The rise and fall of purchase money security interests at general law and under Article 9 regimes

Aidan Drinkwater*

The enactment of the Personal Property Securities Act 2009 (Cth) (PPS Act) has signalled the official arrival of Art 9 of the Uniform Commercial Code (US) in Australia. The legislation will effect a dramatic change to Australia's law of security interests which is in need of reform. At the heart of the new regime is the reorganisation of priority rules around the fundamental principle that priority be afforded to parties that perfect, mostly through registration, their security interest first. This is subject to an exception for purchase money security interests (PMSIs). PMSIs have received limited recognition at general law, however, the PPS Act sets out extensive provisions which incorporate vendor credit arrangements previously considered to be outside the scope of the law of security interests. Accordingly, the existing body of general law relating to retention of title and similar devices will be supplanted by the statutory PMSI regime. The purpose of this article is to consider the effect of this by comparing the establishment and extinguishment of the PMSI and the rights of vendor creditors under the general law with the position under the PPS Act's embodiment of Art 9.

INTRODUCTION

Article 9 of the *Uniform Commercial Code* (US) has officially arrived in Australia. Following a number of failed attempts in the past to reform this country's legal regime for the taking of security interests in personal property, the *Personal Property Securities Bill 2009* (Cth) received Royal Assent on 14 December 2009. While enactment of the *Personal Property Securities Act 2009* (Cth) (PPS Act) has rubber stamped Art 9's arrival, it has been apparent for some time that the new regime was an imminent reality. Set in motion with the release of an options paper in 2006, there has been four years of formal and evolving consultation. This period was punctuated with several drafts of the proposed statute,[1] and a degree of government support that indicated this push for reform, unlike those previously, would actually reach the belts and braces finale of a single national law. Expected to apply from May 2011, the PPS Act will replace the current format comprising more than 70 Commonwealth, State and Territory Acts, as well as key parts of relevant common law and equity, radically changing the law of personal property securities (PPS).[2] The unified approach will embody fundamental principles that redefine an array of legal conceptions relevant to PPS and lever financial arrangements not previously considered to constitute security interests into the jurisdiction of the new legislation.

As revolutionary as all of this sounds, there have been comparable PPS reforms in Canada and, more recently, in New Zealand. Those reforms augment the introduction of the genesis legislation of Art 9 in the United States (US) almost half a century ago, and various revisions since, including its

* Solicitor, Herbert Geer.

[1] The Attorney-General's Department, *Personal Property Securities Bill 2008 – Consultation Draft* (2008) (Consultation Draft) was released in May 2008. The Consultation Draft progressed to an Exposure Draft released in November 2008 and, following further comment and refinement, to the *Personal Property Securities Bill 2009* (Cth). These earlier incarnations of the PPS Act are available at http://www.ag.gov.au/pps viewed 15 February 2010. The PPS Act is available at http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/52E713A46781BBA7CA257693000224F0/$file/PersPropSecur2009.pdf viewed 15 February 2010.

[2] While the PPS Act has technically been enacted, its substantive application has not commenced. For that reason, this article will use the present tense and the term "existing" or "current" regime/law and similar phrases to refer to the law of security interests *prior to* the PPS Act, notwithstanding that in some senses it is no longer the present law.

most significant overhaul in 1999.[3] Many of the growing pains have already been absorbed in these jurisdictions which, in any event, have been widely regarded as successful importers of Art 9.[4] In drafting the PPS Act, Australia was in the fortunate position of being able to tap into the legislative, judicial and academic activity inherent in legal reform and adapt its statute accordingly.[5]

A principal feature of the Art 9 framework is the reorganisation of priority rules so that the time of perfection, mostly through registration, determines priorities between competing security interests in the same collateral. There is an exception to this default rule for purchase money security interests (PMSIs)[6] which, subject to certain conditions, enjoy "super-priority"[7] over pre-existing security interests in collateral. In broad terms, a security interest is a PMSI "when the secured party has provided the finance required by the grantor to acquire the collateral".[8] A vendor that extends credit to the purchaser of goods, for example pursuant to a retention of title (ROT) transaction, would be afforded PMSI super-priority. So, too, would a creditor that advances funds for the purchase of collateral by a debtor.

Under general law,[9] PMSIs developed slowly. Cases recognising the PMSI in certain contexts, and often not in so many words, aggregated throughout the 20th century, culminating in *Abbey National Building Society v Cann* [1991] 1 AC 56 (*Cann*) which has been advanced as a basis for full recognition.[10] Notwithstanding that the "weight of Australian authority"[11] now appears to recognise that the PMSI should be afforded elevated priority, the lack of detailed guidelines is apparent and troublesome. Despite serving the same purpose, ROT and similar arrangements remain subject to their own law and it is not particularly user-friendly nor does it have the best reputation for efficacy. Given this background, introducing a coherent system through the general law did not appear plausible, and commentators proclaimed that statutory reform was necessary.[12] Enter the PPS Act, complete with its Art 9-based PMSI regime directly on point.

The purpose of this article is to consider the effect of the PPS Act by comparing the establishment and extinguishment of PMSIs and the rights of vendor creditors under the general law with the position under its embodiment of Art 9. The article will begin by critically examining the existing framework in Australia, paving the way for discussion of its Art 9 remedy. The article will then

[3] Article 9 of the *Uniform Commercial Code* (US) was introduced in 1962. Since its complete revision in 1999, Art 9 has been commonly referred to as "Revised Article 9" and that terminology will be used in this article. Revised Article 9 was the "product of years of study and drafting" by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute. The NCCUSL is an organisation of State governments charged with the responsibility of drafting and securing enactment of uniform laws across States. Following its inception in 1892, it helped develop a single comprehensive commercial code covering all aspects of commercial transactions including contract, payment and credit.

[4] See, eg Bridge M, "How Far is Article 9 Exportable? The English Experience" (1996) 27 Can Bus LJ 196 at 196: "There can of course be no argument about the export potential of Article 9… Article 9 has already been exported, to great effect."

[5] Notwithstanding that the overseas reference point was always going to play a significant role in the reform process, in its March 2009 report on the Exposure Draft, the Senate Legal and Constitutional Affairs Committee referred to the importance of reliance frequently. For example, it specifically recommended "using overseas provisions as often as possible to allow overseas experience to provide guidance for the Australian model". The committee also recommended that "the bill adopt existing international personal property security conflict of laws provisions, such as the New Zealand conflict of laws model, unless there is a particular reason to depart from those provisions": Senate Legal and Constitutional Affairs Committee, *Report on the Exposure Draft of the Personal Property Securities Bill 2008* (Department of the Senate, 2009) at [4.19], [5.55].

[6] Pronounced "pimmsies".

[7] PMSIs are described as conferring a "super-priority" on the secured party because the security interest has a higher priority than another security interest in the same collateral even if it was perfected earlier by possession or registration: see, eg Attorney-General's Department, *Personal Property Securities Bill 2008 – Commentary* (2008) at [6.54] (Commentary).

[8] Commentary, n 7 at [6.55].

[9] In this article, "general law" refers to the common law and the law of equity.

[10] See, eg Bennett H and Davis C, "Fixtures, Purchase Money Security Interests and Dispositions of Interest and Dispositions of Interests in Land" (1994) 110 LQR 448.

[11] Wappett C, "Personal Property Securities" in Weeks L (ed), *Australian Finance Law* (5th ed, Lawbook Co., 2002) p 502.

[12] Wappett, n 11.

summarise the main features of the Art 9 model so that its treatment of PMSIs may be properly understood. While there are a number of features of PMSIs that render them a special type of security interest, they interact under the same broad regime and are subject to many of the same general requirements as other security interests. In the course of examining the requirements for establishing PMSIs under the general law, the article will also address the rationale driving its recognition. In addition, the article will discuss establishment under the PPS Act and will consider a number of the primary modes of extinguishment of security interests, honing in on some key issues encountered at general law and the approach adopted under the PPS Act proposing to deal with them.

PPS LAW AND REFORM IN AUSTRALIA

Australia's present attempt at Art 9-modelled reform is not its first. Activity traces back to recommendations by the Molomby Committee in 1971.[13] Momentum continued through the 1970s, gathering again in the 1990s with significant publications by several Law Reform Commissions.[14] These efforts may be partially credited with influencing the system for the registration of company security interests under the *Corporations Act 2001* (Cth),[15] which works relatively well, and with the introduction of some legislation.[16] However, a complete re-engineering of the PPS regime properly tailored to the problems identified under the incumbent system was never undertaken. Among the reasons for this were: disagreement between the States over certain key issues;[17] opposition from industry stakeholders; indifference on the part of financiers comfortable with the status quo;[18] and, perhaps the biggest obstacle of all, the "reform fatigue" of the financial services sector from "enormous regulatory changes" imposed in the preceding years.[19] Be that as it may, the consensus has been that the current position is unsatisfactory and reform is desirable. The *Personal Properties Security Bill 2008 – Commentary* (Commentary) (which accompanied the *Personal Property Securities Bill 2008 – Consultation Draft* (Consultation Draft)) declared that "Australia's history with PPS reform demonstrates long held support, and a sound basis, for change",[20] and revealed that the response to the proposals indicated "considerable stakeholder support for reform and resounding approval for the development of a single national law that focuses on the substance of secured transactions".[21]

There are a number of major problems with the existing PPS law. There is a lack of functional basis and an unhealthy concern with the form of a security. Accepted forms of security include the charge, the mortgage, the pledge and title reservation devices, as well as the many nuances of these

[13] Committee of the Law Council of Australia, *Report to the Attorney-General for the State of Victoria on Fair Consumer Credit Laws* (1972).

[14] See Queensland Law Reform Commission and Law Reform Commission of Victoria, *Personal Property Securities Law: A Blueprint for Reform*, QLRC Discussion Paper No 39 and VLRC Discussion Paper No 28 (1992); Australian Law Reform Commission, *Personal Property Securities*, ALRC Discussion Paper No 52 and NSWLRC Discussion Paper No 28 (1993). In 1993, the Australian Law Reform Commission produced a follow-up report with a draft Bill appended to it: Australian Law Reform Commission, *Personal Property Securities*, Report No 64 (1993). For discussion of the background to the drafting of this and other reform material, see Duggan A, "Personal Property Law Reform: The Australian Experience" (1996) 27 Can Bus LJ 176.

[15] Duggan, n 14 at 177.

[16] Allan D, "Personal Property Security – A Long Long Trail A-Winding" (1999) 11(2) Bond LR 178 at 182 suggests that a national conference in Melbourne in 1972 led to the "negotiated compromise" of chattels securities legislation in some States which unfortunately "satisfied few and served only to add further complexity and diversity to this area of Australian law".

[17] Duggan, n 14 at 181-186.

[18] Goode has been a well-known critic of this attitude pointing out that comfort with the "devil you know" should not stymie reform "because bad commercial law militates against business efficiency but also because the law should be just and should be seen to be just": Goode R, "The Modernisation of Personal Property Security Law" (1984) 100 LQR 234 at 246, 251; Hetherington M, "The Constitutional Mechanism for Personal Property Security Legislation in Australia" (2002) 14 Bond LR 4 at 6.

[19] Wappett, n 11 at 498.

[20] Commentary, n 7 at [1.10].

[21] Commentary, n 7 at [1.11].

securities. The priority of each device is determined according to a fragmented mix of equitable and common law principles and bit-part statutory overlay pursuant to which the rights of the parties turn on variables having "no basis in policy or commercial convenience".[22] Courts have beaten the substance drum when looking at transactions, however, as Bridge warns, their regard for this approach is limited to considering whether a transaction is a "sham", and that this notion of substance is a long way removed from Art 9[23] which holds it out as a, if not the, fundamental principle of its operation.

It is a strange situation given that all security devices essentially perform an equivalent task: securing the performance of an obligation, usually to pay back money. Diamond was critical of it in his review of the English system, as summed up well by McCormack:

> [T]he English law suffered from three main defects, namely compartmentalisation, complexity and difficulty in determining priorities. The compartmentalisation problem was overriding and stemmed from the fact that the law lacked functional basis. The law was divided into rigid compartments making it fragmented and incoherent. You had the situation where transactions essentially similar in nature were treated in very different ways which had the effect of complicating the legal issues quite unnecessarily. Complexity and uncertainty was also compounded by the old division between common law and equity which loomed large in the security law field … Simply stated, there were difficulties in determining priorities and priority problems were exacerbated by the fact that there were so many different ways of achieving similar economic ends.[24]

It is not always the secured party that suffers. For example, the English system has rewarded creditors in artificial financing arrangements that exploit common law concepts such as title to defeat other creditors.[25] Sophisticated lenders capitalise by insisting on a suite of interlocking securities that fully utilise the protection available under statute, common law and equity.[26]

Often the tool used to cure issues of the general law that it is unable to cure itself, statutory intervention has historically done little to assist and has arguably blurred the landscape further. The registration requirements emanating from the jumbled rules are predictably complicated, as the Law Reform Commissions of Victoria and Queensland explain:

> Existing registration requirements are piecemeal. They discriminate irrationally between different kinds of transactions, different classes of debtor, and different kinds of property … On the other hand there is excessive overlap between existing registration statutes. Some transactions are subject to more than one registration requirement in the same jurisdiction, while others are subject to separate (though) similar requirements … In many cases, the registration process is unduly cumbersome, while the consequences of failing to register are heavy-handed.[27]

Banks and borrowers participating at the upper end of the financing market may see things differently because the utility of the principal security used in their transactions – the fixed and floating charge – washes away many of these concerns. The general charge provides coverage across the whole of a corporation's personal property, regardless of the type, and is subject to the unified registration system provided by the Australian Securities and Investment Commission (ASIC) and familiar priority rules under federal legislation covering all States (the *Corporations Act*). In addition, very rarely would it be the case that the debtor is not an entity against which a charge can be registered under that statute. Finally, the routine inclusion of a negative pledge prevents the unauthorised granting of subsequent security, even if it is outside the ASIC registration regime, without the reprisal of default and potential enforcement.

---

[22] Queensland Law Reform Commission and Law Reform Commission of Victoria, n 14 at [2.3].

[23] Bridge, n 4 at 198.

[24] MCormack G, "Personal Property Security Law Reform in England and Canada" [2002] JBL 113 at 114

[25] See generally Bridge, n 5 at 196.

[26] Bridge describes the effect of this on reform: "the English bank has obtained all the freedom it needs to make its position ironclad. It is therefore hardly surprising that the banks are not pressing for a reform along the lines of Article 9 … If England were to adopt an Article 9 statute, these hard-won gains would be surrendered for something new whose implications would take some time to be felt": Bridge, n 4 at 221.

[27] Queensland Law Reform Commission and Law Reform Commission of Victoria, n 14 at [2.3].

Notwithstanding, reformists claim the effect of problems with the incumbent system is that the cost of borrowing and doing business is inflated, the free flow of transactions stymied, and the attractiveness of Australia as a target for foreign investment diminished. With its focus on the real nature of the transaction and clear lines of priority when competing interests in collateral clash, the Art 9 model is regarded as the best basis for recalibration. Aside from its internal mechanics, Bridge attributes this to the fact that it:

> [I]s a revolutionary statute designed to fill a gap created by the wholesale sweeping aside of prior law … so it has the advantage for the importer of not being based upon foundations whose absence in the receiving country make it unworkable.[28]

Accordingly, the PPS Act is expected to deliver a more certain, less complex and cheaper framework that addresses the present shortfalls and the demands of Australia's modern economy. The shift will also correlate Australia's finance law with its broader economic policy by ensuring closer economic ties with the US and New Zealand.[29] Australia's cross-investment with these two countries is extensive[30] and matching securities law underpinning it would bolster the relationship.

THE MAIN FEATURES OF ART 9 REGIMES

The "in-substance" approach

The PPS Act[31] follows the Art 9 methodology that supplants distinctions between security devices with a generic concept of security interest depending on economic function. A security interest is defined as an interest in personal property provided for by a transaction that "in substance" secures the payment or performance of an obligation. The definition does not depend on the form of the transaction, identity of the parties or holder of title in the collateral, and does away with the legal versus equitable and fixed versus floating splits.[32] The "old terminology … and favourites of lawyers such as pledge, mortgage, conditional sale, trust receipt, etc … [is] consigned to the corridors of legal history and replaced."[33]

The in-substance touchstone drastically reduces the scope for creditors to marshal priority through the construction of artificial transactions. *Any* arrangement identified to be a security in substance is levelled with all other security interests and is subject to the universal rules.[34]

---

[28] Bridge, n 5 at 196.

[29] This policy has manifested itself in many ways. In relation to New Zealand, one of the more significant is the Australia New Zealand Closer Economic Agreement (ANZCERTA), the objectives of which include, "to strengthen the broader relationship between Australia and New Zealand; to develop closer economic relations between Australia and New Zealand through mutually beneficial expansion of free trade between the countries; and, to eliminate barriers to trade between Australia and New Zealand in a gradual and progressive manner under an agreed timetable and with a minimum of disruption": Department of Foreign Affairs and Trade, *Closer Economic Relations Background Guide to the Australia New Zealand Economic Relationship* (1997) p 6.

[30] Australian Bureau of Statistics, *Analysis and Comments: International Investment Position at 31 December 2007* (2008), http://www.abs.gov.au/ausstats/abs@.nsf/latestproducts/5352.0Main%20Features22007?opendocument&tabname=Summary&prodno=5352.0&issue=2007&num=&view viewed 1 October 2008. See also Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Country Statistics 2005* (2009), http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyReleaseDate/E3A9E37EADCAD2F0CA2573280013C636?OpenDocument viewed 21 January 2009.

[31] It is beyond the scope of this article to cover off on the differences between each of the various Art 9 regimes. The objective of this article is to provide an overview of the *general* features of Art 9 regimes with a bias towards Australia's PPS Act. The author apologises for any slight inaccuracies with respect to other individual Art 9-based regimes that arise from this approach. In addition, references to legislation will accordingly refer to the PPS Act, however, they will not be made in all cases in accordance with the descriptive and general nature of the discussion. Generally, references to specific sections in the PPS Act will be for explanatory purposes or where specific sections of the PPS Act are referred to.

[32] PPS Act, s 12.

[33] McCormack G, "Rewriting the English Law of Personal Property Securities and Article 9 of the US Uniform Commercial Code" (2003) 24 Co Law 69 at 69.

[34] For example, the rules that first-to-file has priority and that priority is lost through incorrect registration.

Another significant consequence is that vendor credit transactions (VCTs) are brought within the PPS regime on the basis that they are functionally equivalent. Gough explains the difference between "'lender credit' – that is, transactions whose legal form is that of a loan of money, whether or not the loan is associated with a particular purpose – and 'vendor credit' – that is, other transactions that are not legally loans, but contracts for the sale or hire of goods".[35] Typically, VCTs rely on the retention or acquisition of legal title by the vendor and encompass a range of credit arrangements including ROT clauses, consignment plans, hire purchase arrangements and leases.[36] While the safety of title conferred clearly operates as the vendor's "security", these transactions were not previously considered to give rise to a security interest in a legal sense because they do not involve an actual grant back of an interest by the purchaser.[37] The functional basis sidesteps title semantics and treats VCTs like any other transactions purporting to secure an obligation. Looking forward, it also has the advantage of being better able to keep pace with avant-garde financing arrangements, tomorrow's examples of commercial consignments and finance leases, crafted to manipulate less nimble legal machinery.[38]

Attachment and perfection

Many of the Art 9 cogs are turned by the concepts of "attachment" and "perfection". A security interest comes to life when it attaches to property – without attachment there can be no security interest. The effect of attachment is that the security interest is enforceable between the grantor and the secured party which holds rights in the collateral[39] and, to this extent, the rights of the grantor are restrained. Attachment occurs when the secured party has given value or otherwise does an act by which a security interest is created (for example, executing a deed) and the grantor has rights in the collateral or the power to transfer rights.[40]

The requirement that the grantor has rights in the collateral is potentially problematic under existing law where purchasers of property subject to a title retention arrangement purport to grant a security interest in the property. Unless there is an exception to the nemo dat quod habet rule (no-one [can] give what one does not have),[41] they will not be deemed to have rights sufficient to grant security because true ownership lies with the vendor. The PPS Act cuts through this issue: the purchaser's/grantor's "limited rights in the collateral, short of full ownership, would be sufficient for the security interest to attach"[42] and would crystallise for the purposes of attachment when they obtain possession.[43]

While not overtly stated as a prerequisite in the PPS Act or its explanatory material, the grantor would need to assent to some sort of security agreement unless the secured party maintains possession or control of the collateral, in which case this element would be self-evident.[44] Consent would ordinarily be uncontroversial because creditors advancing secured funds to debtors as a commercial enterprise invariably require an executed document providing them with the security interest to settle.

[35] Gough W, *Company Charges* (2nd ed, Butterworths, 1996) p 422.

[36] Gough, n 35. For ease of discussion, this article will apply the vendor credit transaction (VCT) terminology throughout and refer to corresponding financiers as "vendors" or "vendor creditors", however "conditional sale" and "conditional sellers", and in relation to leases "lessors", for example, would be other suitable alternatives.

[37] See, eg *McEntire v Crossley Bros* [1895] AC 457.

[38] A previous example of this occurred in the 1940s and 1950s when tighter economic fiscal controls on hire-purchase arrangements led to leasing being a preferred title security device: Gough, n 35, p 433.

[39] PPS Act, s 19.

[40] PPS Act, s 19. The parties may postpone the time of attachment in the security agreement: s 19(3).

[41] This rule is commonly referred to as the "nemo dat rule" and that terminology will be used in this article.

[42] Attorney-General's Department, *Personal Properties Security Bill 2008 Revised Commentary* (2008) at [B.33] (Revised Commentary).

[43] PPS Act, s 19(5).

[44] The agreement does not have to be written to attach, although this is strongly recommended given that enforcement against third parties demands it: PPS Act, s 20.

Perfection refers to the action that secured parties are obliged to take in order to best protect their security interests against third parties. Obviously, the third parties of most concern are those holding competing security interests and purchasers of the collateral who may take it unencumbered. While a perfected security interest is not impenetrable to these, perfection means that the secured party "has done all that may be done"[45] for protection. While perfection is not strictly required for enforceability against third parties, it gives the secured party priority over other claimants in accordance with the PPS Act's first-in-time priority regime.[46] Accordingly, the reality is that perfection is a necessary ingredient for enforceability against other secured parties who will undoubtedly take that step to fortify their rights.

To be perfected, a security interest must be attached and either registered[47] or possessed (other than as a result of enforcement or seizure) or controlled by the secured party.[48] A hallmark of Art 9 regimes is that public notice of a security interest is normally enough to achieve priority against subsequent security interests: registration and possession/control are the two ways of achieving that end.[49] Where registration is the method of perfection – which will account for the vast majority of cases in practice – a written and signed security agreement adequately describing the collateral is required,[50] the intent here being that "[i]n an insolvency situation, other creditors would not be disadvantaged by any misrepresentation by either the grantor or the secured party as to the scope of the collateral covered by the agreement".[51]

Notice filing vs transaction filing

Only certain particulars of security interests require registration in the form of a financing statement, not physical copies of the instrument itself. This form of registration is referred to as "notice filing". Notice filing represents a salient departure from the current "transaction filing" of company charges with ASIC which entails lodgment of the instrument.[52] In a boon for commerciality, the requirements of perfection may be completed in any order, meaning that filing can be completed prior to attachment including before or during the negotiation stages of a transaction.[53] This is not possible under the transaction filing system because it is the terms and conditions of the instrument itself that are the subject of negotiations.

Provided that the description of the collateral is wide enough, the financing statement may cover after-acquired property as well as future advances.[54] For inventory financiers and the like transacting in circulating collateral and ongoing advances, the system's flexibility is extremely useful:

> In simple terms, a financing statement may cover the entire credit relationship of the parties … [A] seller who is contemplating the supply of goods to a buyer over an extended period of time may take a security interest in all the supplies by filing a simple financing statement instead of having to register each contract of sale separately which would be the case if a retention of title clause were held to

[45] Commentary, n 7 at [3.39].

[46] The priority rules under the PPS Act are discussed below.

[47] Registration is also commonly referred to as "filing" and the terms will be used interchangeably in this article.

[48] PPS Act, s 21.

[49] There are other methods of perfection under the PPS Act. The collateral may be "temporarily perfected, or otherwise perfected, by force of" the Act. For example, in circumstances where collateral gives rise to proceeds and the proceeds are not covered by the original registration and are not in a form to warrant automatic perfection, secured parties holding a perfected security interest in the constituent collateral have five business days to perfect their security interest in the proceeds. During that period, their security interest in the proceeds is temporarily perfected by force of the Act: PPS Act, ss 21(1)(a), 33. Another example of temporary perfection would occur in circumstances where collateral is moved to Australia: s 40.

[50] See PPS Act, ss 20, 21.

[51] Commentary, n 7 at [3.33].

[52] *Corporations Act 2001* (Cth), s 263.

[53] PPS Act, s 21(3).

[54] PPS Act, ss 18, 20(2).

> constitute a registrable clause under present English law. The creditor may state simply that he is taking security in certain collateral to cover advances made to the debtor including future advances.[55]

Again, financiers who are comfortable relying on the fixed and floating charge would perhaps query whether the advertised benefits of financing statements represent any real improvements to the registration regime under the *Corporations Act*, although recent changes to New South Wales stamp duty laws requiring additional registrations for net increases in aggregate advances may neutralise that point of view to some degree.[56]

In any event, for prospective financiers new on the scene, the idea is that they would be able to establish whether collateral is subject to existing security interests by searching the register and viewing the financing statement. If an interest appears, the financing statement encourages them to seek out the relevant security agreement where the arrangement is more comprehensively set out: "the information given on the register is necessarily rather general in character, being an invitation for further inquiry rather than a full account of the right in security."[57] Regardless, the "registration obligation … is very extensive in its ambit"[58] and it is this fundamental feature that feeds the Art 9 ideology that the time of registration is the focal point for priority.

Priority

The secured party that is first to file or perfect takes priority over latter security interests even if they attached earlier or the security agreement was entered into earlier. This is known as the "first-to-file" or "first-in-time" rule,[59] and Cuming and Wood articulate its rationale in the following way:

> Once the financing statement is registered any person who is planning to deal with someone named as debtor in the financing statement has the ability to determine whether or not the interest he intends to acquire will be subject to a security interest having a prior status. If such a person goes ahead and acquires an interest in the personal property described in the financing statement without making some accommodation with a registering party or obtaining a discharge of the financing statement, there is no reason to give his interest priority over a subsequent security interest acquired by the registered party.[60]

The first-in-time rule pervades all of the priority principles and they are much simpler as a result: (i) perfected security interests have priority over unperfected security interests; (ii) competing perfected security interests take priority on the basis of the first-in-time rule;[61] and (iii) competing unperfected security interests take priority on the basis of the first-in-time rule.[62] These principles are, of course, subject to certain carve outs, however, they serve as a sturdy foundation for the broader regime.[63]

As the second of the default rules above indicates, the priority time would not necessarily be the time that perfection actually occurred, but rather the time that the financing statement was registered. A later perfected interest would take priority as long as it was registered first and the security interest attached later. The same rule is rolled out to future advances where the date of the advance is not the

---

[55] McCormack, n 33 at 72. For a comprehensive description of how registration under the PPS Act would function and further benefits of the new methodology, see Commentary, n 7, Pt 10; Revised Commentary, n 42, Pt 10; Explanatory Memorandum, *Personal Property Securities Bill 2009* (Cth), Ch 5.

[56] A brief summary of the changes is available at http://www.mallesons.com/publications/2009/Jun/9955271W.htm viewed 15 February 2010.

[57] The Law Commission, *Company Security Interests* (Cm 6654, 2004).

[58] McCormack, n 33 at 69.

[59] This article prefers the "first-in-time" phrasing as it better captures perfection by non-registration which is also subject to the rule.

[60] Wood R and Cuming R, "Compatibility of Federal and Provincial Personal Property Security Law" (1986) 65 Can B Rev 267 at 285.

[61] Under the PPS Act, this rule is subject to the rule providing that a security interest perfected by control always has priority over security interests perfected by any other means: s 57(1).

[62] PPS Act, s 55.

[63] The priority regime is set out in Pt 2.6 of the PPS Act.

determinant of priority. The initial debtors that file first shield all their future advances with the priority time of the original financing statement. In this arrangement it is necessary, of course, to include appropriate details in the financing statement and have a suitably drafted security agreement that covers off the expanded credit relationship of the parties.[64]

The standard priority picture may be altered by virtue of a number of different mechanisms and exceptions.[65] Arguably the most significant occurs in relation to PMSIs which in all but a very limited number of circumstances[66] rank ahead of all other prior security interests in the same collateral. Aptly distinguishing it from the general rule, it has been described as a "second in time, first in line" security interest.[67] Not only is this displacement involuntary, it is also imposed despite the fact that an earlier secured party may have taken all the prescribed steps to best protect its interest from being defeated.

ESTABLISHMENT OF THE PMSI UNDER GENERAL LAW

Rationale and policy

Prior to discussion of their legal treatment, it is appropriate to briefly address the major arguments for and against PMSIs. As would be expected in the light of the concept's stark adjustment to priority, PMSI super-priority has the backing of several policy-related arguments. From a fairness perspective, advocates contend that PMSIs recognise the right of secured parties to retain a claim in assets that they were responsible for adding to the debtor's pool. There is no real effect on other creditors because the debt incurred to pay for the asset is offset by its addition to the pool.[68] This dovetails with Goode's assertion that super-priority is grounded in "the inequity that would result in allowing the prior chargee a windfall increase in his security brought about not with the debtor's money or new funds injected by the prior chargee but with the financing provided by the later encumbrancer".[69] Gough attacks this argument on the basis that it "artificially discriminates between one credit purpose and another. It assumes that financial accommodation for the purpose of, for example, paying wages … is less important than for the purchase of stocks or plant and equipment … It is not a real world distinction".[70]

It could also be postulated that financiers enter into transactions secured by an all-assets charge on the expectation that the asset pool will naturally expand in time and in step with the borrower's business, factoring this appreciation in value of their security to offer more borrower-friendly terms at the outset. There would be nothing preventing a tempering of these terms on the basis that future PMSIs may take priority, however, lending levels and profitability may drop as a result. Notwithstanding, it is likely that the effect of this alone would be negligible given that other financiers in the market, which are obviously subject to the same PMSI threat, would have to make similar adjustments.

A contention which relies on similar reasoning but applies it in favour of the PMSI highlights the undesirable security monopoly that would be created if prior creditors could not have their priority interrupted. Debtors seeking finance from a source other than the already registered financier – commonly holding a general charge – would either be refused or penalised with higher interest rates or set-up costs pursuant to the lower priority forced upon any new financier. Jackson and Kronman express doubts about this view as it "not only rests upon the questionable premise that a debtor's

[64] For a more detailed discussion of this issue, see generally McCormack, n 33 at 72-74.

[65] For example, the voluntary option of subordination remains very much open under the Art 9 regime which gives effect to the contractual stipulation, whether in the security agreement or otherwise, according to its terms: see PPS Act, s 61.

[66] See PPS Act, ss 57 (perfection by control), 64 (non-purchase money security interest in accounts), 71 (chattel paper).

[67] Henderson-Kelly S and Patch R, *Personal Property Securities Bill 2008: Retention of Title Arrangements* (Paper presented at the 9th Annual Insolvency Symposium, 24 February 2009).

[68] McCormack G, "The Law Commission Consultative Report on Company Security Interests: An Irreverent Riposte" (2005) 68 Mod LR 286 at 293.

[69] Goode R, *Legal Problems of Credit and Security* (3rd ed, Sweet & Maxwell, 2003) pp 99-100.

[70] Gough, n 35, p 436.

existing creditors wish to cripple him financially, but also fails to explain one of the most prominent features of the purchase money security interest, its limitation to loans that are used to finance … identifiable new collateral".[71] Nevertheless, they justify the PMSI on economic grounds, expressing the view that later finance would not be available on market-competitive rates without super-priority being afforded.[72]

The thrust and parry of the debate (and there are certainly more arguments on both sides)[73] is manifested in the PMSI's slow development under general law and the theoretical basis upon which it was eventually recognised by the judiciary. While it is apparent there is no definitive, all-conquering rationale, to the extent of this recognition and the doctrine's present consolidation under the PPS Act, the supporting policies have won out.

The floating charge vs the PMSI under general law

Leaving aside the concerns of general law regarding the form of securities, it is only the security interest over a grantor's after-acquired property – the floating charge – that could logically lay claim to priority over the PMSI.[74] By definition, the PMSI enters the security picture contemporaneously with the financed property, so any security granted after that point, no matter how soon, comes second in time. In contrast, the floating charge has been described as an "inchoate security interest which is waiting for the asset to be acquired so that it can fasten onto the asset but which, upon acquisition of the asset, takes effect *as from the date of the security agreement*".[75] As a present security interest, the equitable rule qui prior est tempore potior est jure (the first in time will prevail) would typically operate to protect the priority of the floating charge against security interests created later, at least if they were also equitable in nature.[76] The application of this principle inherently relies on the instant fastening of the floating charge onto the property and so is potentially problematic if another security beats it to the punch. The extent to which the unique nature of the PMSI has allowed it to do this has been an issue that the judiciary has grappled with and goes directly to the heart of the doctrine's development and eventual status under the general law.

The birth and development of the PMSI under general law

Commentators widely attribute the origin of the PMSI to *Re Connolly Bros Ltd (No 2); Wood v The Company* [1912] 2 Ch 25 (*Connolly Bros*).[77] A company had issued debentures secured by a floating charge over all its present and future property and prohibiting the creation of subsequent charges. The company intended to purchase freehold property financed by a loan from a third party on the condition that the company granted a charge over the property to secure the advance. An equitable charge was duly executed purporting to create what is retrospectively recognisable as a PMSI. To resolve the ensuing priority dispute it was held that from the moment the property was acquired by the company it was encumbered by the equitable charge.

Accordingly, the floating charge could "bite" only upon the legal estate in the form that it came into the hands of the company and so it too was subject to the third party's security interest.[78] In dismissing an appeal against the first instance decision, Cozens-Hardy MR proclaimed that "we should

[71] Jackson T and Kronman A, "Secured Financing and Priorities Among Creditors" (1979) 88 Yale LJ 1143 at 1143.

[72] Jackson and Kronman, n 71 at 1167-1175.

[73] See, eg Gough, n 35, pp 434-439.

[74] Jackson and Kronman, n 71 at 1143, 1165. The authors go on to state that: "[i]t is therefore not surprising that in the chattel security field the idea of a special priority for purchase money lenders did not emerge until courts had finally accepted the notion that a debtor can validly encumber property he does not yet own."

[75] Goode, n 69, p 115 (original emphasis).

[76] Dixon B, "Purchase Money Security Interests" (1995) 25 Q Law Soc J 1 at 2.

[77] Notwithstanding, Ng remarks that the decision in *Connolly Bros* is "not without antecedents", observing that the principles laid down in the earlier decisions of *Holroyd v Marshall* (1862) 10 HLC 191 and *Wilson v Kelland* [1910] 2 Ch 306 exhibited somewhat of a similar flavour: Ng G, "Built on Quicksand: The Purchase Money Security Interest Under the General Law" (2006) 80 ALJ 53 at 55.

[78] Ng, n 77.

be shutting our eyes to the real transaction if we were to hold that the unencumbered fee simple in the property was ever in the company so that it became subject to the charge of the debenture holders".[79] Buckley LJ articulated his reasoning as: "on that date [the date on which the conveyance of the relevant property was executed] the company obtained the property subject to a contractual obligation to give a first charge on it to [the third party] … [so] the debenture-holders can get no more."[80]

Ironically, on the basis of its own principles, *Connolly Bros* has been criticised:

> If P has already charged all future property to A, his interest in the property becomes charged to A immediately he [sic] acquires that interest … If, subsequent to the grant of the charge to A, but before contracting to purchase the property, P agrees to charge specific property to B, B's interest in the property similarly only arises when P acquires an interest. Although it is possible to grant a present assignment in equity of future property, that assignment takes effect only when the property comes into existence conferring the same right and interest as if it had belonged to P at the time the charge was given … B's interest can be no better than that of P, and P's interest had previously been charged to A. A's interest is entitled to priority, absent some disqualifying circumstance.[81]

Ng flags a potential issue with this view hinging on the orthodox categorisation of the floating chargee's interest as a mere equity prior to crystallisation, observing that "notwithstanding the force of the arguments offered in support of views to the contrary … if a floating charge gives rise only to a 'mere equity' … then A … cannot rely simply upon the maxim, qui prior est tempore potior est jure, in order to establish priority over a subsequent specific charge".[82] However, as Ng concedes, the unorthodox view is by no means unsupported which attends the *Connelly Bros* reasoning with some doubt, particularly when Goode's "present security" formulation of the floating charge is factored in. Nevertheless, a steady series of judgments applied the *Connelly Bros*' rejection of the temporal interpretation that burdened collateral with floating security before the PMSI was able to take effect.[83]

The judicial theme was disrupted by *Church of England Building Society v Piskor* [1954] Ch 553 (*Piskor*) which has been recognised as the birth child of the troublesome "scintilla temporis" doctrine.[84] On part payment of the purchase price, a purchaser of leasehold property was let into possession and proceeded to grant a number of sub-tenancies. The contract was completed with the purchaser simultaneously granting a legal charge to a third party in exchange for the funds to pay the balance of the purchase price. The question was whether the purchaser at any time during the transaction acquired an interest in the property sufficient to "feed" an estoppel in favour of the tenants. The Court of Appeal responded affirmatively, holding that there was a split second in time, a scintilla temporis, wedged between the acquisition and the creation of the charge during which the purchaser was the absolute owner of the legal estate. This construction was a clear departure from the series of *Connelly Bros* cases which fused the two acts of acquisition and grant together as one.

Despite "a number of attempts … to reconcile the two lines of authority"[85] over the years, there existed a direct conflict between the judicial approaches taken.[86] Consequently, the status of PMSIs at general law was attended with uncertainty. Fortunately, the House of Lords in *Cann* did not persist with the task of forcefully deriving clear law from distinctly polar positions, instead ruling conclusively in favour of one approach to be applied going forward.

[79] *Re Connolly Bros (No 2); Wood v The Company* [1912] 2 Ch 25 at 31.

[80] *Re Connolly Bros (No 2); Wood v The Company* [1912] 2 Ch 25, as cited in Ng, n 77 at 57.

[81] Gordon G and Robertson A, "Equitable Charges and After Acquired Property – Are some Equities More Equal Than Others?" (1991) 2 JBFLP 36 at 38, cited in Ng, n 77 at 57.

[82] Ng, n 77 at 57.

[83] See, eg *Security Trust Co v Royal Bank of Canada* [1976] AC 503; *Coventry Permanent Economic Building Society v Jones* [1951] 1 All ER 901.

[84] Robertson A and Walker G, "Equitable Charges and After Acquired Property: The Demise of the Scintilla Temporis Principle" (1991) 2 JBFLP 116.

[85] Dixon, n 76 at 4.

[86] Dixon, n 76 at 4.

The facts in *Cann* again involved the exchange of purchase money funds for a security interest and entertained direct consideration of whether a legal estate, not yet encumbered by a PMSI, was acquired by the purchaser of property for a scintilla temporis. The House of Lords decided that the acquisition and grant formed a single, indivisible transaction:

> [The] attractive legal logic [of scintilla temporis] … flies in the face of reality. The reality is that, in the vast majority of cases, the acquisition of the legal estate and the charge are not only precisely simultaneous but indissolubly bound together. The acquisition of the legal estate is entirely dependent on the provision of funds which will have been provided before the conveyance can take effect and which are provided only against an agreement that the estate will be charged to secure them … The reality is that the purchaser of land who relies on a building society or bank loan for the completion of his purchase never in fact acquires anything but an equity of redemption … The "scintilla temporis" is no more than a legal artifice and, for my part, I would … hold that *Piskor's case* was wrongly decided.[87]

The strength that may be drawn from *Cann* by the general law PMSI goes beyond the conceptual comfort brought by its approval of *Connelly Bros* and the same motion dismissal of *Piskor's* scintilla temporis. Its principles have been applied routinely outside the confines of real property, as confirmed by Parker LJ in *Whale v Viasystems Ltd* [2002] EWCA Civ 480:

> [T]his approach is not limited to cases involving the purchase of a property coupled with the grant of a mortgage or charge to secure repayment of the funds which were required to enable completion of the purchase to take place … [I]t falls to be adopted generally, in every case where an issue arises as to priority as between equitable interests.[88]

In the Australian jurisdiction, *Cann* was approved in *Sogelease Australia Ltd v Boston Australia* (1991) 26 NSWLR 1 (*Sogelease*) where it was held that a general law PMSI over personal property enjoyed priority over a fixed and floating charge registered under the predecessor to the *Corporations Act*. Given the prominence that companies legislation has enjoyed in Australia, it would be difficult to see how PMSI super-priority could be vindicated any more than this. Furthermore, *Sogelease* was approved by a distinguished Full Court Bench of the Federal Court (Gummow, Hill and Cooper JJ) in *North Western Shipping & Towage Co Pty Ltd v Commonwealth Bank of Australia* (1993) 118 ALR 453. These decisions have crystallised the English jurisprudence and it may be said that Australian law has reached the point where PMSIs are unequivocally recognised and will prima facie rank ahead of pre-existing security interests in after-acquired property. Nevertheless, the precise parameters of its application are far from extensively laid out. As Bridge notes the "instances of [PMSI super-priority] … have to be stitched together and it does not go as far as it does under Article 9 systems".[89]

ESTABLISHMENT OF PMSIs UNDER THE PPS ACT

Establishment

Incorporation of the general law's high-level position is apparent from the coupling of the PMSI's definition as a security interest granted in exchange for finance required to purchase the collateral with the super-priority exception to the first-in-time rule.[90] However, in line with other Art 9 models, the PPS Act goes well beyond this, setting out an extensive PMSI regime explicitly addressing a wider gamut of commercial arrangements and legal issues.

Transactions that may constitute PMSIs

As has been discussed, the general law has afforded substantial recognition to PMSIs in the context of secured purchase money loans. The law applicable to VCTs has developed quite separately. As Gough notes: "[d]espite the fundamental unity of purchase money loans and dispositions on credit, the law

[87] *Abbey National Building Society v Cann* [1991] 1 AC 56 at 92-93.

[88] *Whale v Viasystems Ltd* [2002] EWCA Civ 480.

[89] Bridge, n 4 at 205-206.

[90] PPS Act, ss 14, 62.

treated the two forms of transaction in entirely different ways."[91] Unlike the PMSI, arrangements relying on the retention or acquisition of title have been part of the law for many years.[92] Simpler forms have been "routinely recognised" by the courts[93] and held not to involve the grant of security by purchasers in possession to vendors.[94] Instead, legal title enabled vendors to claim back their property in the event of non-payment or insolvency, furnishing them with "a source of unimpeachable security devoid of the administrative burdens attached to registration. Moreover, the efficacy of retained title kept the new asset from the clutches of the floating charge".[95] To the extent that VCTs have been recognised as being effective without registration, they have therefore enjoyed their own version of super-priority over registrable security interests.[96]

The expanded definition of PMSI under the PPS Act covers a broad array of VCTs, including commercial consignments and "PPS leases",[97] collapsing "the classic and well-understood common law distinction between a transaction of sale … and a transaction of charge or mortgage".[98] There is a carve out for non-serial numbered goods that the grantor intends to use for personal, domestic or household purposes not present in the *Personal Property Securities Bill 2008 Cth – Exposure Draft* (Exposure Draft) which has been criticised in some quarters. Piper Alderman argued "if [the] sub clause … remains … a consumer financier's only security is potentially at risk unless they undertake searches and obtain a release or subordination [from a prior registered general charge holder] which could increase the cost of consumer finance".[99] In contrast, there has been support for the approach on the grounds that it will be of benefit to credit providers obtaining a guarantee as its value will not be eroded.[100] Given the rapid rate at which credit purchases of, for example electrical goods such as large screen televisions, continue to grow in Australia, what amounts to a policy decision to favour the general charge holder shapes as an important one.

Notwithstanding, recharacterising what are favourite tools of vendors, inventory floor planners and equipment financiers has been one of the most controversial aspects of Art 9 importation.[101] They are instantly converted into secured parties carrying the "baggage"[102] of registration and giving notice to break-even with the old default position conferred by title.[103] The increased transaction costs would be most felt by those supplying inventory to multiple buyers and having to file against each.[104]

[91] Gough, n 35, p 7.

[92] See, eg *McEntire v Crossley Bros* [1895] AC 457.

[93] Bridge, n 4 at 206.

[94] See, eg *McEntire v Crossley Bros* [1895] AC 457.

[95] Bennett and Davis, n 10 at 462-463.

[96] McCormack G, *Secured Credit under English and American Law* (Cambridge University Press, 2004) p 171.

[97] PPS Act, ss 13, 14. Notably, the Consultation Draft captured only leases of more than one year. The Exposure Draft added a definition of "PPS leases" to capture other arrangements under which a lessee or bailee of the property "maintains an outward appearance of ownership" and this was retained in the PPS Act. Accordingly, the definition also includes leases of an indefinite term, renewable leases of less than one year, and leases where the lessee or bailee substantially retains uninterrupted possession of the property for more than one year with the consent of the lessor or bailor: Revised Commentary, n 42 at [B.14]-[B.17]; PPS Act, s 13.

[98] McCormack, n 24 at 125.

[99] Senate Legal and Constitutional Affairs Committee, *Report on the Personal Property Securities Bill 2009 [Provisions]* (Department of the Senate, 2009) at [5.13].

[100] Senate Legal and Constitutional Affairs Committee, n 99 at [5.12].

[101] See Gedye M, "Reflections on Some Practical Issues which have Arisen under New Zealand's Personal Property Securities Act and some lessons for Australia" (2004) 15 JBFLP 20 at 20-22; McCormack, n 68 at 302-303.

[102] McCormack G, "Personal Property Security Law Reform in Comparative Perspective – Antipodean Insights?" (2004) CLWR 1 at 9.

[103] Bridge et al make the additional point that "the imposition of a security analysis on the seller's title constitutes a profound interference with the contractual bargain between the parties": Bridge M, McDonald R, Simmonds R and Walsh C, "Formalism, Functionalism, and Understanding the Law of Secured Transactions" (1999) 44 McGill LJ 567 at 590.

[104] McCormack, n 68 at 304.

However, as the *Personal Properties Security Bill 2008 – Revised Commentary* (Revised Commentary) (accompanying the Exposure Draft) states in the context of PPS leases, the "rules … form an important part of taking a functional approach to PPS reform".[105]

McCormack asserts that all of this "undoubtedly weakens the position of a conditional seller",[106] and other concerns have been expressed on the footing that the recharacterisation may prove troublesome outside of the PPS sphere.[107] Notwithstanding, Gedye observes that while the reform "provokes a hostile response from traditionalists … once it is accepted that the … owner's interest must be reconceptualised as a security interest and that this interest can be protected by compliance with the Act … the outcome follows logically and involves no inequity".[108] The Commentary specifically sings the praises of vendor super-priority:

> Though the Bill is not concerned with legal title, conferring purchase money security interest status on retention of title arrangements, long term leases and commercial consignments would protect the legal owner of collateral in these circumstances. The arrangements for purchase money security interests would give these "owners" the means to maintain their priority position – first priority because of their ownership.[109]

There is no such recharacterisation jolt for purchase money lenders because the fundamental nature of their transaction remains unchanged, but having to demonstrate that their funds *enabled* the acquisition poses an extra challenge not typically faced by vendors. The enabling requirement can become an issue where the advance and purchase are not proximate in time, either because the property was acquired before the funds were advanced or some time later.[110] The explanatory material to Art 9 states that the PMSI "requires close nexus between the acquisition of collateral and the secured obligation … [and that a] security interest does not qualify … if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price".[111] Meyer suggests that the requirement raises questions of fact to be determined case by case, and from a strategic standpoint recommends that the lender advance the credit prior to the acquisition, for example by drawing a cheque or wiring funds directly.[112]

Formalities: Perfection and notice

Following the funnelling of a transaction into the PPS Act's PMSI regime, there are special perfection requirements that must be adhered to in order to arm the relevant security with super-priority. In this regard, the PPS Act distinguishes between non-inventory, for example capital equipment and consumer property on the one hand, and inventory on the other. In relation to non-inventory, secured parties have up to 10 days from the grantor taking possession of the collateral (or if the collateral is intangible property, from the time of attachment of the security interest) to perfect their security interest. In relation to inventory there is no 10-day grace period making it important for the financier to prime itself for registration in advance of provision of the collateral. Practically, given that it is permissible under the PPS Act to register at any time prior to settlement, one would expect astute inventory financiers to file as soon as they have enough traction on the impending deal.

Both the Consultation Draft and Exposure Draft imposed an additional burden on inventory financiers to deliver notice of their imminent PMSI to all other secured parties who had perfected their interests. The requirement was a concession for general financiers holding a security covering

---

[105] Revised Commentary, n 42 at [B.14].

[106] McCormack, n 24 at 134.

[107] See, eg Cuming R, "The Internationalisation of Secured Financing Law" in Cranston R (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (Clarendon Press, 1997) pp 501, 522-523.

[108] Gedye, n 101 at 21.

[109] Commentary, n 7 at [6.60].

[110] Meyer K, "A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code" (2001) 50 U Kan L Rev 143 at 144.

[111] *Uniform Commercial Code* (US), § 9-103 (Comment 3).

[112] Meyer, n 110 at 145.

after-acquired property and making ongoing advances on the basis that newly acquired inventory is encompassed by their security. Without PMSIs, a financing statement covering future advances would ensure priority and there would be no need for the general financier to rigorously check the register. However with super-priority factored in, and the absence of a notice requirement, the general financier may be "under the misapprehension that they have priority … [and they] could not be certain that they have maintained their priority for future advances".[113]

Be that as it may, the notice requirement was criticised, not least of all because any PMSI would be readily identifiable on the register for parties poised to make additional advances.[114] Another ground for condemnation was the increase in the cost of compliance for inventory financiers, notwithstanding that their legwork amounted to a corresponding decrease in the administrative obligations of the general financier no longer required to consistently check the security radar. It seems these views have prevailed and, in a move that also had the virtue of not causing further unrest among vendors already grumbling about their extra responsibilities, the provisions were not retained in the final legislation. The consolation prize for general financiers was a further proviso that the registration perfecting any PMSI specifically states that it is a security interest of that kind.[115]

The different perfection requirements and loss of priority for non-compliance make correct categorisation of collateral critical. Certain courts in the US have given great weight to what is expressed by the parties in the security agreement, holding that classifications need to conform with creditors' expectations.[116] Others have looked to the collateral's use and practical characteristics, for example deeming that attachment to land may lead to classification as a fixture.[117] In addition to the definitional parameters provided in the statute, these sorts of issues will obviously come within the scrutiny of the Australian judiciary.

Super-priority rules

The exalted priority enjoyed by purchase money secured parties complying with the relevant statutory provisions is not absolute. Any security interests perfected by control take priority over PMSIs, as do interests of transferees of an account constituting proceeds of inventory in which a PMSI is held.[118] Priority among conflicting PMSIs is decided according to the first-in-time rule except that PMSIs held by a seller, lessor or consignor has priority over those held by enabling lenders.[119] This is a departure from the PPS Act's preference for equal treatment of financing arrangements, regardless of form, and the first-in-time adjudication of priority, however, is consistent with the US where vendors' preferential treatment is tied to the fact that the obligations owed to them are directly linked to the collateral's price "whereas the debt to lenders is one step removed".[120] It is also perhaps another measure designed to avoid exacerbating the shockwaves of recharacterisation.

Extinguishment vs priority

While it is important not to underestimate the complexities that can arise from the application of statutory rules, the provisions in respect of establishment are relatively straightforward and are supported by ample definitions that serve to reduce subjectivity.[121] Accordingly, establishment issues could be expected to be resolved without too much difficulty in most circumstances, particularly with

[113] Commentary, n 7 at [6.71].

[114] McCormack G, "Reforming the Law of Security Interests: National and International Perspectives" [2003] Sing JLS 1 at 11.

[115] PPS Act, ss 62(2)(c).

[116] See, eg *Re Troupe* 340 BR 86 (Bankr WD Okla, 2006); *Sears, Roebuck & Co v Integra National Bank (Re Fiscante)* 141 BR 303 (Bankr WD Pa, 1992).

[117] See, eg *Re Williams* 381 BR 742 (Bankr WD Ark, 2008).

[118] PPS Act, ss 57, 64. For the rules in relation to PMSIs generally, see PPS Act, Div 3.

[119] PPS Act, s 63.

[120] Christenfeld A and Melzer S, "Purchase Money Security Interests", *New York Law Journal* (3 April 2008).

[121] For example, see the definitions of "commercial consignment", "inventory", "negotiable instrument" and "PPS lease": PPS Act, s 10.

the emergence of prudent lending practices calibrated to the Art 9 model. The extinguishment of security interests presents more conceptual issues. This is not least because it introduces another transactional step with more stakeholders, as well as other segments of the law which have their own pre-existing limitations and foibles. Predictably, the general law has demonstrated a severe inability to cope with extinguishment concepts. The scope for improvement is hefty and is an integral focus of the PPS Act's reform agenda.

Prior to engaging the topic of extinguishment it is useful to distinguish it with priority. In general terms, extinguishment questions arise when a type of dealing involving collateral makes it necessary to determine whether the character of a financier's security interest or retained title in the collateral continues unaffected or is extinguished because of that dealing. If the result is extinguishment, the interest dissolves and no longer carries on. In contrast, questions of priority arise when multiple, validly existing, security interests are competing for mutual collateral. Indeed, it may be said that priority *presumes* a contest between *unextinguished* security interests, and the contest is settled according to a set of priority rules where they are ranked relative to each other. While the relegation of an interest behind another could be thought of as a sort of negative modification, there is no change in the interest itself because of a dealing with it. Instead, one static interest previously established by one transaction loses a contest with another static interest with a different transactional genesis.[122]

Extinguishment under the PPS Act and the general law

Introduction

There are numerous modes of extinguishment that apply to all sorts of interests. While it is impossible to cover them all, the purpose of this part of the analysis is to hone in on five "heads" of extinguishment that have proved problematic for the general law and would benefit from Art 9-based reform. They also raise issues that are particularly relevant to PMSI financiers and vendor creditors.

Extinguishment principles as they apply to the ROT subset will be utilised as the basis of the general law's comparison to the PPS Act's extinguishment of PMSIs. Unfortunately, the general law PMSI has not yet been extensively explored precluding a straight "apples with apples" comparison. However, given that ROT confers an elevated status which is not altogether removed from the PMSI's notion of super-priority, and the prolific use of ROT devices by vendors about to become subject to the PPS Act's PMSI regime, the juxtaposition is appropriate and will illustrate the changes that will face vendors in usefully stark terms.

To begin with, transactions involving third party purchasers will be examined.

Third party purchasers

Third party purchaser issues are enlivened in circumstances of unauthorised sales by grantors. Authorised sales generally limit a financier's recovery options to proceeds, allowing purchasers to escape the clawing back of collateral in insolvency.

General law: Bona fide purchasers

Where goods are subject to an unauthorised transfer, the extinguishment of equitable interests by bona fide purchasers of the legal estate can be explained by reference to a number of, sometimes disparate, grounds. There are statutory, common law and equitable varieties of this exception to the nemo dat rule, albeit with significant conceptual overlap. The common law adaptation is consolidated and broadly reflected in the State sale of goods legislation[123] which, in general terms, requires: purchasers to have acquired possession of the goods; the goods to have been bought or agreed to be bought; and that the purchase was made in "good faith" and without "notice" of any lien or right of the original

[122] Accordingly, priority rules do not apply when collateral has been acquired free of a security interest. While the transferee obviously gains proprietary rights in the secured property, it does not acquire a competing security interest required to activate priority rules. This a point specifically made in the explanatory material: Explanatory Memorandum, *Personal Property Securities Bill 2009* (Cth) at [2.105].

[123] See, eg *Goods Act 1958* (Vic), s 31. There are equivalent provisions in the other States.

supplier to the title.[124] Of course, prior to those considerations, there is the overriding threshold ingredient that requires that the purchaser take a legal estate and not merely an equitable one. As Meagher, Heydon and Leeming observe: "[t]here is no general doctrine of 'bona fide purchaser of an equitable estate for value without notice'."[125]

The boundaries of the other relatively uncontroversial requirements can be stated without fanfare. A mere contractual agreement to sell the goods, even at a later date or subject to some condition, will fulfil the requirement that purchasers buy or agree to buy the goods, and possession will be satisfied by actual possession by the purchasers or possession by any other person subject to their control or on their behalf.[126] The good faith element is discharged by the purchaser if they acted honestly – that is not fraudulently or dishonestly – considering the circumstances, regardless of whether those actions were negligent or not.[127] *Benjamin's Sale of Goods*[128] submits that negligence or carelessness may give rise to bad faith if the surrounding circumstances "lead to the inference that the purchaser must have had a suspicion that there was something wrong, and that he refrained from asking questions because he thought that further enquiry would reveal an irregularity".[129] "Notice" is subject to a range of academic and judicial descriptions, but in summary includes actual knowledge of the fact as well as awareness of circumstances that would lead a reasonable person to conclude the existence of that fact.[130] Inversely stated, this is known as "recklessly turning a blind eye".[131] Critically, in commercial transactions purchasers are not affected by the doctrine of constructive notice nor are they under any obligation to make inquiries as to the rights of a vendor to dispose of goods.[132]

Equity's parallel doctrine of "bona fide purchaser for value[133] without notice" has similar parameters although, strictly speaking, equity does not embody a notion of good faith which, analogous to a director's duty of good faith or good faith in contractual negotiations, is a common law concept. Equity, however, does recognise that the knowledge of transaction participants, or putting it more broadly, other unconscionable or improper conduct on their part, can overturn rules that might otherwise apply. Accordingly, third parties whose conduct "involves fraud or participation in a breach of trust occasioning the first conveyance" will be prevented from acquiring good title.[134] Such an outcome can be couched in equity's maxim of "clean hands", or its close brother requiring that any plaintiffs wishing to avail themselves of an equitable remedy "do equity".[135]

Given that the sale of goods involves the extinguishment of equitable interests by virtue of the sale of a legal estate (which necessarily encompasses the unsevered equitable estate), the situation gives rise to an intersection between common law and equity and is resolved, provided that the elements of the doctrine have been made out, pursuant to those equitable maxims that allow the common law to prevail.

[124] See n 123.

[125] Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (4th ed, Butterworths LexisNexis, 2002) p 339.

[126] For a more detailed discussion of the elements of the statutory doctrine, see Guest AG, Sealy L, Reynolds FMB, Miller CJ, Harris D, Treitel GH, Ellinger EP, Morse CGJ and Lomnicka E (eds), *Benjamin's Sale of Goods* (4th ed, Sweet & Maxwell, 1992) pp 326-335.

[127] See, eg *Goods Act 1958* (Vic), s 3(2) and equivalent provisions in other States.

[128] Guest et al, n 126, p 316.

[129] Guest et al, n 126, p 316.

[130] Guest et al, n 126, p 317.

[131] See *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1972] 1 QB 210 at 218.

[132] Gough, n 35, p 389.

[133] Value simply refers to consideration which must only be "valuable and not nominal … [but] need not be adequate": Meagher et al, n 125, p 339.

[134] Meagher RP, Gummow WMC and Lehane JRF, *Equity: Principles and Remedies* (2nd ed, Butterworths, 1984) p 241.

[135] Meagher et al, n 125, p 91.

Ultimately, the equitable doctrine and its statutory/common law equivalents operate to strongly fortify the position of innocent purchasers who will take possession of the legal estate free of all prior equities. The basis for such broad protection lies in the paramount importance that the law gives to protecting commercial transactions. It is this principle that has caused the otherwise resolute nemo dat rule to be modified in order to, as Denning LJ remarks, "meet the needs of our own times".[136]

PPS Act: The good interest provisions

The PPS Act's rules dealing with third party acquisitions ("good interest provisions")[137] set out a number of distinct categories of security-free acquisitions where "reasonable commercial expectations require protection of the title acquired by a third party transferee".[138] These include where: the security interest is not perfected by the secured party; serial numbers are misstated in registrations of prescribed serial-numbered property; consumer property is purchased and valued below $5,000; and property is purchased in the ordinary course of business. There are also special rules dealing with motor vehicles.[139] Generally, the good interest provisions apply to sale and leasing transactions[140] and whether or not the security interest is perfected.[141]

The concept of "knowledge" remains "central"[142] and third parties with the prescribed degree will not be able to cause the extinguishment of pre-existing security interests.[143] Depending on which category is under consideration, the purchaser cannot have knowledge of the security interest itself, or that the transaction constituted a breach of the security agreement. Unsurprisingly, if the security interest is not perfected, the secured parties may not rely on knowledge to save them from extinguishment unless the transferee participated in the transaction that gave rise to relevant security.[144]

Knowledge is separated into actual and constructive knowledge and, again, the applicable parameters depend on the class of third party transfer in question.[145] There are also certain carve outs for transferred collateral held as inventory.[146] Under the Consultation Draft, the concept of constructive knowledge consisted of what amounted to recklessly turning a blind eye,[147] closely

[136] *Bishopsgate Motor Finance Corp Ltd v Transport Brakes Ltd* [1949] 1 KB 332 at 336-337.

[137] This article will follow this terminology which was adopted for the provisions in the Commentary, n 7 at [5.3]. The good interest provisions are set out in the PPS Act, Pt 2.5.

[138] Commentary, n 7 at [5.1].

[139] See Explanatory Memorandum, *Personal Property Securities Bill 2009* (Cth) at [2.79]-[2.83].

[140] For ease of discussion, use of the terms "purchaser" and "buyer" includes a lessee, and "seller" and "vendor" includes a lessor unless otherwise indicated.

[141] PPS Act, Pt 2.5, s 42(a).

[142] Commentary, n 7 at [5.7].

[143] The extinguishment terminology is a useful one for the present analysis, however, the Explanatory Memorandum, *Personal Property Securities Bill 2009* (Cth) notes that the provisions do not use the term "extinguish" but rather "taking free of a security interest" is preferred "because there may be circumstances where the security interest is attached to more than one item of collateral and the transferee is acquiring only one of those items": at [2.70]. The Commentary also notes that the slightly different spin is "flexible enough to deal with the interest of a buyer and that of a lessee … [and] circumstances when property is returned to the seller". In these circumstances the secured party's interest will continue in some capacity so will not be extinguished per se: Commentary, n 7 at [5.5]-[5.6].

[144] PPS Act, s 43.

[145] PPS Act, Pt 2.5, s 297.

[146] PPS Act, ss 44(2), 45(2), 45(4), 46(2).

[147] Commentary, n 7 at [5.9]; Consultation Draft, n 1, s 41.

mirroring the general law's position. The Exposure Draft, and subsequently the PPS Act, scrapped this for a duty to inquire if an honest and prudent person would have done so to more "closely … [reflect] the current law on constructive notice".[148]

In a notable departure from other Art 9 models, the element of good faith has been ousted.[149] In the Exposure Draft this was done in favour of a general obligation to act honestly and in a commercially reasonable manner, which was effectively shoehorned into the space where the good faith concept would have operated. The objective and subjective formulation required that people act honestly according to the standards of ordinary people and know their actions were honest according to those standards.[150] The Commentary states that the reason for the change was that good faith was thought to have an unsettled and unclear meaning in Australian law. However, it was difficult to identify the difference between that approach and the definition of good faith in the State sale of goods legislation and at general law: both of these existing formulations directly refer to honesty and reasonableness. In any event, the general obligation was narrowed in the PPS Act and now only applies to enforcement actions,[151] the implication seemingly being that "honesty" is adequately covered by the formulation and application of the knowledge provisions.

There are two other concessions made for secured parties in addition to those built in to the provisions discussed above. Purchasers must provide "new value", which does not include the forgiveness of an antecedent debt (as opposed to "value" which does), where it is deemed necessary to ensure that there is "something in the hands of the debtor that the secured party can pursue if their interest is extinguished".[152] This markedly lifts the general law's bar for consideration and is a measure that augments the re-engineered conception of security in proceeds. In addition, the rights of the secured party are "subrogated, in relation to the property, to the rights (if any) of the transferor … including the right to receive any [unpaid] part of the purchase price for the property".[153]

Sales in the ordinary course of business

In circumstances where collateral is sold in the ordinary course of business, the PPS Act operates to extinguish the security interest unless the purchaser has actual knowledge that the transaction is a breach of the security agreement.[154] The absence of a constructive knowledge element is consistent with the common law position that does not impute third parties with a duty to inquire in commercial settings, and is a reflection of the PPS Act's paramount commitment to commerciality and the free flow of transactions.

Moving from the quality of knowledge to its content, the Commentary explains the reason for the provisions requiring specific knowledge of a breach, rather than merely of a security interest: "[m]any transferees are aware that the businesses … they deal with have given security interests in their inventory … [and] the fact that a transferee is aware of a security interest in the goods does not disqualify … [them] from … protection".[155] McCormack contends that the PPS Act's reference to a breach of the actual agreement is also not substantially different from the existing state of affairs.[156]

[148] Revised Commentary, n 42 at [B.12]. See PPS Act, s 297. There are certain property transfers that presume the actual or constructive knowledge of the transferee, and provisions relating to knowledge requirements in relation to bodies corporate and other entities: ss 298, 299. Onus of proof obligations in relation to knowledge are set out in s 296.

[149] Commentary, n 7 at [5.12]. New Zealand and Canada have grappled with whether purchasers are under an implied duty to make inquiries as part of their overall obligation to act in good faith. The removal of the good faith concept may manifest an intention on the part of the drafters to avoid this issue.

[150] Commentary, n 7 at [5.13]; Exposure Draft, n 1, s 235. This was an all-pervading concept of honesty that applied to all rights and obligations that arose under a security agreement or the Exposure Draft.

[151] Senate Legal and Constitutional Affairs Committee, n 99 at [3.27], [3.28]; PPS Act, s 111.

[152] Commentary, n 7 at [5.14]. See definitions of "value" and "new value": PPS Act, s 10.

[153] PPS Act, s 53.

[154] PPS Act, s 46.

[155] Commentary, n 7 at [5.28].

[156] McCormack, n 96 at 107.

The resemblance to the general law's treatment of third parties purchasing goods subject to a floating charge is fairly obvious: the security's implied licence only ceases if the purchaser has actual knowledge of a breach. However, McCormack goes further, claiming that even in relation to property sold subject to a fixed charge there is no significant departure from existing law because "[b]uyers take free … of fixed charges provided that they do not actually know of … [their] existence".[157] The general law's position on notice is crucial to that argument. Generally, a purchaser takes subject to a duly registered fixed charge, however, the person has to come within the category of someone who might reasonably be expected to search the register, perhaps through prior dealings. If they are not, then they rank ahead of the secured party holding a fixed charge.[158] The PPS Act's explicit statement that a person does not have constructive notice of the contents of a registration merely because the information is on the register is consistent with McCormack's view.[159]

Previously, once a person is deemed to have actual or imputed notice of a charge, there has been debate about whether it includes notice of the charge's restrictive covenant. In direct contrast with the express provisions of the *Corporations Act*[160] that operate to "fix subsequent chargees with constructive notice of the restrictive covenant",[161] courts in England have decided that it does not. Of course, under the PPS Act, awareness of the breach of a security agreement closes down the issue in practice because the reason for the breach will almost certainly be the restrictive covenant contained within it.

Through the application of the in-substance test deeming the floating charge a security interest like any other, the PPS Act also removes the need for debate regarding the classification of the floating charge as a mere equity and clarifies that attachment occurs at the usual time when value is given, and the grantor is able to transfer property rights, not some time later when the security fixes as a result of default.[162]

Proceeds

To the extent that they cover outstanding debt, the risk of loss to innocent purchasers is mitigated by an effectively taken interest in proceeds. Given that most ROT clauses explicitly provide an authority for goods to be on-sold so that the primary purchaser can use the proceeds to satisfy extended credit – and even if the contract is silent on the point courts will generally wire it in[163] – extending priority over the goods to cover proceeds becomes more valuable still.

General law: Tracing

Unfortunately, tracing at general law has proved no mean feat for vendors who are forced to engage in the "Pandora's Box" of common law and equitable tracing.

Claimants may only trace at common law if they have a sufficient common law right upon which to base the claim. From this perspective, the academic and judicial support for the view that an effective ROT clause is able to underpin a tracing claim appears well-founded: the legal title that vests in the vendor is an absolute common law right. ROT vendors appear cognisant of this and the priority that may be gleaned from it:

> The most obvious reason … [to trace] is that a person who has the right … will take priority over other creditors in the case of … insolvency. This consideration has led to the proliferation of reservation of

[157] McCormack, n 96 at 107.

[158] McCormack, n 96 at 107.

[159] PPS Act, s 300.

[160] See *Corporations Act 2001* (Cth), ss 263(1)(a)(iii), 274(2)(a).

[161] Ali P, *The Law of Secured Finance: An International Survey of Security Interests Over Personal Property* (Oxford University Press, 2002) p 123, citing Gough, n 35, p 852. As noted, this is a relatively new development only arising after the introduction in 1982 of the *Companies Code* legislation: p 852.

[162] PPS Act, s 19(4).

[163] See, eg *BHP Steel Products Ltd v HH Robertson (Aust) Pty Ltd* [2002] NSWSC 336.

title clauses, whereby suppliers of goods for manufacture attempt to retain sufficient interest in the goods to enable a tracing remedy to be employed should the manufacturer go in to liquidation.[164]

There are intrinsically very few recognisable rights, so ROT circumvents a significant barrier to common law tracing. However, while retaining ownership in property may be an initially effective attempt to warehouse a future common law tracing claim, it will only succeed to the degree that the foundational rights are not extinguished. For example, in the context of fixtures where ownership rights are seldom more precariously poised, ownership can be lost to landowners by the mere act of affixing the collateral to their land. If extinguishment was deemed to occur, as it very well may in this scenario, it would not be possible to advance a common law tracing claim.

The routine commercial exercise of mixing proceeds with other funds so that they lose their identity represents another serious threat. In what has been described as the "primary rule of common law tracing",[165] claims will typically be knocked out if funds have been mixed. Notwithstanding, as Murr observes, there are a number of cases[166] where claimants have traced into mixed funds at common law, demonstrating that this is an area that is not completely settled.[167]

The spectre of mixed funds extinguishment, combined with the much wider gamut of equitable rights upon which a claim may be based, has helped make recourse to equitable tracing, unfettered in this regard, "almost a reflex action"[168] and Palmer remarks that "modern case law demonstrates … a significant role for the equitable tracing rules in commercial law".[169] In respect of ROT vendors this was demonstrated in *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588 (*Associated Alloys*)[170] where the High Court controversially held that vendors' equitable ownership in proceeds may give rise to a right to a tracing claim in equity.[171]

That is not to say equitable tracing does not face its own idiosyncratic challenges. One of the most problematic has been whether or not a fiduciary relationship is a necessary starting point for a claim and, if so, what factors give rise to its existence. Early on there was undeniably a strict requirement that the party subject to the tracing claim be a fiduciary of the claimant, however, this has been drastically loosened by the readiness of courts to derive the relationship outside those confines.[172] Moreover, recent decisions in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 and *Foskett v McKeown* [2001] 1 AC 102 indicate that the absence of a pre-existing fiduciary relationship is now unlikely on its own to prove a bar to tracing proceeds.[173] Still, the chances of being successful will increase for a vendor if it can establish the purchaser as a fiduciary. While an assortment of affirmative and negative indicators can be drawn out from the mass

[164] Palmer N, *Bailment* (2nd ed, Lawbook Co., 1991) pp 287-288.

[165] Murr D, "Recovering Lost Assets: Tracing at Common Law and in Equity" (2006) 27 Aust Bar Rev 174 at 175.

[166] See, eg *Lipkin Gorman (Firm) v Karpnale Ltd* [1992] 2 AC 548, where a common law tracing claim was upheld despite the proceeds were undoubtedly mixed with other funds.

[167] Murr, n 165 at 3.

[168] Murr, n 165 at 3.

[169] Palmer, n 164, p 290.

[170] For discussion of the effect of permitting an equitable tracing claim on secured and unsecured creditors, see Solomons D, "The Regulation of Romalpa Clauses: The Limitations of Equity" (2008) 16 Insolv LJ 69.

[171] Solomons, n 170. Another recovery option for sellers arises from *Barnes v Addy* (1874) LR 9 Ch App 244 which found that sub-purchasers could be personally liable in circumstances where they knowingly assisted in a breach of trust by the purchaser or knowingly received trust property. This may be of practical benefit, for example, when the proceeds are unavailable or when a seller's tracing claim fails. For further discussion, see Murr, n 165 at 8-11.

[172] Murr, n 165 at 6-7.

[173] Ali, n 161, p 235.

of case law to assist,[174] there are certainly no guarantees for vendors who have frequently had claims denied despite convincing evidence that their circumstances fitted the fiduciary bill.[175]

Until recently, another issue facing vendors was the tendency that courts would recharacterise their interests in proceeds as charges. The logic was that, in reality, the vendor's interest purported to secure the payment of a debt.[176] In these circumstances the vendor's "charge" would be unregistered on the basis of the mistaken understanding that it did not need to be and would be void as against an administrator or liquidator in accordance with the *Corporations Act*.[177] In any event, *Associated Alloys* unwound the prevailing trend, holding that proceeds clauses did not operate as charges and, moreover, that a successful equitable tracing claim lead to priority over all other secured and unsecured creditors. Although this decision strengthened the position of vendors in respect of proceeds, it did not address a number of connected priority issues.[178] Accordingly, there is still much to be resolved.

PPS Act: Security interests in proceeds

Under the PPS Act, a security interest automatically attaches to proceeds arising from a dealing in collateral unless the security agreement provides otherwise or the secured party has given express or implied authority for the transfer to be made free of the security interest.[179] There is no break-in priority provided that either the initial registration encompassed proceeds[180] or the secured party registers its interest specifically in the proceeds within five business days from conversion.[181] Analogous provisions address perfection by possession or control.[182] Importantly, the good interest provisions apply to collateral in its original form as well as proceeds.[183]

Ruling out real property, the Commentary outlines the scope of what may constitute proceeds:

> [T]he proceeds of collateral are the personal property that derives from a dealing with the collateral. It includes a right to an insurance payment or other compensation arising from loss or damage to the collateral, and a payment made in discharge of chattel paper, intangible property, an investment property or a negotiable instrument.[184]

To avoid the "substitution of unrelated property of equivalent value for the original collateral",[185] proceeds need to be "identifiable" or "traceable" property obtained as a result of the dealing.[186] Whether proceeds are traceable or not would be determined according to "existing jurisprudence"[187] allowing an unsettled and complex build up of general principles through the Art 9 door.[188] This is an

[174] McCormack teases out a number of cases on point in various jurisdictions and concludes with drafting recommendations based on them. For example, storing goods and keeping proceeds separately from other goods and proceeds has been found to indicate the existence of a fiduciary relationship: see McCormack G, "Title Retention and the Company Charge Registration System" in Palmer N and McKendrick E (eds), *Interests in Goods* (2nd ed, Lloyds Commercial Law Library, 1998) pp 742-751.

[175] McCormark, n 174, pp 742-751.

[176] See, eg *Compaq Computer Ltd v Abercorn Group Ltd* [1991] BCC 484; *Re Highway Foods International Ltd* [1995] BCC 271.

[177] *Corporations Act 2001* (Cth), s 266.

[178] Collier B, *Trans Tasman Perspective on Select Issues of Financing Stock and Debtors – Australian Perspective* (Speech delivered at the 19th Annual Banking and Financial Services Law Conference, 6 June 2002).

[179] PPS Act, s 32(1).

[180] PPS Act, s 33(1).

[181] PPS Act, s 33(2).

[182] PPS Act, s 32(5).

[183] PPS Act, s 42(b).

[184] Commentary, n 7 at [6.36]. For the statutory meaning of proceeds, see PPS Act, s 31.

[185] Commentary, n 7 at [4.13].

[186] PPS Act, s 31.

[187] Commentary, n 7 at [4.15].

[188] The governing law in relation to the validity of a security interest in proceeds, other than proceeds that are an account, is the law that governed the validity of the security interest in the original collateral: PPS Act, s 241.

unfortunate link for a framework self-proclaimed as straightforward and remedial. In the US, proceeds cease to be identifiable when they are mixed, so reverting back to the incumbent tracing principles has ominous potential. That being said, prudent vendors would quickly tailor their documentation to include obligations for purchasers to establish individual bank accounts to separate their proceeds. Most ROT proceeds clauses already include this requirement and with the increased efficacy offered by the PPS Act's automatic attachment principle, usage should become even more prevalent. Accordingly, recourse to the complicated tracing principles should hopefully be scarce.

Canada has preferred to place more reliance on the legislation itself. In ruling over their incarnation of Art 9, Canadian courts will not revert to equitable tracing rules if to do so would discord with underlying statutory policy.[189] They have also held the secured party's right to trace proceeds is a statutory right not dependent on finding a fiduciary relationship between the debtor and a secured party claiming proceeds. The PPS Act has followed this lead and explicitly rules out the fiduciary relationship as a prerequisite,[190] at least carving out one troubling aspect of the existing jurisprudence upon which some other parts of the inquiry will depend. Given that tracing has taken on a novel statutory dynamic, relying on the legislation where possible, either directly or indirectly as has been the theme in Canada, appears to be a more rational approach.

Fixtures

General Law: The development of unsatisfactory principles

As may be ascertained from its founding maxim quic quid plantatur solo, solo cedit (whatever is affixed to the soil belongs to the soil), the law of fixtures is not particularly kind to ROT vendors. By operation of law, chattels annexed to land have their status transformed. The vendor's contractually designed title suddenly becomes "devoid of content" and vests in the landowner pending detachment.[191] The tension created at the ROT/fixtures interface is evident. ROT transactions pull title to goods in the direction of the vendor while affixation of those goods to land wrenches title the landowner's way at the "magic moment"[192] of affixing. The courts have introduced numerous exceptions that chip away at the absolutivity of the original rule in an attempt to rebalance the interests of stakeholders and achieve a desired level of commercial relativity.

Responding to the fatal threat of annexation, vendors routinely reserved in the contract the right to enter upon the land to detach the fixture upon which it was restored to chattel status. The courts upheld this right not merely as a personal but as an equitable interest in the land to which the fixture was annexed. Its first express recognition came in *Re Samuel Allen & Sons* [1907] 1 Ch 575 where Parker J prioritised the interest of a hire-purchase supplier over a subsequent equitable mortgagee without notice stating that, "in my opinion … [the equitable mortgagee] must be held to take subject to the earlier agreement".[193] Bennett and Davis argue that Parker J, faced with unclear authority, was "evidently making a policy decision … [that] [t]itle retention agreements were to be encouraged and the efficacy of the supplier's rights was crucial in that regard".[194] Despite this, on the footing of indefeasibility of title, landowners and mortgagees have dominated priority battles since,[195] manifesting the plainly obvious: recognition of an interest is a "toothless tiger" without priority.

In any event, the judiciary's focus shifted to whether an item of property was a chattel or a fixture.[196] The idea was that the classification was determinative of the rights of the parties: a chattel

[189] See *La Salle Recreations Ltd v Canadian Camdex Industries Ltd* (1969) 4 DLR (3d) 549 at 553.

[190] PPS Act, s 31(2).

[191] Bennett and Davis, n 10 at 448.

[192] Polston R, "The Fixtures Doctrine: Was it Ever Really the Law?" (1995) 16 Whittier L Rev 455 at 464.

[193] *Re Samuel Allen & Sons* [1907] 1 Ch 575 at 581-582.

[194] Bennett and Davis, n 10 at 450.

[195] Cooper D, "Retaining Title to Fixtures" (1991) 6 Auck LR 477 at 489.

[196] Griggs L, "The Doctrine of Fixtures: Questionable Origin, Debatable History, and a Future that is Past!" (2001) 9 APLJ 51 at 55.

belonged to the vendor and a fixture belonged to the landowner. The test that emerged depended upon the degree and purpose of annexation and has stood for almost a century. In more modern times, consideration has "definitively swung in favour of the latter" of the two strands[197] and the prior has arguably been filed into "a catalogue of other evidentiary factors that *may* assist deliberation".[198] The decision appears to presently boil down to an overall assessment of the circumstances of each case with the objective purpose of the parties being the first and most important reference point. A more pessimistic view considers that this is merely reflective of a "tangled and artificial web of exceptions"[199] and that the "test" has deteriorated into something which is not really a test at all. What is clear is that the precise nature of the chattel/fixture inquiry is not. It is a state of affairs that has been criticised, if not attacked, by commentators,[200] and there is a loud chorus calling for "simplicity, certainty and theoretical cohesion [to] be returned to this area of the law".[201]

A number of ideas for reform have been put forward. Abbs correctly acknowledges that a one-size fits all solution is unattainable, suggesting that cases be separated by their "genus" (for example landlord/tenant, mortgagor/mortgagee, vendor/purchaser) before being subjected to the core question of which party is "most deserving of the benefit of the item in dispute"?[202] This goes some way to cracking the enormous range of situations in which disputes arise and ties in bespoke policy considerations by allowing a finer point to be put on factors regarded as especially important to each genus. Furthermore, the solution is considerate of existing law and could be catered for relatively comfortably. Three more radical reforms couched in property law are canvassed by Griggs, although he concedes that none of them are sufficiently satisfactory. The grant of profit a prendre would allow the supplier to have a co-existing interest in land with severance rights, however, it would represent an unrealistic departure from the principle's confinement to the removal of items that grow naturally. Rendering the right to enter and remove as caveatable would allow vendors to intimate annexation, as would a restrictive covenant which "attach[es] to the land and run[s] with … [it] should ownership change",[203] yet both suffer from serious theoretical and practical deficiencies.[204]

Bennett and Davis contend that a vendor's priority to fixtures is predicated on the super-priority accorded to the PMSI at general law:

> An application of the … [general law PMSI] to fixtures would seem to favour the supplier. While the initial title retention to the chattel is no doubt valid, this PMSI is suspended upon annexation to the land. The supplier is no longer the legal owner of the fixture and the question is whether the supplier's equitable interest can be given effective PMSI status through *Cann* reasoning. The reality is that the acquisition of the legal interest in the fixture by the landowner is entirely dependent upon the extension of credit by the supplier. This credit is in turn extended only against the landowner's agreement that there be a first ranking security right over the fixture. To the extent of the credit, the supplier is a purchase money financier … His equitable interest merits "paramount" status as a PMSI, and *Cann* and the authorities approved therein provide a legal mechanism for English law to achieve that end.[205]

There may be another theoretical basis upon which the *Cann* line of cases could be advanced in favour of this paramount interest. If one accepts that a chattel affixed to the land becomes part of that land, the PMSI supplier could be interpreted as contributing to the purchase price of the land to the extent of the credit extended, or at least to the extent that the fixture increases the land/property value.

[197] Griggs, n 196 at 55.

[198] Abbs R, "The Law of Fixtures: Informed Principle or Independent Predilection" (2004) 11 APLJ 31 at 34 (original emphasis).

[199] Ward N, "The Race for Possession: The Rights of Retention of Title Suppliers of Fixtures" (1998) 26 ABLR 184 at 201.

[200] See, eg Griggs, n 196; Abbs, n 198; Ward, n 199.

[201] Griggs, n 196 at 69.

[202] Abbs, n 198 at 36.

[203] Griggs, n 196 at 67-68.

[204] Griggs, n 196 at 67-68.

[205] Bennett and Davis, n 10 at 469.

Under this interpretation, fixtures financing transactions resemble those in the *Cann* cases and, in the same way, after-acquired property security interests could only attach to the land subject to the fixture's PMSI carve out.

PPS Act: Fixtures

In a significant departure from the Consultation Draft which set out a broad sub-regime, the PPS Act opted not to proceed with the attempt to reform the law of fixtures. The reason proffered was that concerns had been expressed by the States and Territories about the operation of the provisions on their laws. Unfortunately, the explanatory material does not elaborate on the nature of the concerns, a disappointing result given that this area of the law desperately needs clarification and on its face would benefit greatly from reform.

For the purposes of this article, it is worthwhile considering the earlier proposal. The Consultation Draft's statutory mode of reform enabled a holistic remedy that would be unattainable by grafting reforms from existing general law principles, the problems with which were exemplified by the significant conceptual flaws of the approaches suggested above. The provisions aimed to rectify the "maze" that is fixtures law by striking "a balance … [between] existing and subsequent interests in the land to which the fixture is, or becomes, affixed and the interest of the fixtures creditor".[206] A simple framework consisting of a default rule with delineated exceptions was the means to that end.

The default rule conferred priority on the interest in the land except in four prescribed cases where priority in the fixture prevailed:

1. the security interest in the fixture was perfected prior to affixation;[207]
2. the PPS Register and any relevant lands title register contained information that allowed an acquirer of the interest in land to ascertain that there is a security interest in a fixture that is affixed to the land;[208]
3. the holders of the interest in the land consented to their interest in the fixture being subordinated;[209] and
4. the security interest was granted over an existing fixture and a search of the PPS register and any relevant lands title register disclosed it.[210]

Irrespective of views in certain quarters that overall ROT suppliers are worse off under an Art 9-based regime,[211] this approach would have been of undoubted benefit to them. The setting out of a specific system of registration and priorities would have armed ROT vendors with the knowledge of what steps are required to establish their security interest and, most importantly, keep it safe. This would have been a giant leap forward from the incumbent framework that enables the "unilateral actions or intent of one individual … to transform the legal status of an item"[212] regardless of what measures are taken.

Making the omission of the sub-regime more unfortunate is the fact that, drilling down, the rules themselves appeared to be logical. One could not begrudge the priority of vendors if they perfect prior to affixation. On the other hand, it is difficult to argue with the severe penalty of loss of priority for failure to register when the PPS legislation makes it abundantly clear that the registration requirement is absolutely critical. Establishing an interrelationship between the PPS Register and the lands title registers would have helped bring a welcome nexus to sectors of the law that are disparate and do very little talking except in the bloody battlefield of the courtroom. Landowners would no longer be able to blanket-acquire property affixed to their property, however, even they would have to concede that title

[206] Commentary, n 7 at [8.11].

[207] Consultation Draft, n 1, s 130(1).

[208] Consultation Draft n 1, s 130(2).

[209] Consultation Draft, n 1, ss 131(1), 149.

[210] Consultation Draft, n 1, s 131(2).

[211] See, eg McCormack, n 102 at 9; McCormack, n 68 at 304.

[212] Griggs, n 196 at 52.

should not pass where vendors have financed the fixture and told the world about their interest through the megaphone of registration. Moreover, any losses would surely be offset by "[k]nowledge of … [a] priority scheme [that] enables [them] to plan their activities, including borrowing for or financing the addition of fixtures as improvements to real estate".[213] Furthermore, the potential for dispute and litigation, often drawn out due to the complexity of fixtures law, would be significantly reduced.

On the surface it appears that enactment of the Consultation Draft's fixtures provisions would have achieved the vaunted aim of balancing stakeholder interests with far more success and with greater clarity than the existing law of fixtures has been able to muster, particularly given the 18-month consultation period that elapsed between their release and enactment that would have provided significant scope for ironing out problem areas.

Cross-collateralisation and restructuring

Transformation vs dual status

Cross-collaterisation in respect of PMSIs can occur in various ways. The parties may purport to secure purchase money obligations with non-purchase money collateral or non-purchase money obligations with purchase money collateral. They may also attempt to secure purchase money obligations with after-acquired property or future debt with existing purchase money collateral. Prior to Art 9's comprehensive revision in 1999, PMSIs involved in cross-collateralisation faced the risk of losing their super-priority. A class of decisions favouring the "transformation rule"[214] held that the presence of a non-purchase element "transformed" the entire security into non-purchase money. This view was "based on the idea that impurities in the relation between claim and collateral … lead to a forfeiture … [of] purchase money status",[215] and applied irrespective of whether sound allocation methods could properly isolate the purchase money element.[216]

Other courts preferred the "dual status" interpretation which permitted the allocation of the value of collateral between the respective elements, preserving super-priority to the extent that the collateral secured obligations incurred in its acquisition.[217] This rule necessitates an allocation method to properly account repayments to the purchase money and non-purchase money portions of the overall obligation. Carlson observes that parties found to have turned their minds to this issue were more likely to have the arrangement upheld "when a security agreement provides an allocation formula, courts are willing to abide by it, and indeed have been persuaded to institute the dual status rule".[218]

The dual status rule prevailed under Revised Article 9,[219] and it has been encapsulated in the PPS Act. The definition of PMSI expressly recognises cross-collateralised security to the extent that obligations or collateral relate to purchase money.[220] Addressing the allocation issue, the provisions also provide guidelines on how payments shall be applied, sensibly leaving it up to the parties in the first instance.[221]

All-monies clauses

"All-monies" clauses seek to retain title in all goods supplied to a company at any point in time where money is owed to the vendor, regardless of whether or not the amounts relate to the unpaid goods in

[213] Griggs, n 196 at 68.

[214] See, eg *Re Snipes* 86 BR 1006 at 1007 (Bankr WD Mo, 1988); *Re Booker* 9 BR 710 (Bankr MD Ga, 1981); *Re Jones* 5 BR 655 (Bankr MDNC, 1980).

[215] Carlson DG, "Purchase Money under the Uniform Commercial Code" (1992) 29 Idaho L Rev 793 at 821.

[216] Carlson, n 215 at 844.

[217] Defined as "purchase money obligations" in the PPS Act: s 14(7).

[218] Carlson, n 215 at 823.

[219] Carlson notes that part of the reason for this may have been that prior to the *Uniform Commercial Code* (US) the transformation rule "simply did not exist": Carlson, n 215 at 824.

[220] PPS Act, s 14(3), (4).

[221] PPS Act, s 14(6).

issue.[222] This "widens the pool of goods which may be repossessed as 'security' for the supplier's debt and … avoids … the problem of identifying specific goods that have not been paid for".[223] All-monies clauses have previously been classified as charges due to their resemblance to interests securing the payment of an unpaid debt, however, courts have recently held that they are a valid method of retaining ownership in goods.[224]

Insofar as the outstanding debt relates to something other than goods previously sold, an all-monies arrangement will be cross-collateralised. The PPS Act's support for cross-collateralisation is, to a degree, consistent with the position of all-monies clauses at general law: both regimes preserve priority despite the presence of a non-purchase money element. However, the PPS Act is more restrictive because of its limitation to purchase money obligations, while the reserved title at general law is able to "secure" *all* of the purchaser's debt with respect to the vendor, not just the debt corresponding to the goods in possession. Nevertheless, correlating the purchase money collateral and debt goes to the heart of the PMSI's underlying justification and is not an unreasonable restriction.

Restructuring/refinancing

Historically, PMSI debt that was restructured or refinanced also faced the risk of losing its status. These transactions are ordinarily effected through the substitution of the existing security agreement with a new one setting out the revised terms. Therefore, proceeds of the loan are not technically used to acquire rights in the collateral – these rights are already vested in the secured party pursuant to the earlier agreement. In the US, the intervention of Revised Article 9 again fell the way of the PMSI, preserving its status following renewal, refinancing, consolidation or restructuring of the financing.[225] Given the isolating mechanisms of the dual status doctrine, stripping away super-priority on the basis of a restructure which does not materially change the core PMSI obligations or collateral does not stand to reason. It is a point not missed by the drafters of the PPS Act who understandably followed the US example,[226] although with this stipulation: "care may be required to ensure that it is possible to demonstrate the link between the original secured obligation and the … restructured obligation."[227]

CONCLUSION

The complexity of Australia's existing law pertaining to security interests created a pressing need for reform, and the enactment of the Art 9 model embodied in the PPS Act is timely. Its functional basis, first-in-time rule and extensive registration ambit serve to cut through an uneasy mix of general law and statute applicable to PPS. The built-up residue of uncertainty, particularly in relation to extinguishment, has been targeted and improved through decisive statutory intervention. While the removal of the fixtures provisions appears to be an opportunity missed, those addressing a number of other problematic areas remain intact.[228] Obviously, the judiciary will still play a significant adjudicative role in the Art 9 age, however, with a more unambiguous and expansive blueprint and the ready made body of jurisprudence available in overseas jurisdictions, decisions should by and large be less complicated to make.

Notwithstanding that the concept of the PMSI was overtly recognised in *Cann*, beyond that, it remains largely unexplored at general law and is comparatively piecemeal when juxtaposed with the PMSI establishment and extinguishment rules in the PPS Act. Contrastingly, ROT establishment and

[222] Johns M and Newman D, *Navigating the ROT Minefield* (Maddocks, 2004) at [12], http://www.maddocks.com.au/download/navigating.pdf viewed 15 August 2008.

[223] Walker K, "All-Moneys Retention of Title Clauses: An Update" (1993) 67(8) Law Inst J 725 at 725.

[224] *Armour v Thysse Edlstahiwerk* [1991] 2 AC 339; *Puma Australia Ltd v Sportsman Australia Ltd* (unreported, Qld Sup Ct, 28 August 1991).

[225] *Uniform Commercial Code* (US), § 9-103(f). It should be noted that this section only applies to non-consumer cases. In consumer cases, courts are left to determine the proper rules: Meyer, n 110 at 157.

[226] PPS Act, s 14(5).

[227] Commentary, n 7 at [6.64].

[228] As well as those addressed in this article, provisions relating to commingling and accessions have been retained in the PPS Act and are targeted to address pre-existing legal sore spots in those areas: see PPS Act, Pts 3.3, 3.4.

extinguishment principles have been explored in depth at general law. Unfortunately, the results have been confusing and vendors have learnt the hard way just what a "minefield"[229] ROT law can be by having their title recharacterised as a charge or destroyed through dealings including, but not limited to, the mixing of funds, annexation to land or a purchase made by an innocent third party. Despite the PPS Act supplanting title with a properly registered security interest, vendors are not subject to the same volatility and are very much in control of the steps required to protect their interest. In the US, Art 9 posed its own threats to PMSI super-priority through cross-collateralisation and the restructuring of debt, however, the PPS Act has followed Revised Article 9 with provisions that preserve the security in harmony with its fundamental rationale. Against this background, one would expect PMSIs to become a useful and prevalent financing technique for vendors and other purchase money financiers who should familiarise themselves with the PPS Act's provisions "so that they can take maximum advantage of the device and mitigate against its limitations".[230]

McCormack warns that "Article 9 is clearly not a panacea for every problem thrown up by the existing provisions" and it is impossible to gauge the ultimate success of the PPS Act until it comes into force. The benefits remain largely theoretical for the moment and while there has been a significant amount of time and effort invested in the drafting, credible concerns have been expressed in relation to the speed in which the final stages of the reform process concluded.[231] The next few years will not only be a revolutionary period for the Australian law of securities, but also a revealing one.

[229] *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttnick Ltd* [1984] 1 WLR 485 at 499.

[230] Christenfeld and Melzer, n 120.

[231] In its report on the *Personal Property Securities Bill 2009* (Cth) (which very closely mirrors the eventual legislation enacted only a few months later), the Senate Legal and Constitutional Affairs Committee stated that "this process has been somewhat foreshortened and has led to the committee still holding a number of unresolved concerns about the Bill … The process has also led to many further complaints from stakeholders about the haste with which it is being pursued … The Bill was very substantially restructured and re-written since the exposure draft … and there appears to have been little if any further consultation initiated by the department with stakeholders": Senate Legal and Constitutional Affairs Committee, n 5 at [2.10]. The Senate, however, asserts that sufficient time has been provided and that the outstanding issues reflect "the fact that there are stakeholders out there who take diametrically opposed views about … this bill … But we would say, ultimately, the bill itself is still achieving the global policy end that was intended … [and] the concerns that are still being raised are minor when compared to the scope of the bill and the scope of the policy reform": at [4.18].