in 1991 as the Canadian Conference on Personal Property Security Law.

Ontario, Manitoba, Saskatchewan, Alberta, British Columbia, New Brunswick, Nova Scotia, the Northwest Territories and the Yukon Territory all now have Article 9 type legislation.[55] Indeed Ontario, Manitoba and Saskatchewan are into their second generation of this type of legislation.[56] This leaves Newfoundland and Prince Edward Island as the only common law provinces without Article 9 type legislation.[57] According to Professor Jacob Ziegel, a leading Canadian expert in personal property security legislation, "Article 9 now firmly dominates the discourse and analysis of chattel security law problems from one end of Canada to another."[58]

The flexibility of the Canadian *Personal Property Security Acts* and their commercial success is highlighted by the fact that even the civil law province of Quebec has taken steps to reform its personal property securities laws along similar lines.[59]

Features of the Canadian reforms

The Canadian legislation is not identical from province to province and there are some substantial differences between Ontario and the other provinces.[60] However, the British

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[55] *Personal Property Security Act* 1990 (Ontario); *Personal Property Security Act* 1993 (Manitoba); *Personal Property Security Act* 1993 (Saskatchewan); *Personal Property Security Act* 1988 (Alberta); *Personal Property Security Act* 1989 (British Columbia); *Personal Property Security Act* 1993 (New Brunswick); *Personal Property Security Act* 1995 (Nova Scotia); *Personal Property Security Act* 1993 (Northwest Territories); *Personal Property Security Act* 1986 (Yukon Territory).

[56] Ontario has had the 1967 and 1990 Acts; Manitoba the 1973 and 1993 Acts; and Saskatchewan the 1980 and 1993 Acts.

[57] Newfoundland is presently engaged in a comprehensive reform of its judgment enforcement law. That initiative will result in the development of an electronic judgment enforcement registry that will also support the reform of personal property security laws. Prince Edward Island has had a *Personal Property Security Act* on its statute books since 1990 but the Act has remained unproclaimed. It seems that it was enacted for symbolic and informational purposes only and no immediate plans for implementation have been announced; Walsh, Op. Cit. n 51.

[58] JS Ziegel, Paper delivered at the Annual Workshop on Commercial and Consumer Law, University of Toronto, October 1995.

[59] Ziegel, Ibid and Walsh, Op. Cit. n 51, page xxiii.

[60] The Western Canada Model Act is more comprehensive in scope and detail giving direction on a number of points on which the Ontario legislation is silent and applying to a wider range of transactions. In balancing the interests of the parties to a security agreement, the Western Canada Model Act tends to favour the debtor's side rather more than the Ontario legislation. Most significantly, the Western Canada Model Act places greater emphasis on the publicity function underlying the mandatory

Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, North West Territories and, to a lesser extent, Yukon Acts are all very similar to each other as they are all based on the Western Canada Model Act. Despite the differences which exist, the basic model for each of the Canadian Acts is Article 9 and each province has a single registry covering the whole province.

The Canadian *Personal Property Security Acts* are not simply a restatement of Article 9. Although they reflect the basic framework of Article 9, the Canadian Acts have filled gaps in its operation that the American experience had exposed and introduced new and innovative features. For example, the Canadians have developed extremely sophisticated computerised registries to enable registration and searching to be conducted by serial number against consumer goods and equipment in addition to the debtor's name.

The Canadian legislation (particularly the Acts based on the Western Canada Model Act) and the registration systems established by them are clearly the benchmark on which any Australian reform should be based. The success of computerised registries in Canada is now forming the basis of computerisation of the Article 9 registries in the United States.[61]

Electronic registration and on-line searching facilities have been available in Ontario and British Columbia for some time and New Brunswick has an entirely paperless personal property security registry system. In contrast, many of the Article 9 registries in the United States are not fully computerised and some have no on-line searching facilities. Many of the Article 9 registries also still operate on a city and county registry system rather than a single registry for the entire State,[62] although this is currently under review.

Assessing the Canadian reforms

Although the Canadian *Personal Property Security Acts* have been an undoubted success[63], they have not been without their flaws. Many defects and anomalies have been identified and rectified by amendment[64] and there is a clear recognition that personal property security legislation must continue to evolve.

"Secured financing is a complex and dynamic activity and its legislative framework must remain responsive to changing patterns of commercial practice, to changing policies on

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registration of security interests and on preserving the reliability of registry searches; Walsh, Op. Cit. n 51, page xxiv.

61 RCC Cuming, "Computerisation of Personal Property Securities Registries: What the Canadian Experience Presages for the United States", Uniform Commercial Code Law Journal, Volume 23, Spring 1991, page 331.

62 Ziegel, Op. Cit. n 58 and C Walsh, "New Brunswick's New Personal Property Security Regime", Journal of Banking and Finance Law and Practice, September 1994, page 240.

63 A detailed survey of commercial lawyers in Ontario and overwhelming anecdotal evidence suggests that the reforms have been worthwhile: JS Ziegel and D Denomme, "How Ontario Lawyers View the Personal Property Security Act: An Empirical Study, (1992) 20 Canadian Business Law Journal, page 90.

64 JS Ziegel, "The New Provincial Chattel Security Regimes", The Canadian Bar Review, Volume 70, 1991, page 681.

the appropriate balance to be struck among the relevant players and, indeed, to newly-discovered deficiencies in its operation."[65]

The lack of total harmonisation between the Canadian *Personal Property Security Acts* is one perceived shortcoming although it appears that the prospects are now good for much greater harmonisation, if not uniformity, in the near future[66]. Also, there is still some uncertainty in the law because of conflicts with Canadian federal legislation relating to banking, bankruptcy and insolvency, patents, copyright, trademarks, industrial designs, shipping and railways which provides for certain specific types of security. The rights and priorities of parties with security interests registered under the provincial statutes need to be considered in light of this federal legislation.[67]

Because of the differences in substance and detail between the 1967 and 1990 Ontario *Personal Property Security Acts* and Article 9 of the *Uniform Commercial Code* on the one hand and the *Personal Property Security Acts* in the rest of Canada based on the Western Canada Model Act on the other, some of the case law developed by the Ontario and American courts is inapplicable in the Canadian jurisdictions that have adopted the Western Canada Model Act. This is an important factor when considering the shape of reform in Australia.

The common legal heritage of Canada and Australia, the broad similarities between the banking and financial systems of the two countries, and the many other similarities between the respective economies suggest that the experience and legislative models available in Canada warrant particular if we are to embark upon our own reforms.

It has been suggested, that under the Canadian system each province has its own personal property securities legislation and registry system and that this somehow detracts from the usefulness of the Canadian legislation as a model for Australia.[68] The Canadians' inability to agree on uniform legislation implemented through one national registry may be a particular product of the nature of Canadian federalism.[69] In Australia our federal system is much more centralist than in Canada and, in many respects, we have a much stronger record of agreeing to uniform legislation among the States and Territories than

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[65] Walsh, Op. Cit. n 51, page xxiii.

[66] In any event, Professor Ron Cuming of the University of Saskatchewan has observed that on-line access to each of the provincial registries has, to a large extent, overcome the lack of a single national registry in Canada: Personal Property Securities Law Workshop, Bond University, December 14-17 1995.

[67] Zeigel, Op. Cit. n 58 and Ziegel, Op. Cit. n 64.

[68] ALRC Report, paragraph 3.21 and J Goldring, "Problems of Law Reform: The Law of Personal Property Securities - A Commentary on Chapters by Professors Ralph Simmonds and Tony Duggan" in M Gillooly (Ed.), Securities Over Personalty, Federation Press, Sydney, 1994 at pages 298-9.

[69] Professor RCC Cuming of the University of Saskatchewan has expressed the view that uniformity for its own sake is not desirable if there are good policy reasons why legislation should be different from one province to another. For example, regional economic factors may well be different and different provinces may have reasonable differences of opinion in relation to provisions dealing with issues such as remedies. He has also noted that with on-line access to each province's registry being available across Canada there is little need for one national registry; comments made at the Personal Property Securities Law Workshop, Bond University, December 14-17, 1995.

has been achieved in Canada. The point to be derived from this is that in looking at the Canadian laws, regard should be had to the workability of the legislation and the efficiency of their registry systems and not the fact that somewhat different legislation and different registries prevail in the different provinces. In any event the degree of harmonisation in the Canadian legislation is now much greater than it has been previously.

7 CONCLUSION

It is widely acknowledged that traditional security laws which developed last century in England are no longer adequate. The Americans were first to recognise this as the pre-Article 9 personal property security laws in America were even less adequate than our laws currently are.

The benefits of the North American legislation are well summarised in the ALRC Report:

"The Article 9 approach, as applied with local variations in all of the jurisdictions mentioned, is attractive in its simplicity and almost universal applicability.

- Its use of a functional definition - which looks to the substance of the transaction and not the form - overcomes the complicated and confusing rules which previously applied to different kinds of security interests.
- Ordinary securities and reverse securities which are similar in commercial or economic effect or purpose, but legally different, are treated alike.
- A single set of rules applies to all kinds of securities to determine when they are enforceable against third parties.
- Archaic common law priority rules are dispensed with in favour of a more streamlined set of priority rules.
- Registration is a voluntary act but there is incentive to register since priority as against third parties cannot be assured without registration or possession.
- A single regime overcomes the difficulties of choosing which register to file in and of searching many different registers within one jurisdiction.
- While the single register is open to public inspection, priorities depend not on notice (actual or constructive) but on the date of registration."[70]

The Canadian *Personal Property Security Acts* have been thoroughly tested and, where necessary, updated to make them more efficient and effective and to meet the needs of modern business. The Canadian jurisdictions have also been at the forefront of establishing computerised registries designed to maximise the commercial and public benefit of broad based personal property securities legislation.

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[70] ALRC Report, paragraph 3.20.

Like New Zealand, Australia should look to the Canadian experience for inspiration.

Craig Wappett
21 May 1999