



DEPARTMENT OF TREASURY

PERSONAL PROPERTY SECURITY BILL 2011

Consultation Paper

August 2011

1. OVERVIEW

1.1 Purpose and background

This Consultation Paper provides an overview of the draft Personal Property Security (PPS) Bill. This overview is intended to guide interested stakeholders who want to understand or comment on the PPS Bill.

The Government is pursuing reforms to the country's legal framework for loans and other obligations that are secured by personal property. The end goal of these reforms is to establish a uniform system for the registration and regulation of security interests. The PPS Bill provides a legislative framework which is consistent and comprehensive for creditors and which will bring PNG in line with current international business standards.

The PPS Bill gives effect to policy reforms that were approved by the National Executive Council (NEC) on 2 December 2010 (Decision No. 253/2010). In summary, NEC:

- noted that the current legal framework for loans secured by personal property is outdated and that reform of this legal framework will promote commerce by increasing the availability of credit for many businesses and individuals;
- approved the preparation of a draft Personal Properties Securities Bill; and
- noted that Treasury will consult with stakeholders and hold public consultations and workshops.

1.2 Consultation Process

Under the timetable developed by the Department of Treasury, it is proposed that the PPS Bill will be presented to Parliament during the sittings scheduled for November 2011. This places time pressures on the Government as well as industry stakeholders with an interest in these reforms.¹

¹ It is important to note, however, that even if the PPS Bill is enacted in 2011 in accordance with the current timetable, the commencement date for the PPS Act will be set at a later time to ensure that a full public information campaign can be conducted and that the PPS Registry is established and ready for use.

To date the development of the PPS Bill has been guided by a broad range of stakeholder consultations. Further public consultations will be held during September, including a public workshop and face-to-face meetings between the Department of Treasury (and its consultants) and key public sector and private sector stakeholders. This will be an opportunity for interested members of the public to learn more about the proposals in the draft PPS Bill and also to provide feedback in addition to, or instead of, feedback provided through written submissions.

Stakeholders are also invited to present written submissions on the PPS Bill to the Department of Treasury by no later than **Friday, 30 September 2011**.

Written submissions should be made out for the attention of Mr. Igimu Momo, First Assistant Secretary, Structural Policy and Investment Division (**SPID**) and can be sent by one or more of the following media:

Email: igimu_momo@treasury.gov.pg (copied to roddie_wada@treasury.gov.pg)

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2. THE PPS BILL – SOME BASIC QUESTIONS AND ANSWERS

2.1 What is a PPS Bill?

A PPS Bill is a proposed law about security interests in personal property. Personal property is all forms of property other than real estate. A security interest is an interest in personal property that in substance secures payment of a debt or other obligation regardless of the form of the transaction.

The PPS Bill seeks to improve access to credit. A prosperous economy requires access to credit but in PNG credit conditions are difficult for many people. With better access to credit, PNG businesses and consumers can more easily:

- purchase machinery, vehicles and computers that will boost productivity;
- expand business inventory, to meet the needs of producers, service suppliers and consumers;
- modernize agriculture and smooth cash-flow problems for farmers;
- smooth cash-flow problems caused by seasonal or cyclical cash needs (for example, cash-flow required for importing goods, exporting goods, or replacement of inventory);
- improve buildings, to increase the value and marketability of real property; and
- broaden consumer financing options, to give consumers greater access to goods and services.

2.2 What is a PPS Registry?

A key element of the PPS Bill is to establish a single national electronic Personal Property Security Registry (**PPS Registry**).

Currently, the arrangements for registering security interests across PNG are variable and unreliable with separate registers and legislation in relation to different types of personal property. The PPS Bill's proposal of a single national PPS Registry will bring all of this information together in the one, definitive register. The PPS Registry would replace multiple existing registers currently administered by government agencies. The PPS Registry will be computer-based, updated in real time and accessed publicly.

2.3 Why use personal property as collateral for loans?

Lenders want security, or collateral, as support for important loans. Although they may sometimes accept personal guarantees for small loans, these guarantees are often insufficient. Collateral may be land and buildings or collateral may be personal property. Lenders often prefer loans that are secured by land but many borrowers do not have land to offer (or their land may already be subject to a mortgage or lease).

The PPS Bill only applies to loans that are secured by personal property as collateral; it does not apply to mortgages on land as security for loans. In short, the PPS Bill applies where collateral is any property other than land and buildings. The practical problem is to unlock the potential of

personal property as collateral for loans. Strengthening the law to address this problem will help borrowers to get more credit on better terms.

Under the PPS Bill, the personal property that may be used as collateral includes:

- business assets, such as equipment, inventory (stock in trade), or accounts receivable;
- tangible goods of any kind, including consumer goods;
- intangibles, such as bank accounts, shares and bonds, warehouse receipts, bills of lading, letters of credit, or intellectual property;
- crops, livestock, or farm products; and
- extracted goods, such as timber after it is cut from the land or minerals after they are extracted from the ground.

Importantly, the borrower and lender may agree that collateral will consist of personal property that the borrower owns now, or that the borrower may acquire in the future. The PPS Bill, if enacted, shall give people greater freedom to make collateral agreements than is available under current law.

2.4 Why is a new PPS Bill needed?

The first benefit of the PPS Bill is that it provides a consistent framework for all loans that are secured by personal property and this framework would be captured in a single law. PNG already has several different laws that relate to loans that are secured by personal property. These various laws are captured in both legislation (such as the Instruments Act 1953 that governs bills of sale and the Hire-purchase Act 1966) and in the common law². If enacted, the PPS Bill would replace all existing legislation and some aspects of common law with a single law, the PPS Act.

The second benefit of the PPS Bill is that it provides a modern, up-to-date legal framework. Much of the current legislation and common law rules are now outdated and inconsistent with best practice in secured transactions law. The result is that it is often difficult and expensive to use personal property as collateral. Also, enforcement of loan agreements that are secured by personal property is expensive and time consuming. This means that creditors are often unwilling to consider personal property as collateral. Ultimately, borrowers pay for this inefficiency in the form of depressed credit that is provided under unattractive terms and conditions.

The proposed PPS Bill will improve the economy in PNG in the following four ways:

- strengthen borrowers' power to give rights in collateral to lenders and reduce the cost of doing so;
- clarify the rights of secured lenders against other creditors, in case of a dispute over collateral;
- give transparent information to buyers of collateral and to prospective creditors, to help them make informed decisions about purchases and loans; and
- streamline the enforcement of agreements, in the event of a default by the borrower.

² The "underlying law" – that is, the common law of PNG – consists of the decisions of PNG's courts and also the principles and rules of common law and equity in English common law as it stood on September 16, 1975 (the date of Independence).

2.5 What is the experience of other countries that have introduced a PPS Bill?

The introduction of a PPS Bill has already proven effective in promoting business and consumer credit in dozens of countries from the large and wealthy (such as the US or China) to the small and developing (such as Solomon Islands and Vanuatu). The development of PPS legislation began in the US and Canada in the 1950s and 1960s and has since spread around the world to Europe, Asia and elsewhere.³ In the Pacific, the reforms have already been successfully adopted by New Zealand, Vanuatu, Solomon Islands, Tonga, the Federated States of Micronesia and the Republic of the Marshall Islands. Australia recently enacted a PPS Act and it will commence later in 2011.

³ Similar reforms have also been implemented by numerous Eastern European countries (including Albania, Bosnia, Bulgaria, Kosovo, Poland, Romania, Slovakia and Ukraine) and by several Asian countries (including Cambodia, China and Vietnam).

3. PPS BILL – SUMMARY AND KEY ISSUES

The remainder of this Consultation Paper summarizes each Chapter in the PPS Bill and highlights key issues that the public may wish to comment on.

3.1 Summary

The major elements of the PPS Bill are covered in the following chapters.

- **Attachment of security interests to collateral (Chapter 3):** A security interest is a property right that ‘attaches’ to property when certain conditions are met.
- **Rights and duties of the debtor and the secured party (Chapter 4):** This Chapter provides for the rights and duties of the debtor and secured party in certain circumstances.
- **Perfection of security interests against third parties (Chapter 5):** Security interests may be perfected so that the secured party can enforce the security interest against third parties (such as certain buyers of collateral and certain other creditors). In general, security interests can be perfected through registration of a notice, possession (in the case of tangible collateral) or control (in the case of investment property or a deposit account).
- **Prioritization of conflicting security interests (Chapter 6):** Priority rules help to resolve disputes between secured parties whose interests in collateral come into conflict with the interests of other creditors and with the interests of buyers of collateral. The general priority rule is that the first security interest to be registered or perfected has priority over other security interests (that is, ‘first to register wins’). However, there are a number of exceptions for special types of collateral or special commercial circumstances. Many priority rules under existing law depend on legal form and terminology. By contrast, the purpose of priority rules in the PPS Bill is to create incentives that promote credit.
- **Registration of notices of security interests (Chapter 7):** An electronic notice registry, the PPS Registry, would receive notices and make them available for public search. The notices alert prospective creditors and buyers of collateral of the possible existence of a security interest. The registration date of a notice may establish the date by which priority of competing claims is measured.
- **Enforcement of security interests (Chapter 8):** This Chapter provides for the rights and duties of debtors, secured parties and others upon the debtor’s default on a secured obligation. No matter what the form of the transaction, the secured party has the right, upon default, to take possession or control of collateral and to sell it or otherwise obtain value from it. Where possible, non-judicial enforcement mechanisms are provided.
- **Transition provisions (Chapter 9):** The PPS Bill provides transitional arrangements for existing security interests.

3.2 CHAPTER I – Interpretation

The purpose of this Chapter is to define key terms and concepts used in the PPS Bill that carry a meaning that may vary from the meaning encountered in every day usage (section 1).

3.3 CHAPTER II – Application of the Act

Chapter II defines those transactions that are subject to the PPS Bill and those transactions that are excluded from the scope of the PPS Bill.

3.3.1 *Transactions that are subject to this Act (section 9)*

The PPS Bill applies to all transactions where the effect of an agreement is that personal property secures an obligation. The PPS Bill applies no matter what form or terminology is used by the parties and regardless of their intent. The PPS Bill applies to existing security devices such as company charges, pledges and chattel mortgages.

The PPS Bill also applies to some transactions that do not create security in personal property but which need to be included in the PPS Registry to avoid creating confusion for prospective secured creditors. These transactions include leasing and consignment of goods and the sale of accounts. Finally, the PPS Bill applies to the interests of execution creditors for the purposes of registration and priority. (Execution creditors are persons who have the right, usually obtained in court, to seize personal property for the satisfaction of a debt.)

3.3.2 *Transactions that are not subject to this Act (section 10)*

The PPS Bill does not apply to loans or other obligations that are secured by real estate (land or buildings). Also, the PPS Bill does not apply to transfers of certain rights to payment (such as future wages, or accounts that are sold as part of the sale of a business or that are assigned for the purpose of debt collection). The reason for these exceptions is that a prospective creditor cannot be deceived by the status of the property as potential collateral, and therefore registration and priority rules are not necessary.

3.4 CHAPTER III – Security Agreements, Attachment of Security Interests, etc

The purpose of Chapter III is to ensure that security agreements are effective, despite some common law practices of the past. A security interest must ‘attach’ to collateral to be enforceable against the debtor. The Chapter establishes the conditions for the attachment of security interests to collateral under security agreements.

3.4.1 *Effectiveness of Security Agreement and Security Interest (section 12)*

This section ensures that a security agreement is effective and that it may be enforced against people who have purchased collateral or against execution creditors who claim an interest in the collateral. The security agreement remains effective despite common law to the contrary. For example, a security agreement may not be challenged on the grounds that the collateral is not in the secured party’s possession or that the debtor has the right to deal in the collateral.

3.4.2 *Attachment of Security Interest to Collateral and Proceeds (section 13)*

A security interest is a property right. The right ‘attaches’ to property when all of three conditions are met: (i) the debtor obtains rights in the collateral, (ii) the secured party gives something of value to the debtor and (iii) there is a security agreement that describes the collateral (or the secured party takes possession or control of the collateral).

A security interest in collateral is deemed also to be a security interest in proceeds of the collateral. Proceeds are property received in exchange for the collateral.

3.4.3 *CHAPTER III – other (sections 14-16)*

Other sections in Chapter III relate to:

- the security interest of an intermediary (for example, a securities broker) in the securities of a customer for the purpose of securing agreed payments for services (section 14);
- obligations secured by property that is acquired after the security agreement is concluded (‘after-acquired property’, section 15); and
- security agreements in which the secured party agrees to make advances of funds in the future (‘future advances’, section 16).

3.5 **CHAPTER IV – Rights and Duties of the Debtor and the Secured Party**

Chapter IV provides for the rights and duties of the debtor and secured party when: (i) the secured party has possession of collateral; (ii) the secured party controls investment property or deposit accounts; or (iii) the secured party takes an assignment of an account. Also, the secured party must periodically provide, upon request of the debtor, a statement of account.

3.5.1 *Secured Party’s Duty to Preserve Collateral (section 17)*

Secured parties sometimes take and retain possession of collateral while loans are outstanding. While in possession of the debtor’s property, a secured party must take reasonable care of the property. Reasonable expenses, such as insurance and maintenance costs, may be charged to the debtor. Money received in exchange for the collateral should be used to reduce the secured debt, or remitted to the debtor, but other increases may serve as further collateral.

3.5.2 *Investment property, deposit accounts and account debtors (sections 18-20)*

It is not possible for a secured party to take possession of a deposit account or investment property (other than certificated shares). Instead, a security agreement may allow the secured party to take ‘control’ of these forms of collateral. (Methods of ‘control’ are detailed in Chapter I.) The security agreement may also allow an account (that is, an account receivable) to be assigned so that, upon default, the account debtor makes payments to the secured party. The duties of secured parties in each of these circumstances are outlined in sections 18 to 20.

3.5.3 *CHAPTER IV – other (sections 21-22)*

Security agreements may be complicated and sometimes there may be confusion as to what currently constitutes collateral and the exact amount of the secured debt. The debtor has the

right, within reason, to require the secured party to give a statement of account or a list of collateral (section 21). In limited circumstances, a secured party has the right to accelerate payment by the debtor (section 22).

3.6 CHAPTER V – Perfection of Security Interests

This Chapter provides the methods by and circumstances under which security interests are perfected. Perfection is a technical concept that provides a form of protection for a secured party that is stronger than the mere attachment of their security interest. The perfection of a security interest will affect the priority it has relative to other security interests in the collateral and its status in the event of the insolvency or bankruptcy of the debtor. A security interest is perfected when it has attached to collateral and when a notice has been registered, or in some cases, when the secured party takes possession or control of the collateral.

3.6.1 Perfection of a Security Interest (sections 23-26)

The general rule is that a security interest is perfected when it has attached to collateral and at least one means of perfection has been completed. The order of the steps to perfect and the steps for attachment are not relevant. There are three methods of perfection.

(a) Perfection by Registration of a Notice

Any security interest can be perfected through registration, except a security interest in money (other than cash proceeds). A security interest in money must be perfected through possession because no one should be expected to check the PPS Registry before taking cash to determine whether there is a perfected security interest in it.

(b) Perfection by Taking Possession of Collateral

A security interest in goods and quasi-tangible property (such as chattel paper, cheques, letters of credit, documents of title, etc) may also be perfected by taking possession of the collateral.

(c) Perfection by Control of Deposit Accounts and Investment Property

In addition to registration, a security interest in deposit accounts or investment property may be perfected by taking control of the deposit accounts or investment property. (Methods of 'control' are detailed in Chapter I.)

3.6.2 Continuity of perfection and temporary perfection (sections 27-28)

As there are multiple methods of perfection, a security interest remains continuously perfected if the method changes and there is no gap in time when no method of perfection applies (section 27). In certain circumstances, ordinary commerce is facilitated if security interests in certain instruments and documents of title remain perfected temporarily while the debtor takes possession of the documents for the purpose of taking delivery of goods or negotiating transactions (section 28).⁴

⁴ For example, suppose that Bank holds a warehouse receipt to perfect a security interest in the receipt and then Bank releases the receipt to Debtor for a short period of time to enable Debtor to manage goods covered by the receipt. The security interest remains perfected during this short period of time.

3.6.3 *Perfection of security interest in certain types of personal property (sections 29-31)*

The rules of perfection are clarified for the following types of personal property:

- goods that are in the possession of a bailee (for example, goods held in a warehouse);
- proceeds (that is, property or property rights received in exchange for the collateral); and
- supporting obligations (for example, a guarantee or a letter of credit)

3.6.4 *Perfection of Security Interest in goods that are returned or repossessed (section 32)*

A security interest re-attaches to goods that the debtor sells free of a security interest and then reacquires. Section 32 clarifies the priority of different security interests that may arise in this situation.

3.7 **CHAPTER VI – Priority of Security Interests and Rights of Third Parties**

This Chapter provides for the resolution of disputes between secured parties whose interests in collateral come into conflict with the interests of other creditors and with the interests of buyers of collateral. The Chapter provides general priority rules for resolving disputes, but takes into account that special types of collateral and special commercial circumstances warrant exceptions to the general rules.

3.7.1 *General Priority Rules (Part 1, sections 33-37)*

The general priority rules (section 33) are:

- the first security interest that is perfected, or for which notice is registered, has priority over other security interests (that is, ‘first to register wins’);
- a perfected security interest has priority over an unperfected security interest; and
- between conflicting unperfected security interests, the first to attach has priority.

The registered interests of execution creditors are superior to the interests of *unperfected* security interests. Buyers of chattel paper, documents and instruments take this property free of any perfected security interests if the buyers give new value and without knowledge of the security interest (section 34).

The time of perfection in collateral is also deemed to be the time of perfection in any proceeds of the collateral (section 35). Section 36 clarifies the priority of a perfected security interest in the case where collateral secures future advances.

3.7.2 *Priority of Purchase-Money Security Interests (Part 2, sections 38-44)*

In the case of ‘purchase-money security interests’ (**PMSIs**)⁵, commercial activity is best promoted by the rule: ‘second to register wins’. This gives PMSIs a super-priority over general security interests that were perfected earlier in time.

⁵ A PMSI is a particular type of security interest. A PMSI is distinguished from a standard security interest in two main ways: its manner of creation and the priority it receives relative to other security interests in the same collateral. A PMSI is a security interest in collateral that secures the assistance provided by the secured party to the grantor to enable their purchase or acquisition of rights in the collateral.

The general priority rule for purchase-money security interests is that a perfected PMSI in goods (other than inventory or livestock) has a super-priority over other security interests in the goods and in proceeds of the goods (section 40). The same rule applies to perfected PMSIs in inventory or livestock. However, in these cases, the holder of the PMSI must give notice to any prior secured party who has registered a notice (sections 41 and 42).

Example 1 – purchase-money security interests (PMSIs) – trade credit

(The most common example of a PMSI is the sale of goods on credit – trade credit.)

Suppose that Bank (the first secured party) has a perfected security interest in all of Company's existing and future-acquired property. Later, Car Dealer (the second secured party) sells a truck to Company on credit and perfects the security interest in the truck by registration.

This trade credit provided by Car Dealer enabled the Company to purchase the truck and so now Car Dealer's security interest is called a 'purchase-money security interest'. It has super-priority over Bank's general security interest (but only to the extent of the value of the truck).

Even though Car Dealer registered second, its PMSI wins over Bank's security interest with respect to the truck, because without the PMSI it is unlikely that the Car Dealer would have extended credit for the purchase.

If two PMSIs are in conflict, the general priority rules apply except that a PMSI held by a trade creditor has priority over a PMSI held by a secured party who lent money to the debtor for the purpose of purchasing the goods (section 43).

A PMSI has priority over the interests of an execution creditor if the PMSI is perfected within 5 days of the date that the debtor obtains possession of goods (or other tangible collateral), or within 5 days of the date that the PMSI attaches to intangible collateral (section 44).

3.7.3 Buyers and Other Persons to Whom Collateral is Transferred (Part 3, sections 43-51)

Buyers and lessees of goods, in general, take the goods subject to a perfected security interest in the goods (section 46). This result is deemed to be fair because the buyer or lessee had the opportunity to learn of the security interest before the sale by searching the PPS Registry. Effectively this means that, unless an exception applies, buyers should check the PPS Registry to determine whether property to be bought is subject to a security interest.

Example 2 – buyers must check the PPS Registry

(After goods are purchased, they still remain subject to any prior, perfected security interest)

Suppose that:

- (1) Creditor registers a notice of a security interest in farmer's tractor; and then
- (2) Farmer sells the tractor to Neighbour.

Result: Neighbour takes the tractor subject to Creditor's security interest. Creditor may enforce the security interest by taking possession of the tractor from Neighbor and selling it. Neighbor could have avoided this result by searching the PPS Registry and discovering the security interest prior to the purchase.

The rule discussed above (buyers take collateral subject to prior, perfected security interests) is not always in the best interests of commerce. Sometimes it is best to protect the buyer from

prior security interests even if the buyer could have discovered the security interest by checking the PPS Registry and even if the buyer had actual knowledge of the security interest.

Example 3 – buyers are protected when they buy in the ordinary course of business

Suppose that Bank has a security interest in the inventory of Supermarket (that is, in the goods held for sale by Supermarket). Supermarket sells groceries to Consumer and then defaults on its obligations to Bank.

Under the general rule, Bank has the right to seize the groceries from Consumer because Supermarket has defaulted. This result would clearly deter people from buying goods from shops. Therefore, the PPS Bill protects buyers from security interests if they buy ‘in the ordinary course of business.

In this example, Consumer takes the groceries free of Bank’s security interest because Supermarket is in the business of selling goods of that kind.

There are exceptions to the general rule for buyers and lessees of:

- goods that are sold/leased in the ordinary course of the seller/lessor’s business (section 47);
- consumer goods, unless the buyer has actual knowledge of the security interest or the goods are valued at more than PGK 5,000 (section 48);
- goods that are covered in sections 27, 30 and 32 (that is, goods that are temporarily perfected, proceeds, or are returned or repossessed) (section 49); and
- serial numbered vehicles, but only if the vehicle’s serial number is not correctly registered (section 50).

A buyer of timber as cut or minerals as they are extracted takes the timber or minerals free of an interest arising out of mortgage or other encumbrance on the land (section 51).

A security interest is subordinate to any right provided by law to a person to retain collateral where the person provides materials or services in the ordinary course of business with respect to the collateral (section 52).⁶

Example 4 – car buyers must check the PPS Registry

(Car buyers can search the PPS Registry for the vehicle’s serial number)

Suppose that:

- (1) Creditor registers a notice of a security interest in Debtor’s car that includes the car’s serial number; and then
- (2) Debtor sells the car to Neighbour.

Result: Neighbour takes the car subject to Creditor’s security interest. Creditor may enforce the security interest by taking possession of the car from Neighbor and selling it. Neighbor could have avoided this result by searching the PPS Registry for the car’s serial number and discovering the security interest prior to the purchase.

⁶ For example, supposes that TV Repair Shop repairs a TV that is already collateral for a secured loan. The TV Repair Shop, while it is in possession of the TV, has the right to retain the TV until payment is made for materials and service that is has provided. This right is superior to the security interest in the TV.

The PPS Bill does not prohibit a debtor from transferring rights in collateral to a third party, nor does it prohibit debtors and secured parties from making enforceable agreements that limit or prohibit such transfers or that make such transfers instances of default (section 53).

3.7.4 Persons to Whom Negotiable Collateral is Transferred (Part 4, sections 54-58)

Cash and negotiable collateral are of such a special nature that special priority rules are necessary. The PPS Bill maximizes the rights of secured lender in such collateral without damaging their transfer. The relevant types of cash or negotiable collateral are:

- holders of money that is proceeds (section 54);
- creditors who receive cheques or electronic funds transfers from accounts that are collateral (section 55);
- purchasers of instruments or securities (section 56);
- holders of negotiable documents of title (section 57); and
- purchasers of chattel paper (section 58).

3.7.5 Assignments & Transfers of Accounts and Subordination of Priority (Part 5, sections 59-64)

“Accounts” (also known as accounts receivable or receivables) is a term that refers to certain rights to receive payment. For example, an account is created any time a business sells goods or services on credit. Accounts may be valuable as collateral to secure a loan. Alternatively, a business may choose to sell its accounts. Typically, a buyer of accounts will be a bank or other finance company that has experience in managing accounts and collecting payments.

If accounts are used as collateral, the borrower signs a security agreement in which the borrower gives the secured party a security interest in the accounts. In other words, the borrower “assigns” the accounts to the secured party to secure payment. “Assignment” is a general term meaning a transfer of rights from an assignor (the person entitled to payment) to an assignee (the secured party). Under the PPS Bill, the assignment of accounts just means that the business’s right to receive payments is transferred to the secured party to secure the business’s obligation. In other words, the secured party may collect payments from the account debtors if the business defaults on its obligation.

An account debtor may be notified that an account has been assigned to “a secured creditor however this notice is *not* a precondition for the attachment, perfection, or enforcement of a security interest in an assigned account or accounts (section 60). This provision, which is contrary to some common law precedent, is designed to facilitate the use of accounts as collateral for secured loans. However, the PPS Bill does not disturb common law principles that provide that an assignee has the same rights and duties to claims as the assignor (section 61).

Modifications to contracts for accounts that are made under commercially reasonable circumstances are effective against assignees (section 62). Finally, agreements that restrict a debtor’s ability to assign an account are unenforceable against third parties (section 63). This rule removes a potential barrier to the sale or assignment of multiple accounts.

Secured parties may agree to subordinate their interests to any other interest. Such agreements are enforceable. Registration of subordination agreements is not necessary (section 64).

3.7.6 Priority in Deposit Accounts and Investment Property (Part 6, sections 65-66)

Part 6 sets out special rules regarding the priority of security interests in:

- deposit accounts (section 65)
- investment property, including brokerage accounts managed by stockbrokers (section 64)

In particular, suppose that a bank has a security interest in a deposit account and that the deposit account is maintained by that bank. In this case, the bank's security interest has priority over a conflicting security interest in the account unless the conflicting security interest is perfected by control by another secured party with the bank's consent.

3.7.7 Priority in Special Classes of Tangible Collateral (Part 7, sections 67-74)

Part 7 sets out special rules regarding the priority of security interests in:

- Fixtures (sections 67-70);
- Crops (section 71);
- Accessions (section 72);
- Commingled Goods (section 73); and
- Vessels registered under the *Merchant Shipping Act* (section 74).

(a) Priority of security interests in fixtures

A fixture is personal property that is attached to a building or land in a manner that causes real property law to apply to the personal property. For example, when an air conditioning unit is fixed to a building, real property law becomes applicable to the air conditioner and the air conditioner becomes a fixture. A security interest in goods that attaches before the goods become fixtures has priority over a mortgage on the land to which the goods become fixed (even if the mortgage includes both the land and any fixtures on that land). However, if a security interest attaches to goods after they become fixtures, the security interest is subordinate to a mortgage.

Example 5 – fixtures

(security interest that attaches to goods before they become fixtures)

Suppose that:

- (1) Landowner purchased a building by taking out a mortgage with Bank. The mortgage gives Bank an interest in the building and any fixtures that are attached to the building.
- (2) Landowner borrows money from Creditor to buy an air conditioning unit. Creditor has a security interest that attaches to the air conditioning unit.
- (3) Landowner then fixes the air conditioning unit to the building so that the air conditioning unit becomes a fixture.

Once the air conditioning unit becomes a fixture, both Creditor and Bank have an interest in it. However, Creditor's security interest takes priority to the extent of its value: this provides an incentive for building improvement loans. Bank is no worse off because if Creditor does not have priority then it won't make the loan and the air conditioning unit won't be purchased. Bank is better off when the air conditioner loan is repaid and the land subject to Bank's mortgage is more valuable.

(b) Priority of security interests in crops

A perfected security interest in crops that are growing has priority over a mortgage if the debtor has possession of the land or a registered interest in the land (Section 71).

(c) Priority of security interests in accessions

Accessions are goods that are installed or fixed to other goods. A security interest in goods that become an accession remains effective in the accession, contrary to common law. The PPS Bill priority rules govern a conflict between a secured party with a security interest in an accession and a secured party with a security interest in the goods to which the accession has been installed.

Example 6 – accessions

(security interest in goods that become accessions to other goods)

Suppose that:

(1) Car-owner purchases a car by taking out a secured loan from Bank A. The security agreement gives a security interest in the car to Bank A and a notice is registered.

(2) Car-owner purchases a replacement for a broken engine by taking out a second secured loan from Bank B. The security agreement gives Bank B a security interest in the new engine and a notice is registered.

(3) Car-owner installs the new engine in the car so that the engine becomes an accession.

Once the engine becomes an accession, both Bank A and Bank B have an interest in it. However, Bank B's security interest takes priority under the PMSI rule, discussed above. This rule gives incentive to Bank B to make the loan. (Bank A is no worse off because it now has security in an operating car.)

(d) Priority of security interests in commingled goods

Commingled goods are goods that are united with other goods in such a way that the identity of the goods is lost. For example, if a farmer's coffee beans are deposited in a silo with the beans of other farmers then it is not possible to determine which beans belong to which farmer. Commingling of goods that are collateral can lead to disputes among competing creditors. Section 73 explains how these disputes would be resolved.

3.8 CHAPTER VII – Registration

The purpose of this Chapter is to establish and provide for the governance of an electronic notice registry, PPS Registry. The PPS Registry receives notices and maintains them for public search. The notices alert prospective creditors and buyers of collateral of the possible existence of a security interest. The registration date of a notice may establish the date by which priority of competing claims is measured under the previous chapter.

3.8.1 Establishment of an electronic registry (sections 75-77)

The PPS Registry is the key to successful implementation of the PPS Bill. In conjunction with the priority rules, the PPS Registry helps secured parties to know their rights in advance possible disputes. Greater legal certainty means less risk, which is the key to increased credit.

It is proposed that an electronic, internet-based PPS Registry would be established in the Investment Promotion Authority (IPA) that would receive and report information supplied by secured parties regarding secured transactions that may be concluded under the PPS Bill.

The duties of the PPS Registry are purely administrative. The PPS Registry is required to accept:

- notices of security interests (including initial notices, amendments, continuation statements and termination statements);
- notices of the interests of execution creditors; and
- notices of security interests in property established before the PPS Bill commences.

Notices are only intended to alert prospective creditors and buyers of collateral of the possible existence of a security interest. Notices do not create security interests and therefore the acceptance or refusal of a notice at the PPS Registry does not constitute the creation or the failure to create a property right in any personal property. Consequently, it is unnecessary for the registrar to examine documents or judge their authenticity for the purpose of establishing or prioritizing property rights.

In general, the public is free to search for notices on the PPS Registry without charge. However, the IPA may adopt regulations establishing fees for registration of notices, and for search reports that carry the seal of the IPA.

3.8.2 Initial Notice of a security interest (sections 78-81)

The first registration made by a secured party with respect to a security interest is called the initial notice (section 78). The initial notice must:

- identify the debtor
- identify the secured party; and
- must describe the collateral.

In addition, if the collateral is related to land (fixtures, timber to be cut, minerals before extraction), the initial notice must identify the land where the collateral or future collateral is located. Also, if the collateral is a serial-numbered vehicle, the initial notice must include the vehicle's serial number. No other documents need accompany the notice to the PPS Registry.

A notice may be registered before a security agreement has been concluded and before a security interest attaches to collateral (section 79). This is important because a secured party may want to assure that its priority will be maximized before incurring the expense of negotiating a security agreement. A notice is may be effective even if it contains errors. The notice is ineffective only if it is found to be seriously misleading and the only way in which it may be seriously misleading is if the notice insufficiently provides the name of the debtor (section 81).

3.8.3 Name of debtor and the effects of a change of circumstances (sections 82-83)

Prospective creditors and buyers of collateral are entitled to search the PPS Registry to determine the status of personal property. Usually this requires a search of the debtor's name. Therefore, the debtor's name must be accurately stated as accurately as possible. Section 81 clarifies when the name of the debtor is sufficiently accurate. Section 83 clarifies whether a notice remains effective if there is a change in circumstances such as the sale of collateral or a change of name or address of the debtor.

3.8.4 *Notices – duration, amendment, continuation and termination (sections 84-90)*

(a) Duration

A notice is effective for five years after which it lapses unless it has been continued or terminated. Upon lapse, the notice is no longer effective to perfect a security interest (section 84).

(b) Amendment

A notice may be amended by the secured party at any time to change any of the information in the notice (section 85). If the collateral description is changed to add collateral, the debtor must authorise the amendment in the same manner as for an initial notice. The amendment is effective as to the added collateral only from the date of the amendment.

(c) Continuation

Within six months of the lapse of a notice, a secured party may register a continuation statement that will extend the duration of the notice by an additional five years (section 86).

(d) Termination

The secured party may terminate a notice at any time. If the debtor and secured parties have no further obligations to one another, a debtor may demand that the secured party register a termination statement and the secured party must comply (section 87).

(e) Effectiveness

Initial notices, amendments, continuations statements and termination statements are effective from the time they are searchable by the public in the electronic registry (section 88), the PPS Registry.

(f) Refusal to register

The PPS Registry may only refuse to register a notice on strictly limited grounds (section 89).

3.8.5 *Public access to registry records and duties of the registrar (sections 91-93)*

The registrar's duties are merely clerical and can be performed automatically by an electronic registry, the PPS Registry. Each notice is assigned a unique registration number and the date of receipt is noted. The registrar must index notices so that anyone can search the PPS Registry by any of the following criteria:

- registration number;
- debtor name;
- vehicle serial number, in the case of a serial-numbered vehicle; and
- real property identification number, in the case of land-related collateral.

The PPS Registry will provide a search report containing all notices that meet the search criteria, with their registration numbers and registration dates.

3.9 CHAPTER VIII – Enforcement of Security Interests

The purpose of this Chapter is to provide for the rights, duties and obligations of debtors, secured parties and others, upon the debtor's default on a secured obligation. These enforcement provisions complement other rights and remedies available, such as may be contained in the security agreement, statutes or common law.

3.9.1 *The rights and remedies of the secured party upon default by the debtor (sections 94-97)*

A secured party, upon the debtor's default, has enforcement rights under the PPS Bill as well as rights under any other law. In addition, any rights agreed to by the debtor in the security agreement are enforceable.

Upon default by the debtor, the secured party may:

- collect accounts, or notify account debtors to pay the secured party rather than the debtor;
- collect proceeds;
- if the collateral is a license, seize the collateral and obtain value by re-licencing the collateral;
- take possession of collateral by any method provided by law;
- take control of goods at the debtor's premises without removing it, if practicable (for example, by seizing the keys to a vehicle); or
- if the collateral is a document of title, proceed as to the document or as to the goods covered by the document under any method of enforcement that is commercially reasonable.

3.9.2 *Disposition of collateral (sections 98-100)*

Disposal of property by the secured party may be on an 'as-is' basis, or after repair or preparation. Disposition may be by private sale, public sale, in whole or in part, or by lease or credit sale or other commercially reasonable means.

Where practical, the secured party must provide notice of the disposition of collateral to the debtor, to any person known to be an owner of the collateral and to any holder of a subordinate security interest.

3.9.3 *Rights of Purchasers of Collateral (section 101)*

When a buyer takes collateral from a secured party, the buyer receives all the rights that the debtor had in the collateral, as well as any rights of a subordinate secured party. In order to protect buyers and to encourage them to buy, the buyer takes these rights even if it is subsequently determined that the transfer did not comply with the PPS Bill or other law.

3.9.4 *Appointment of receivers and the rights and duties of receivers (section 109)*

A security agreement may provide for the appointment of a receiver upon default and may provide for the rights and duties of the receiver. A receiver may take control of collateral and manage the collateral in a commercially reasonable manner, accounting to the debtor for its actions. Additionally, a court may appoint a receiver.

3.9.5 CHAPTER VIII – other (sections 102-108 and 110)

Chapter VIII also includes provisions relating to:

- transfer of a license by the secured party (section 102);
- any surplus or deficiency remaining after the disposition of collateral (section 103);
- the secured party's right to retain collateral rather than dispose of it (section 104);
- the debtor's right to redeem the collateral or reinstate the security agreement if the debtor pays to the secured party the secured debt and any enforcement expenses (sections 105 and 106);
- the enforcement of a security interest if an obligation is secured by a mortgage in land in addition to other personal property (section 107);
- applications to court to issue orders to enforce rights of the debtor and the secured party (section 108); and
- the manner of notification to debtors, secured parties and other persons (section 110).

3.10 CHAPTER IX – Transition Provisions

3.10.1 *Transitional arrangements for existing security interests*

The PPS Bill provides transitional arrangements for existing security interests. This chapter on transition applies to any transaction that falls within the scope of the PPS Bill and that was concluded prior to the commencement of the PPS Bill (**Prior Transactions**). Notice of security interests arising from Prior Transactions can be registered on the PPS Registry using a transition notice.

3.10.2 *Priority arrangements during transition*

The chapter also contains provisions to clarify the priority arrangements for two situations that may arise during the transition period:

- disputes between two Prior Transactions; and
- disputes between a Prior Transaction and a security interest created under the PPS Bill.

In the first situation, disputes over collateral between two Prior Transactions will be resolved under the relevant laws that applied before the PPS Bill commenced. In other words, there is no change from the current treatment of these transactions.

Example 8 – transition arrangements

Suppose that:

- (1) Creditor A holds a company charge (or some other security interest in personal property) before the commencement of the PPS Bill.
- (2) Creditor B acquires a security interest in personal property after the commencement of the PPS Bill.

If Creditor A registers a transition notice at any time during the 60-day window then its security interest (the company charge) has priority. However, if Creditor A registers the notice after the window expires then priority is determined based on the date that the notice is registered.

In the second situation, there would be a transition ‘window’ of 60 days beginning on the date of commencement of the PPS Bill. If a creditor with a Prior Transaction registers a transition notice during this window, the creditor will have priority over any security interest created under the PPS Bill, unless a super-priority rule under the PPS Bill is applicable. (For example, there are super-priority rules in relation to PMSIs and deposit accounts perfected by control).

3.11 CHAPTER X – Commencement

The PPS Bill is to take effect when the PPS Registry is available and the IPA is prepared to administer it. It is important that the PPS Bill does not take effect prior to the availability of the PPS Registry, as a secured party’s priority against others is usually measured from the time of registration.

3.12 Schedule 1 – Consequential Amendments

3.12.1 Acts to be repealed

‘Chattel mortgages’ given to creditors by individuals are registered under the *Instruments Act 1953*. These chattel mortgages are transactions within the scope of the PPS Bill and so the *Instruments Act 1953* is no longer needed.

‘Hire-purchase’ is a title retention scheme, in which the seller of goods retains ownership of goods sold to a buyer until all payments are made by the buyer. All title retention schemes, including hire-purchase, are included within the scope of the PPS Bill and so the *Hire-Purchase Act 1966* is no longer needed.

3.12.2 Acts to be amended

The *Companies Act 1997* would be amended with respect to the registration and priority of company charges. Currently, company charges may apply to real property and personal property. The amendment would limit the scope company charges to real property only. The provisions on company charges will have no application to a security interest in personal property because such security interests will be subject to the PPS Bill.

The *Stamp Duty Act 1952* would be amended so that the Act does not apply to transactions that are subject to the PPS Bill. Transactions (such as chattel mortgages) that are subject to registration under the *Instruments Act 1953* are already exempt from Stamp Duty. The amendment makes this policy universal for security interests in personal property. The practical effect of this amendment is that transactions that would formerly have constituted company charges would also be exempt from stamp duty.