

# **Explanatory Memorandum**

**Bill for an Act**

**entitled**

**Personal Property Security Act 2011**

**December 2011**

# Bill for a Personal Property Security Act (PPSA)

## Contents of this Explanatory Memorandum

This memorandum contains two explanations of the bill.

- A. **Brief explanation.** First is a brief and general explanation of the overall purpose and policies of the bill. General examples are provided to illustrate how the policies would work in practice.
- B. **Summary of each Part and Division.** Second is a short summary of each of the bill's ten Parts. Examples are provided that illustrate in greater detail the workings of the bill and the relationships between overall policy goals and each Part of the bill.

## Background to the Development of the Bill

The bill for a Personal Property Security Act (PPSA) is the result of several years of work. An initial diagnostic report on secured lending in Papua New Guinea was conducted by the Asian Development Bank in 2006. The Government of PNG requested technical assistance for further study in 2009. The Department of Treasury held consultations with private stakeholders throughout 2010, and a policy statement sponsored by then-Treasurer Peter O'Neill was endorsed by the NEC. Bill drafting then began at the Department of the Treasury with assistance from the Asian Development Bank. The bill drafting process included further consultations with private sector stakeholders throughout 2011. A draft bill and explanatory note were released for public comment in August, followed by a revision to incorporate many suggestions.

## Drafting Methodology

The PPSA of Saskatchewan, Canada was used as the primary model for the bill. The Saskatchewan PPSA served as the basis for the PPSAs of all Canadian provinces except Ontario and Quebec. The Saskatchewan PPSA was also the basis for drafters of the New Zealand PPSA, which in turn served as a pattern for Vanuatu. The drafters of the Australian PPSA (yet to take effect) also relied greatly on the Saskatchewan PPSA. The use of a common model will lower transition costs. Also, there will be a greater supply of secondary legal resources (court cases, teaching materials, law review articles, practice manuals) to support businesses and legal practitioners.

The bill is not, however, a copy of Canadian legislation. Special circumstances in Papua New Guinea frequently required drafters to add, delete, or modify provisions to fit PNG circumstances.

## PPSAs Around the World & in the Pacific

The principles of the PPSA were first developed in the U.S. in the 1940s and implemented state by state in the 1950s and 1960s. Canadian provinces followed closely in the 1960s and 1970s. More recently, reforms modelled on PPSA principles have been adopted in New Zealand, Australia, Vanuatu, Solomon Islands, Tonga, and other countries as well. The Law Commission advocates reform in the U.K. PPSA principles have been the basis for recent conventions on international financing of certain equipment and accounts receivable.



## A. BRIEF EXPLANATION

### General purpose and means

The purpose of the bill is to promote commerce. How to do this? The means is by facilitating business and consumer credit. Specifically, the bill reforms the law governing the use of personal property as collateral to secure a loan. (Personal property means property other than land or buildings.) If secured loans are easier, less expensive, and more reliable to make, more people will have the opportunity to participate in the economy and the economy will grow.

The four general policies of the bill are:

1. To simplify and reduce the cost of lending secured by personal property.
2. To clarify the rules governing conflicting interests in personal property.
3. To provide transparent information to those who need it with respect to collateral agreements.
4. To reduce the time and cost, and improve the reliability, of enforcement tools.

### Who may give or take collateral?

Under a PPSA, any person may give a *security interest* in personal property to any other person. A *security interest* is merely a property right, like a charge or mortgage, that secures an obligation. The person who gives the security interest is the debtor. The person who takes the security interest is the secured party.

A security interest is given in a security agreement. The security agreement need not contain any special terminology or follow any prescribed form. The security agreement need only be signed by the debtor and describe the collateral. All other formal terms and conditions are up to the parties to decide upon. A single security agreement may be secured by multiple security interests. Multiple security agreements may be secured by a single security interest.

These principles simplify existing law and reduce costs. Today, secured lending relies on a variety of technical legal forms. Each form has its own legal rules on creating and enforcing security rights in collateral. The rules are not uniform, and expensive consequences may follow from selecting the incorrect form. Under the PPSA, the rules are the same no matter who is the borrower or lender, and no matter what is the collateral.

### What may be collateral?

Collateral may be personal property of any nature. Goods are a common example of collateral. Goods may be consumer goods, such as appliances and furniture. Goods may be the equipment of an enterprise, such as machinery and vehicles. Goods may be the inventory (stock in trade) of a shopkeeper, or the raw materials of a manufacturing plant. Goods may be crops or livestock.

Collateral may also be intangible. Common examples of intangible collateral are deposit accounts, and customer accounts (receivables). Other intangibles include intellectual property and licenses. Collateral may be stocks and bonds, letters of credit, negotiable instruments, warehouse receipts and bills of lading.

Collateral need not exist at the time the parties make the security agreement. They may choose that a security interest in collateral will apply to property that the debtor acquires at any time in the future.

These principles simplify and expand existing law. Today, certain forms apply to tangible collateral while other forms apply to intangible collateral. Some borrowers (companies) can promise future-acquired property as collateral, while others (proprietors and partnerships) cannot. Under the PPSA, people are not restricted from structuring a collateral agreement in any manner they please.

### **Who is interested in the PPSA, other than debtors and secured parties?**

One reason lenders hesitate to take personal property as collateral is the risk posed by competing claims to the collateral. Third parties – persons other than the debtor – may acquire interests in collateral in several ways. For example: (a) the debtor might sell the collateral; (b) the debtor may have already given a security interest in the collateral, or in the future may give a second security interest in the same collateral; (c) lawsuits, tax claims, bankruptcy and insolvency may give others the right to seize and liquidate collateral. Problems also arise when goods that are collateral become commingled with, or attached to, other goods.

Under existing law, various laws may apply to one dispute or another, and common law will govern the rest. Further, the result of existing rules may create a disincentive to give credit, rather than an incentive to give credit.

The PPSA will create a single place to look for the priority rule that will resolve competing claims. For each possible conflict, the lenders will know their risk in advance. Each of the PPSA's priority rules is designed to give lenders an incentive to lend.

### **What happens to collateral upon default?**

Borrowers who pay their debts on time and in full are the people who pay for inefficient and expensive enforcement against borrowers who default. They pay for inefficiency in the form of depressed amounts of credit, unfavourable terms and conditions, and higher interest rates. If enforcement of agreements is improved, credit conditions will improve.

Under existing law, each legal form for security (e.g. hire-purchase, finance lease, registered bill of sale, fixed charge, floating charge) has its own enforcement rules. Some are more expensive and less efficient than others. Judicial intervention is sometimes required when it is not necessary.

The bill creates a single set of enforcement rules, no matter what the legal form. Upon default, the secured party has the right to take possession of collateral and to dispose of it. The secured party, subject to business-like standards, is authorised to liquidate the collateral in a variety of ways. Where possible, judicial procedure is avoided.

### **Transition**

The PPSA would not commence until the registry is implemented. The bill gives secured creditors a reasonable period of time (six months) in which to register pre-PPSA security interests that were created under previous legal forms such as title retention, registered bill of sale, and company charge. Registration within the six month period assures those creditors of priority in their collateral from the date of commencement of the PPSA.

## Examples of PPSA Transactions

### **New Equipment**

Construction Company needs a new backhoe. Equipment seller (or Finance Company) extends credit for the purchase.

*Collateral: the backhoe. (The parties may agree that other property will secure the loan as well.)*

### **Consumer Goods**

Consumer wants a new TV now. TV Dealer sells a TV to Consumer on credit.

*Collateral: The new TV.*

### **Inventory**

Car Dealer needs cash-flow financing for the enterprise. Bank lends money for the purchase of cars on an on-going basis.

*Collateral: all assets of the enterprise, whether presently owned or acquired in the future, including present and future inventory, accounts, deposit accounts, and proceeds of collateral.*

### **Crops**

Farmer needs seed and fertilizer for the upcoming growing season. AgriFinance Company lends money for the purchase of agricultural inputs.

*Collateral: Present and future crops, and their proceeds.*

### **Importing**

Off-Shore Supplier (secured party) gives credit to PNG Importer (debtor) for purchase of TVs to be sold to Dealers that have already signed purchase contracts.

*Collateral: (a) the goods, (b) customer accounts, (c) documents of title issued by the warehouse that stores the goods when they arrive.*

### **Exporting**

Off-shore Companies sign contracts to purchase goods from PNG Manufacturer, who needs credit to store the goods, and to load and ship the goods to the Off-Shore Companies. Bank lends the money to PNG Manufacturer.

*Collateral: (a) the goods, (b) customer accounts, (c) documents of title, (d) proceeds of customer accounts as they are collected. (The collateral may also be simply "all the assets of PNG Manufacturer, whether presently owned or acquired in the future.")*

## **B. SUMMARY OF EACH PART & DIVISION**

### **PART I. – PRELIMINARY**

To the extent that this Act regulates or restricts the qualified rights or freedoms referred to in the Constitution, the Act is a law that is made for the purpose of giving effect to the public interest in public order. [§1]

Key terms are defined where a special understanding of the terms is necessary for the purposes of the bill. The purpose of a definition may be to assure that it has broad meaning, or restricted meaning, or a different meaning under the circumstances than the word's every-day meaning. [§2]

In the priority rules of Part VI, secured parties who have “control” of deposit accounts and investment property (stocks and bonds) have priority over people whose priority depends on registration in the registry. The bill defines what it means to have “control.” [§§3-4]

The results of several priority rules depend on whether or not buyers and others have “knowledge” of certain facts. The bill states how one may determine whether individuals, partnerships, and companies have “knowledge” of a fact or an event. [§5]

Security agreements and registered notices must describe the collateral. The bill assures that collateral descriptions may be general or specific. [§6]

Some goods can be classified differently, depending on the circumstances. For example, a TV is consumer goods when used at home, equipment when used in a hotel, and inventory when held for sale at a shop. Priority rules vary, depending on their classification. The bill states how one determines the classification of goods. [§7]

Proceeds of collateral (money or property received in exchange for collateral) must be traceable if they are to be claimed by secured parties. There is conflict in common law about whether proceeds are traceable when they are held by someone in trust for another. The bill makes clear that a trust (fiduciary) relationship does not prevent collateral from being considered traceable. [§8]

The results of some priority rules on stocks and bonds depend on the time that collateral is considered to be in a person's possession. The bill states how one determines the exact time of possession. [§9]

### **PART II. – APPLICATION OF THE ACT**

The bill applies to all transactions that have traditionally been used to create security in personal property. These transactions include pledge, chattel mortgage, and company charge. [§10]

Sellers of goods sometimes retain ownership of the goods until they are paid for. Some believe that the retention of ownership prevents this arrangement from being considered a use of property as collateral. Even if that is technically true as a legal matter, others say that the substance is the same: (1) a debt is owed, (2) the debtor is in control of the property, and (3) the creditor has the right to reclaim it upon default. The bill adopts the latter position. A transaction that, in substance, provides for security in personal property is

subject to the PPSA no matter the technicalities of the legal form. This principal also applies to the sale of accounts and consignments. [§10]

For purposes of notice and priority, the bill also applies to execution creditors (persons who have a right, against the debtor's will, to seize property, including judgment holders, tax authorities, bankruptcy trustees, and company liquidators). [§10]

The bill does not apply to obligations secured by real property (land or buildings), mining tenements or petroleum licenses. The bill does not apply to promises that loans will be secured by wages or receipts from superannuation funds. The bill does not apply to a sale of accounts that is part of the sale of a business or an assignment of accounts for the purpose of debt collection. [§11]

If enacted, the Act will "bind the state." This means that future governments are obligated to implement the law as enacted, unless it is amended or repealed. [§12]

### **PART III. – SECURITY AGREEMENTS, ATTACHMENT OF SECURITY INTERESTS, AND SECURED OBLIGATIONS**

The bill makes clear, contrary to some conflicting common law, that a security agreement is effective against the debtor and third parties, no matter what types of rights the debtor has in the collateral. [§13]

Under the common law, a right in property does not arise until it "attaches" to the property. Attachment makes the right enforceable against the person who gives the right. Under the bill, a security interest, given by a debtor, attaches to collateral and is enforceable against the debtor when (1) the debtor owns or acquires rights in the collateral, (2) the secured party gives something of value to the debtor (such as a loan or a promise to make a loan), and (3) the debtor has signed a security agreement, or transferred possession or control of the collateral to the secured party. Attachment of a security interest to collateral is also attachment of a security interest in proceeds (property received in exchange for the collateral). [§14]

In order to resolve conflicting common law authority, a security interest attaches to future-acquired property even if the debtor has not set aside funds or made special arrangements for the acquisition. Also, a security agreement that calls on the secured party to make future advances is enforceable even if the future advances are not made. [§§15 & 16]

### **PART IV. – RIGHTS AND DUTIES OF THE DEBTOR AND THE SECURED PARTY**

Debtors usually have possession of collateral in modern commercial circumstances, but there are times when the secured party takes possession. When the secured party has possession, the bill requires the secured party to take reasonable care of the property, and permits the secured party to keep profits or increases in the collateral as additional collateral. (The parties may agree otherwise.) The same is true where the secured party has control (a substitute for possession) of deposit accounts or investment property such as stocks and bonds. [§§17-19]



If a secured debt is paid, a secured party who is collecting money on the debtor's accounts receivables must notify those who owe on the account that they should make future payments to the debtor. [§20]

The debtor is entitled, from time to time, to request the secured party to provide clarifications, such as a statement of account, a list of collateral, and other details about the status of the secured obligation. [§21]

Conflicting common law is resolved by a clarification that a secured party may accelerate payment of a debt based on a determination that the collateral is in jeopardy or the loan is insecure, but only if there is a commercially reasonable basis for that determination. [§22]

## **PART V. – PERFECTION OF SECURITY INTERESTS**

Security interests can be “perfected.” A perfected security interest is a security interest that has maximum enforceability against third parties, such as buyers of collateral and other creditors.

A security interest is perfected when it has attached to collateral and a method of perfection has been completed. There are three methods of perfection. First, the secured party may register a notice that describes the collateral in the registry established in Part VII. Second, the secured party may take possession of goods, money, and other types of tangible collateral. Third, the secured party may take control (defined in Part I) of deposit accounts or investment property. A security interest may be perfected simultaneously by more than one method, and is continuously perfected so long as one method applies without a gap during which no method applies. [§§23-27]

Sometimes a gap in perfection is permitted for a short period to accommodate practical needs. For example, a secured party may release a warehouse receipt to a debtor for a short period, enabling the debtor to remove goods from the warehouse. A security interest in the warehouse receipt that is perfected by possession remains perfected while the debtor uses it. [§28-29]

A security interest in collateral extends to proceeds (money or property received in exchange for collateral). If the security interest is perfected, the security interest in proceeds is also perfected. If the proceeds are perfected by registration and the proceeds are not adequately described in the registered notice, the secured party has 14 days to amend the notice to correct the description. [§30]

Frequently, a secured party takes a security interest in accounts receivable that are, in turn, secured by other property such as goods, promissory notes, letters of credit, or even mortgages in land. A perfected security interest in such an account receivable is also a perfected security interest in the underlying collateral. [§31]

Sometimes security interests in goods are extinguished when the goods are taken away by buyers or lessees, but the goods are then returned to the seller or lessor (who is also the debtor). The bill provides that the returned goods are still collateral and a security interest in them re-attaches. A series of rules balances the interests of parties if intervening security interests in the goods arise. [§32]

## **PART VI. – PRIORITY OF SECURITY INTERESTS AND RIGHTS OF THIRD PARTIES**

Secured parties may find that people other than the debtor acquire conflicting rights in collateral. For example, a debtor may give a conflicting security interest to another lender, or may sell the collateral to a buyer. The secured party may also find that a judgment holder, tax authority, bankruptcy trustee or company liquidator may take control of collateral without the debtor's consent. Problems may also arise in special circumstances, such as where collateral is commingled with, or attached to, other property. Part VI of the bill sorts out conflicts between secured parties and third parties, and makes provisions for the commingling of goods and the attachment of goods to other property.

### ***Division 1 – General Priority Rules***

The main priority rule is that the first security interest for which a notice is registered (or the first to be perfected) has priority over other security interests. Unperfected security interests have priority by order of attachment. [§33]

The priority date for proceeds dates back to the date of registration of the notice that perfects the security interest in the original collateral. [§34]

The priority date as to collateral that secures future advances dates back to the date of registration of the notice that perfects the security interest. [§36(1)]

An execution creditor (judgment holder, tax authority, bankruptcy trustee or company liquidator) has priority over a security interest if its interest is registered by notice in the registry before the security interest is perfected. [§35]

Where a security interest has priority over the interest of an execution creditor and the security interest secures future advances of money from the secured party, the priority of the security interest extends only to advances made before the execution creditor registers a notice, or before the secured party knows of the execution creditor's interest, whichever comes first. [§36(2)]

Secured parties may agree to rearrange or subordinate their priority rights in collateral, and the agreement is enforceable by and against all affected parties. A subordination agreement does not create a new security interest, so there is no need to register an additional notice. [§38]

### ***Division 2 – Priority of Purchase-Money Security Interests***

A purchase-money security interest is a security interest given by a debtor to a secured party to secure a loan that is used to purchase specific goods. The goods themselves are the collateral. For example, Consumer borrows money to buy a car and the lender takes a security interest in the car. The security interest is a purchase-money security interest.

A purchase-money security interest (PMSI) has special status, as noted below. A PMSI does not lose its status because the goods also secure another obligation, or because other collateral also secures the PMSI. A PMSI does not lose its status because the loan is renewed, or refinanced. [§40]

Perfected purchase-money security interests have priority over other security interests, even if notice of a competing security interest was filed earlier than the PMSI. [§41-42] Why? The reason for this “super-priority” is to promote financing of goods such as equipment, inventory, livestock and consumer goods. For example, suppose Bank has a general security interest over all the assets, present and future, of Construction Company. Now suppose that Dealer would like to sell a backhoe to Construction Company on credit, taking the backhoe as collateral. If Dealer’s security interest in the backhoe is junior to Bank’s general security interest, Dealer is unlikely to engage in this transaction. Commerce is deterred.

The super-priority in Section 41 applies to goods other than inventory. As to inventory, Section 42 provides the same rule, but requires the PMSI secured party to notify the general creditor. The purpose of the notice is that a general creditor who finances inventory is likely to be making regular advances and may want to reconsider in the event of a super-priority in inventory.

In general, perfected PMSIs also have prior over the interests of execution creditors. [§44]

### ***Division 3 – Buyers and Other Transferees of Collateral***

The general rule is that people take collateral subject to any security interest in the collateral. (§46) For example, suppose Lender has a security interest in Debtor’s printing press, and Debtor sells it to Buyer. Unless an exception to the rule applies, Buyer takes the printing press subject to Lender’s security interest and Lender would be within its rights to repossess it from Buyer. Buyer could protect itself by checking the registry to determine the existence of a prior, perfected security interest.

Under the general rule, a person takes collateral free of a security interest if the person (1) has no knowledge of the security interest, (2) has no knowledge that the acquisition violates the secured party’s rights, and (3) the security interest has not been perfected. In addition, if the collateral is tangible, the person must take delivery of the collateral before it is perfected in order to take the property free of a security interest. [§46(1)&(2)]

#### ***Special rules for automobiles and fixtures***

The general rule is slightly different where automobiles are concerned. A buyer of an automobile takes the automobile free of a security interest if the automobile’s serial number is not registered. [§50] For example, suppose John wants to buy an automobile advertised by Joseph in the newspaper. John would be wise to determine the serial number of the car and search the registry for that serial number. If the serial number is not found in the registry, John will be sure that he can purchase the automobile without fear that it is subject to a security interest. If the serial number is in the registry, however, John will know that the automobile may be collateral for an outstanding loan.

For someone who proposes to buy an automobile, this rule makes it very easy to determine whether the automobile is subject to a security interest. The person need only search the serial number (vehicle identification number) of the automobile.

Similarly, a buyer of fixtures takes the fixtures free of a PPSA security interest if the real property identification number is not registered on the notice that perfects the security interest. [§52]

***Buyers “in the ordinary course of business”***

There are exceptions to the general rule. The most important is the exception for a buyer of goods “in the ordinary course of business.” This term is a term used in common law to refer to the usual sale of goods by a seller who is in the business of selling goods of the type in question. For example, a furniture dealer is in the business of selling dining tables, and a typical customer would be a buyer “in the ordinary course of business.”

A buyer in the ordinary course of business takes collateral free of a security interest, even if the buyer knows of the security interest and even if the security interest is perfected. [§47] For example, Lender has a security interest in Dealer’s inventory of printing presses, and Dealer sells a printing press to Buyer for cash. The result is that Buyer, who buys in the ordinary course of business, takes the printing press free of Lender’s security interest.

To revisit the example above of the automobile sale, suppose that John bought the automobile from a dealer, rather than in response to Joseph’s newspaper advertisement. John is now a buyer in the ordinary course of business, and there is no need for John to search the registry for the automobile’s serial number.

A buyer of minerals or petroleum (after extraction) or timber (after it is cut) in the ordinary course of business also takes free of any encumbrance on the land from which the goods were extracted or cut. [§51]

***Other exceptions for tangible collateral***

Other notable exceptions to the general rule:

- A buyer of consumer goods takes the goods free of a perfected security interest, unless the purchase price is higher than PGK 5,000. [§48]
- A lien on goods has priority over a security interest if the lienholder has possession of the goods and the lien secures payment for materials or services supplied with respect to the goods. For example, if TV Repair Service has a lien on a TV that it holds to secure payment for repair services, the lien has priority over a security interest in the TV. [§53]

***Division 4 – Persons to Whom Negotiable Collateral is Transferred***

Negotiable collateral is collateral that is very liquid, like cash, or which is transferable by endorsement, such as a share certificate or a document of title.

People who take cash or electronic funds transfers generally take the cash and funds free of a security interest. [§§55&56] The same is true for people who purchase stocks, bonds, negotiable documents of title, and chattel paper. [§§57, 58 & 59]

***Division 5 – Assignments and Other Transfers of Accounts***

(Note: an account debtor is a person who owes payment on an account that has been assigned or sold by a debtor to a secured party. For example, suppose Bank has a security interest in Dealer’s accounts receivables. Dealer sells inventory to Customers on credit and Customers make periodic payments to Dealer. In this case, Bank is the secured party, Dealer is the debtor, and Customers are account debtors.)

Contrary to some common law authority, it is unnecessary to notify an account debtor of the attachment, perfection, or enforcement of a security interest in an account. For the purposes of enforcement, however, an account debtor who is making payments to a debtor may continue to do so until proper notice is delivered. [§61(1)&(2)]

An account debtor continues to enjoy its rights under an account, even though it has been assigned. [§62] Any modifications to a security agreement between the debtor and account debtor are enforceable against the secured party. [§63]

In order to promote the free assignability of accounts, and thereby promote cash flow financing, an agreement that restricts the assignment of accounts is generally unenforceable. [§64]

***Division 6 – Priority in Deposit Accounts and Investment Property***

A secured party may perfect a security interest in a deposit account in one of two ways: by registering a notice that describes the account, or by taking control of the account.

If there are two security interests in a deposit account, one perfected by registration and the other by control, the security interest perfected by control has priority even if registration occurred at an earlier time than control. Multiple security interests in accounts that are perfected by control have priority according to the date of control. [§65(1)&(2)]

If the secured party is the financial institution that maintains the account, it has priority over other secured parties, unless the other secured party controls the account by becoming a signatory on the account (that is, the bank’s customer with respect to the account). [§65(3)&(4)]

Security interests in deposit accounts do not generally have any effect on the common law rights of financial institutions to set off the cash in a deposit account against an unsecured debt owed to the institution by the owner of the account. [§66]

Security interests in investment property (stocks and bonds) may also be perfected by registration or control. A security interest perfected by control has priority over a security interest perfected by registration. [§67]

***Division 7 – Priority in Special Classes of Tangible Collateral***

***Fixtures***

Sometimes goods, which are personal property, become fixed to land and buildings to an extent that causes real property law to apply. In other words, the goods may become

subject to the rights of the owner of the land or a mortgage holder. These goods are called “fixtures.”

The general rule is that a security interest in fixtures is subject to the rights of those who hold interests in real property, such as owners and mortgage holders. There are two exceptions.

A security interest in fixtures has priority over an owner or mortgage holder if the goods are readily removable factory or office machines, consumer appliances, or equipment that is not essential to the operation of the real property. [§68(3)]

A purchase-money security interest in goods that become fixtures has priority over the interest of an owner or mortgage holder, unless the mortgage was taken for the purpose of constructing the very building to which the goods become fixtures. [§68(4)&(5)] For example, suppose Dealer sells a generator to Owner on credit for installation on Owner’s land, which is subject to Bank’s mortgage. Dealer perfects a security interest in the generator at the time of the sale. Upon installation, the generator becomes a fixture and Dealer’s security interest has priority over the rights of Owner and Bank.

If a secured party has priority in a fixture, the secured party may remove the fixture upon default [§69], subject to appropriate court orders [§70].

A mortgage holder may settle a dispute with a secured party over fixtures by making fair payment to the secured party and then by retaining the fixtures. [§71]

### ***Crops***

A security interest in crops, whether growing or to be grown in the future, is not affected by a subsequent sale, lease, or mortgage of the land relating to the crops. [§72(3)]

A security interest in crops, whether growing or to be grown in the future, has priority over a prior mortgage on the related land, or any interest in the owner of the related land. [§72(4)]

### ***Accessions***

An “accession” is goods that become fixed to other goods, while retaining their original identity. For example, a car engine is an accession when installed in a car because even though it is fixed to the car, the engine retains its original identity.

Contrary to some conflicting common law, a security interest in an accession continues in the goods after they become an accession. [§73(2)&(3)]

If there is a security interest in the whole thing to which an accession is fixed, the applicable priority rules govern conflicts among security interests. For example, suppose that Lender #1 has a security interest in a car that eventually needs a new engine, and Lender #2 finances a new engine by taking a purchase-money security interest in the engine. Lender #2 would have priority in the engine over the interest of Lender #1.

### ***Commingled goods***

Commingled goods are goods that become mixed with other goods in such a manner that the identity of the goods is lost. For example, the coffee beans of Farmer #1 are commingled goods if they become mixed in a storage bin that also holds coffee beans of Farmer #2 and perhaps others.

Contrary to some common law authority, a security interest in commingled goods continues in any product or mass of goods that is created when the goods are commingled. [§74(1)]

With certain provisos, in the case of separate security interests in goods that become commingled, each security interest is entitled to share in the product or mass of goods in the proportion that the secured obligation bears to the sum of obligations secured by all security interests. [§74(2)-(5)]

Consistent with favorable treatment elsewhere for purchase-money security interests, a purchase-money security interest in goods that are commingled may prevail over a non-purchase money security interest in some circumstances. [§74(6)]

### ***Vessels and aircraft***

The creation and registration of mortgages in vessels and aircraft are provided for in the *Merchant Shipping Act 1975* and the *Civil Aviation Act 2000*. Such a mortgage has priority over any security interest that attaches or is perfected under the PPSA. Otherwise, the PPSA applies to security interests in vessels and aircraft. [§75]

## **PART VII. – REGISTRATION**

### ***General provisions***

The Personal Property Security Registry receives notices of security interests and the interests of execution creditors (such as judgment holders, bankruptcy trustees, and liquidators). The registry does not have any regulatory authority over the registration of notices. The registrar may set certain fees and adopt regulations that do not conflict with the purposes of the PPSA. [§§76-77, 90, 92]

The court registers a notice of the interest of an execution creditor, no earlier than the time of entry of a money judgment or the appointment of a trustee or liquidator. [§78]

A notice is effective from the time it is available for public search. [§89]

### ***Contents of notice***

A notice need merely identify the debtor and secured party and describe the collateral. The debtor must authorise the notice, and does so automatically by signing a security agreement. [§79] Notices may be registered prior to the conclusion of a security agreement, and may relate to multiple security agreements. [§§80-81]

A notice is effective unless it is seriously misleading. The primary way that a notice may be seen as seriously misleading is if it fails adequately to name the debtor. The PPSA gives guidance to secured parties on ways to assure that they name the debtor sufficiently to avoid misleading notices. [§§82-83]

A notice that becomes seriously misleading because the debtor changes its name will continue to be effective for four months from the change of name, and then continues to be effective if the secured party (within the four-month window) amends the notice to correct the debtor's name. [§84]

***Changes to a notice***

A notice may be amended to change the name and address of the parties or to change the collateral description. The rules are similar to the rules for registration of an original notice. If collateral is added, the notice is effective against the added collateral only from the date of registration of the amendment. [§86]

An amendment may not change the duration of the notice. The parties may choose the duration of the initial notice. Six months prior to its lapse, however, the secured party may extend the notice for an additional five years. [§§85&87]

A notice may easily be terminated, and a secured party must terminate a notice if there is no further secured obligation and the debtor makes a written demand. [§88]

***Public access to notices***

Notices are public records and anyone is free to search them. A search report must communicate all the information contained in a notice, including its registration number, registration date, and duration. Certified search reports may be used in court without further attestation by the registrar. [§93]

Although notices are public information, a notice does not constitute “constructive notice” to the world, for the purpose of the judicial doctrine of constructive notice. [§94]

**PART VIII. – ENFORCEMENT OF SECURITY INTERESTS**

***Scope of enforcement rules***

The enforcement rules of the PPSA do not apply to a transfer of an account or chattel paper, to a lease for a term of more than one year and to a commercial consignment that does not secure payment or performance of an obligation, and the interest of an execution creditor. A secured party may pursue any or all rights under the PPSA simultaneously or in any order. [§95]

A secured party, upon the debtor's default, has enforcement rights under the PPSA as well as rights under any other law. In addition, any rights agreed to by the debtor in the security agreement are enforceable. [§96]

***Collection rights of secured party***

Upon default, and with respect to accounts that are collateral, the secured party may collect accounts directly if possible, or notify account debtors to pay the secured party rather than the debtor. Proceeds may also be collected. Money collected may be applied to the expenses of enforcement and the secured obligation. [§97(1)]

If collateral is a license, the secured party may seize the collateral and obtain value by re-licensing the collateral. [§97(2)]

***Secured party's right to take possession and to dispose of collateral***

Upon default, the secured party has a right to take possession of collateral by any method provided by law. If practicable, the secured party may take control of goods at the debtor's premises without removing them. If the collateral is a document of title, the secured



party may proceed as to the document or as to the goods covered by the document under any method of enforcement that is commercially reasonable. [§98]

***Manner of disposal of collateral***

Disposal of property by the secured party may be on an "as-is" basis, or after repair or preparation. Disposition may be by private sale, public sale, in whole or in part, or by lease or credit sale or other commercially reasonable means. The secured party may buy the collateral at a public sale. [§99]

***Duty to act reasonably***

The secured party must behave in a commercially reasonable manner in dealing with repossessed collateral. However, this doesn't mean that the disposition must be perfect, obtaining the best possible price under the best of circumstances. If collateral is disposed of in recognized markets or in a way that is customarily used by people who deal in such property, the disposition is commercially reasonable. [§100]

Where practicable, the secured party must provide notice of disposition, 7 days in advance, to the debtor, to any person known to be an owner of the collateral, and to any holder of a subordinate security interest. Notice is not required where collateral is perishable, in imminent danger of decline in value, or under other circumstances that make notice impracticable or unreasonable. [§101]

The secured party may purchase the collateral, if the sale is a public sale and the purchase price is reasonable. [§102]

Purchasers of collateral take the collateral free of the debtor's interest in it. [§103]

Proceeds from the disposition of collateral are applied to the secured debt and the expenses of enforcement. The debtor remains liable for any deficiency – the difference between the secured obligation and the proceeds of disposition. The debtor is entitled to any surplus. The secured party must provide the debtor with an accounting of the disposition. [§105]

***Secured party's right to retain collateral***

The secured party may retain collateral in satisfaction of the secured obligation in accordance with a plan that is agreed to by the debtor and other interested persons or that is approved by a court. [§106]

***Debtor's right to redeem collateral***

A debtor may redeem collateral by paying the secured obligation and any expenses incurred by the secured party to enforce the security agreement. [§107]

***Enforcement of a security interest in a mortgage***

Some security interests are, in turn, secured by mortgages. For example, a security interest may exist in a right to receive rents on real property. The right to receive rent may, in turn, be secured by a mortgage on the real property. In that case, a security interest in the account also constitutes a security interest in the mortgage. That is because a secured party may have to enforce the mortgage right to collect the account.

A secured party that wishes to enforce mortgage rights may do so without limiting its rights to pursue any other personal property that secured the obligation. [§108]

***Applications to Court***

Courts may issue appropriate orders to enforce rights of the debtor and the secured party under the PPSA. [§109]

***Receivers***

A security agreement may provide for the appointment of a receiver upon default, and may provide for the rights and duties of the receiver. A receiver may take control of collateral and manage the collateral in a commercially reasonable manner, accounting to the debtor for its actions. Additionally, a court may appoint a receiver. [§110]

**PART IX. – CONFLICT OF LAWS**

Papua New Guinea law applies to security interests if collateral is in PNG or is to be moved to PNG, and also if the security agreement provides that PNG law is the law governing the security agreement. [§112]

If goods are outside of Papua New Guinea when a security interest in them is perfected under the law of another country, the security interest may be perfected under the PPSA under certain circumstances. [§§113-114]

If a perfected security interest exists in collateral located in Papua New Guinea and the debtor relocates to another country, the security interest will continue to be perfected for up to 60 days from the date of relocation. [§117]

If a security interest is perfected in a country other than Papua New Guinea by a method other than public registration and the collateral is not in the possession of the secured party, the security interest is subordinate to an interest acquired when the collateral was situated in PNG. [§118]

A security interest in minerals or petroleum is governed by the law where the minerals or petroleum are extracted, even if the security interest was given under the PPSA. [§119]

**PART X. – TRANSITION PROVISIONS**

The transition provisions relate to transactions that took place prior to the PPSA, such as company charges, registered bills of sale, and hire-purchase agreements (and other title retention transactions).

Priority disputes between creditors whose rights in collateral arose before the commencement of the PPSA are decided under the law in effect at the time of those agreements. The PPSA does not apply. [§120(2)]

To avoid a dispute between a prior creditor and a PPSA secured party, a prior creditor may register a “transition notice.” [§120(4)]

If a transition notice is registered within 180 days of the commencement of the PPSA, the priority of a prior creditor against a PPSA secured party will date from the

commencement of the PPSA. The effect will be to assure the prior creditor of full priority afforded by the PPSA priority rules, from the date of the commencement of the Act. If the transition notice is registered later than 180 days from the commencement of the PPSA, the priority of the prior creditor against a PPSA secured party will date from the registration date of the transition notice. [§120(6)]