DROPPED HS AND THE *PPSA*: LESSONS FROM THE *FAIRBANX* CASE

ANTHONY DUGGAN*

I INTRODUCTION

The *Personal Property Securities Act 2009* (Cth) ('*PPSA*') is scheduled to commence operation in early 2012. The statute is based in part on Canadian provincial legislation that, in turn, derives from Article 9 of the United States *Uniform Commercial Code* ('*UCC*').[1] Article 9 is a model statute drafted by the National Conference of Commissioners on Uniform State Laws in collaboration with the American Law Institute and it has been adopted in all States. The result is that United States secured lending law, although primarily a State responsibility, is substantially uniform throughout the country. The same is true in Canada. All the common law provinces and territories have enacted personal property securities statutes which, with the exception of the Ontario *Personal Property Security Act*,[2] are based substantially on a model statute drafted by the Western Canada Personal Property Security Act Committee (now the Canadian Conference on Personal Property Security Law). The *OPPSA* shares many common features with the Model Act, but there are quite a number of differences in the details.[3]

New Zealand enacted a personal property securities statute in 1999.[4] The *NZPPSA* closely follows the text of the Canadian Model Act, as enacted in the province of Saskatchewan.[5] One advantage of this approach is that it enables New Zealanders to draw freely on Canadian case law and secondary materials as

* Hon Frank H Iacobucci Chair, Faculty of Law, University of Toronto; Professorial Fellow, Faculty of Law, University of Melbourne. This article is a revised version of an address to a Personal Property Securities Reform Masterclass, Law Society of Western Australia, Perth, 20 August 2010.

1 *Uniform Commercial Code* (US) § 9-1 ('*UCC*').

2 *Personal Property Security Act*, RSO 1990, c P-10 ('*OPPSA*').

3 For a fuller account, see Ronald C C Cuming, Catherine Walsh and Roderick J Wood, *Personal Property Security Law* (Irwin Law, 2005) 8–11.

4 *Personal Property Securities Act 1999* (NZ) ('*NZPPSA*').

5 *Personal Property Security Act*, SS 1993, c P-6.2 ('*Sask PPSA*').

a guide to the interpretation of its own statute.[6] By contrast, Australia has elected to take a more free-wheeling approach. The *PPSA* takes the Canadian Model Act as its starting point, but it departs from the model in numerous significant respects in terms of both drafting and substance. Canadian learning will help considerably in coming to grips with the parts of the *PPSA* that adhere to the Canadian Model Act but will be of limited, if any, use for the rest of the statute. The upshot is that Australia will have to develop its own body of case law and literature for at least some parts of the statute. In the meantime, parties and their legal advisers will have to rely on their own resources to interpret the legislation's meaning.

The purpose of this article is to demonstrate that, despite the above caveat, the *PPSA* shares many common features with Canadian law and the basic concepts are the same, though differences in drafting style may obscure some of the similarities. In these common areas, Australian courts and legal practitioners should be able to derive considerable assistance from Canadian cases and other materials. The focus of the article is the recent Ontario Court of Appeal decision in *Fairbanx Corp v Royal Bank of Canada*.[7] The *Fairbanx* case is concerned with the *OPPSA*, which differs in some respects from the Canadian Model Act. Nevertheless, given the common ground between the *OPPSA* and both the Canadian Model Act and the *PPSA*, much of what the Court says in the *Fairbanx* case is significant. The case is instructive in a number of respects: (1) it is a good illustration of how the *PPSA* perfection requirements work and the consequences of non-perfection; (2) it demonstrates the effects of mistakes in the financing statement; (3) it provides a useful context for talking about how the registration and search system works; and (4) it draws attention to the expanded application of the *PPSA*.

6 The New Zealand courts routinely refer to Canadian cases. At the level of secondary materials, one of the leading *NZPPSA* texts is a local edition of Cuming and Wood's handbook series on the Alberta, British Columbia, Manitoba and Saskatchewan personal property securities legislations: Michael Gedye, Ronald C C Cuming and Roderick J Wood, *Personal Property Securities in New Zealand* (Thomson Brookers, 2002). An Australian work of this nature is infeasible, given the differences between the *PPSA* and the Canadian Model Act.

7 (2010) 319 DLR (4th) 618 (Ontario Court of Appeal) ('*Fairbanx*').

II THE *FAIRBANX* CASE: OVERVIEW

The *Fairbanx* case involved a debtor[8] whose name was 'Friction Tecnology Consultants Inc', 'Tecnology' being spelt without an 'h'. The debtor carried on business using the orthographically correct but legally incorrect spelling of its name, that is, with the 'h' in 'Technology'. The debtor spelled its name this way on its letterhead and invoices. It also used the legally incorrect spelling in its agreement with Fairbanx. The agreement with Fairbanx was a factoring agreement, involving the outright assignment of the debtor's accounts receivable. As a general rule the *OPPSA* applies only to security agreements, but section 2(b) provides that the Act also applies to the outright assignment of an account. There is a similar provision in section 12(3)(a) of the *PPSA*, which reads: 'a security interest … includes … the interest of a transferee of an account … [whether or not the transaction concerned, in substance, secures payment or performance of an obligation]'.

Fairbanx registered a financing statement but used the legally incorrect spelling of the debtor's name ('Technology'). Later, the debtor approached the Royal Bank for a loan secured on the debtor's present and after-acquired personal property, including its accounts receivable. The bank did a search using the debtor's legally incorrect name ('Technology') and discovered Fairbanx's registration. The bank agreed to the loan some months later and at that point performed another register search, this time using the legally correct spelling of the debtor's name ('Tecnology'). The search did not turn up Fairbanx's entry. The bank went ahead and registered its own financing statement, using the legally correct spelling of the debtor's name ('Tecnology'). As a condition of the loan, the bank required the debtor to stop factoring its accounts to Fairbanx, but the debtor disregarded this requirement.

The bank and Fairbanx ended up in dispute over several accounts the debtor had factored to Fairbanx. Since the transactions were subject to personal property securities legislation, the outcome of the dispute depended on the priority rules under the legislation. There were two rules potentially in play. The first one, in section 30(1) of the *OPPSA*, provides that in a competition between two security interests both perfected by registration, priority turns on the order of registration. The same rule appears in sections 55(4) and (5)(a) of the *PPSA*. Fairbanx argued that this rule applied and that because it was the first to register, it had priority.

The other priority rule in play was section 20(1)(a), which provides that an unperfected security interest is subordinate to a perfected security interest in the

8 In common with Article 9 and the other Canadian personal property securities legislations, the *OPPSA* uses the expression 'debtor' to describe both the party who gives the security interest and the party who owes the obligation secured: *OPPSA* s 1(1). In most cases, these parties will be one and the same – in other words, the party who gives the security interest will be the party owing the obligation. But in some cases, the security interest may be given by a third party, eg, where A makes B a loan and C gives A security interest to secure B's obligation. In that case, the *OPPSA* provides, in effect, that 'debtor' refers to either B or C, depending on the statutory context. The *PPSA* takes a different approach: it describes the party who gives the security interest as the 'grantor' and the person who owes the obligation as the 'debtor', even in cases where these parties are one and the same: *PPSA* s 10.

same collateral. The same rule appears in section 55(3) of the *PPSA*. The bank argued that Fairbanx's security interest was unperfected because of the spelling error in its financing statement and, because the bank itself was perfected, it had priority. The Court ruled in the bank's favour.

III THE PERFECTION REQUIREMENT AND THE CONSEQUENCES OF NON-PERFECTION

The *Fairbanx* case is a good illustration of the perfection requirement. 'Perfection' is one of the two key personal property securities legislation concepts. The other key concept is attachment. Broadly speaking, attachment marks the point where the secured party acquires an enforceable security interest. There are three main requirements for attachment: (1) there must be a security agreement; (2) the secured party must give value, for example in the form of an advance or the promise of an advance; and (3) the debtor must have rights in the collateral.[9] This last requirement means that if the collateral is after-acquired property, the security interest does not attach until the debtor acquires the property. The requirement reflects the *nemo dat* principle and it goes back to cases like *Holroyd v Marshall*[10] and *Tailby v Official Receiver*.[11]

To put the point another way, attachment refers to the vesting of the secured party's security interest. On the other hand, 'perfection', broadly speaking, is about publication of the security interest. The basic idea is that security interests should be publicised so that third parties can find out about them before dealing with the debtor. There are two main methods of perfection. The first is by the secured party taking possession of the collateral.[12] The second is by registering a financing statement.[13] The *PPSA* also provides for perfection by control where the collateral is a bank account ('ADI account'), investment property and certain

9 *OPPSA* s 11; *PPSA* s 19.

10 (1862) 10 HLC 191.

11 (1888) 13 App Cas 523. These cases establish that an agreement for a security interest in after-acquired property creates an equitable interest in the secured party's favour at the point where the property comes into the debtor's hands and without the need for any further action on the secured party's part. An equitable interest is vulnerable to a subsequent purchaser of the legal estate for value and without notice of the prior claim. One of the many reforms the *PPSA* achieves is to remove this risk from the secured party; under the *PPSA*, the secured party's security interest is a statutory one, as are the rules governing priority between competing claims.

12 *OPPSA* s 22; *PPSA* s 21(2)(b).

13 *OPPSA* s 23; *PPSA* s 21(2)(a).

other items.[14] The consequence of non-attachment is that the secured party has no security interest.[15] By contrast, failure to perfect does not invalidate the security interest. But it does mean that the security interest may be subordinate to, or ineffective against, certain competing interests. Examples include the debtor's liquidator or trustee in bankruptcy,[16] a purchaser of the collateral for value[17] and a competing perfected security interest in the same collateral.[18] This last rule was the one the court applied in the *Fairbanx* case.

IV INVALIDATING ERRORS IN THE FINANCING STATEMENT

The *Fairbanx* case is also interesting because it demonstrates the effect of mistakes in the financing statement. The governing provision in the *OPPSA* is section 46(4), which provides that a financing statement is 'not invalidated nor is its effect impaired by reason only of an error or omission therein … unless a reasonable person is likely to be misled materially by the error or omission'. The corresponding Australian provisions are in sections 164 and 165. Section 164(1)(a) provides that 'a registration … is ineffective because of a defect in the register if, and only if, there exists … a seriously misleading defect in any data relating to the registration'.[19] Section 164(2) provides that 'in order to establish that a defect is seriously misleading, it is not necessary to prove that any person was actually misled by it'.[20]

In Ontario, the courts have held that the test is an objective one.[21] In Australia, the wording of the provision makes this point explicit. The proposition

14 *PPSA* s 21(2)(c). Sections 25–29 deal with the methods of perfecting by control. The details vary depending on the type of collateral in issue, but for an ADI account, the secured party has control if the secured party: (1) is the ADI; (2) is able to direct disposition of funds from the account without the grantor's further consent; or (3) takes over the account: s 25 (1)(a). Section 12(4A) removes any doubts about whether an ADI can take a security interest in its customer's account and one implication of s 25(1)(a) is that, in such a case, the ADI achieves automatic perfection by control. The advantage of perfection by control is that it trumps perfection by the other methods so that, for example, a security interest perfected by control has priority over any prior registered security interest in the same collateral: s 57. These rules run counter to the *PPSA*'s publication objectives, but their proponents justify them on the ground that they are necessary to facilitate security interests in cash deposits, investment property and the like.

15 *PPSA* s 19(1) describes this outcome by saying that 'a security interest is enforceable against a grantor in respect of particular collateral only if the security interest has attached to the collateral'. This is misleading because it implies that a security interest may still be enforceable against third parties even if it has not attached whereas, on first principles, without attachment there can be no security interest at all. *OPPSA* s 11(1) makes the opposite mistake: it describes the consequences of non-attachment by saying that 'a security interest is not enforceable against a third party unless it has attached', implying that a security interest may still be enforceable against the debtor even if it has not attached.

16 *OPPSA* s 20(1)(b); *PPSA* s 267.

17 *OPPSA* s 20(1)(c); *PPSA* s 43.

18 *OPPSA* s 20(1)(a)(i); *PPSA* s 55(3).

19 'Defect' includes an irregularity, omission or error in the registration: *PPSA* s 10.

20 Compare *Sask PPSA* s 43(8). There is no corresponding provision in the *OPPSA*.

21 See, eg, *Re Lambert* (1994) 20 OR (3d) 108 (Ontario Court of Appeal).

that there is no need to prove anyone was actually misled leads to the conclusion that the secured party cannot avoid the section simply by proving that the other party to the litigation was not misled. In the *Fairbanx* case, the Court made the point this way: 'a creditor's subjective knowledge of the existence of a financing statement or its registration is irrelevant. The test is an objective one – whether *a reasonable person* would be materially misled by an error.'[22] In the *Fairbanx* case, the bank knew about Fairbanx's interest from the first of the two searches it did. But the Court held that the bank's knowledge was irrelevant. It is likely an Australian court would reach the same result, applying section 164 of the *PPSA*.

Though this outcome seems harsh on Fairbanx and unduly generous to the bank, there are several policy justifications. One is that a strict error rule increases the incentive for a secured party to get its financing statement right and this, in turn, increases the reliability of the register. Another is that introducing a knowledge qualification would increase litigation costs, first, because the courts would have to inquire into the competing party's state of knowledge and this would mean longer and more expensive trials, and secondly because it would make case outcomes less predictable. There is a similar issue in the context of the first to register priority rule.[23] This provision gives priority to the party who is first to register, even if that party had notice of the competing security interest at the time of its security agreement with the debtor. In Canada, the courts have refused to read in a notice limitation and have at least implicitly rejected the argument that it is bad faith for a secured party to complete a security agreement and register a financing statement with knowledge of a competing unperfected security interest in the same collateral.[24]

So far as Australia is concerned, this aspect of the legislation signals a significant policy shift. Section 280 of the *Corporations Act 2001* (Cth) ('*Corporations Act*'), which deals with priority between competing company charges, provides in part that a registered charge (A) has priority over a subsequent registered charge (B), but not if charge B was created first and the B chargee proves that the A chargee had notice of the B charge at the time the A charge was created.[25] By contrast, *PPSA* sections 55(4)–(5) provide simply that

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22 (2010) 319 DLR (4th) 618, [17] (Feldman JA)

23 *OPPSA* s 30(1) Rule 1; *PPSA* ss 55(4), (5)(a).

24 See, eg, *The Robert Simpson Company v Shadlock and Duggan* (1981) 31 OR (2d) 612 (Ontario Superior Court). Moreover, in all provinces except Ontario there is an express provision to the effect that a person does not act in bad faith merely because she acts with knowledge of the interest of some other person: see, eg, *Sask PPSA* s 56(4). The policy reasons for discounting the knowledge variable are the same as in the invalidating errors context: for a fuller account, see Douglas G Baird and Thomas H Jackson, 'Information, Uncertainty and the Transfer of Property' (1984) 13 *Journal of Legal Studies* 299, 312–16.

25 Section 280(1) reads in part as follows:

> A registered charge on property of a company has priority over:
>
> (a) a subsequent registered charge on the property, unless the subsequent registered charge was created before the creation of the prior registered charge and the chargee in relation to the subsequent registered charge proves that the chargee in relation to the prior registered charge had notice of the subsequent registered charge at the time when the prior registered charge was created.

Correspondingly, s 280(2) provides:

> A registered charge on property of a company is postponed to:

priority between two or more registered security interests turns on the order of registration and there is no notice qualification.[26] The *Corporations Act* is an example of what Baird and Jackson refer to as a 'notice statute',[27] while the *PPSA* is an example of what they call a 'race statute'.[28] Australia's switch from the notice statute model to the race statute model signals its at least implicit acceptance of the policy considerations outlined above.[29]

V THE REGISTRATION AND SEARCH SYSTEM

The *Fairbanx* case is also interesting because it illustrates the unforgiving nature of Ontario's registration system. Ontario's system is an exact match one. In other words, for a debtor's name search, the name the searcher uses must exactly match the debtor's name as it appears in the secured party's financing statement, otherwise the search will not retrieve the entry.

In the *Fairbanx* case, the only discrepancy was the 'h' in 'Technology', but this was enough to make Fairbanx's entry unsearchable by any searcher using the correct spelling. This means that even though Fairbanx's error seemed to be a very minor one, it was still materially misleading and it invalidated the financing statement. It was materially misleading in the sense that a reasonable searcher, using the debtor's correct name, would not find Fairbanx's entry and so it would not be alerted to Fairbanx's claim. This point is borne out by what actually happened in the *Fairbanx* case: the bank did its first search using the incorrect spelling, and it found Fairbanx's entry, but when it did the second search using the correct spelling, the entry did not show up.

The other Canadian provinces have adopted a close similar match system. As the name suggests, in a close similar match system, a search will return all entries against the exact name the searcher uses and also entries against closely similar names. In a close similar match system, a mistake like the one in the *Fairbanx*

(a) a subsequent registered charge on the property, where the subsequent registered charge was created before the creation of the prior registered charge and the chargee in relation to the subsequent registered charge proves that the chargee in relation to the prior registered charge had notice of the subsequent registered charge at the time when the prior registered charge was created.

26 Section 55(4) provides:

> Priority between 2 or more security interests in collateral that are currently perfected is to be determined by the order in which the priority time (see subsection (5)) for each security interest occurs.

Section 55(5)(a) provides:

> For the purposes of subsection (4), the priority time for a security interest in collateral is, subject to subsection (6), the earliest of the following times to occur in relation to the security interest:
> (a) the registration time for the collateral.
> 'Registration time' has the meaning given by s 160: ss 10 and 160 provide in effect that the registration time is the time when the registration becomes available for search.

27 Baird and Jackson, above n 24.

28 Ibid.

29 There is no reference to these policy considerations in Explanatory Memorandum, Personal Property Securities Bill 2009 (Cth).

case would probably not make the security interest unsearchable: in other words, a search against the debtor's correct name would still retrieve the entry.[30]

Both systems have pros and cons. The advantage of close similar match systems is that they are more tolerant of mistakes by secured parties and searchers. The main disadvantage is a potentially noisier search certificate. In other words, under a close similar match system the search certificate will typically list multiple entries and the searcher will then have to sort through them all to identify the relevant one.[31] Ontario decided that, on balance, an exact match system was preferable and Australia has made the same choice.[32] The thinking behind Ontario's choice of an exact match system is that Ontario has a larger population than any of the other provinces. This means that a close similar match system would be likely to show up more entries, particularly for common names, and so search certificates would be proportionately noisier. In other words, the costs of a close similar match system would be higher in Ontario than they are in the other provinces.[33] This consideration is even stronger in the Australian context, given that the *PPSA* register is a national one and the entire country's population falls within its ambit.

Australia's adoption of an exact match system means that, as in Ontario, seemingly minor mistakes, like the one in the *Fairbanx* case, will be enough to invalidate the financing statement and to make the security interest unperfected. On the other hand, there may be some consolation – in Australia, the debtor's name is not the primary search criterion as it is in the other personal property securities legislation jurisdictions. Instead, section 171(1)(a) of the *PPSA* provides for search against 'the grantor's [debtor's] details as required to be included in the financing statement'.[34] If the grantor is a body corporate, the relevant details are: the ARSN if the grantor has one; the grantor's ACN if it has one; the grantor's ARBN if it has one; and otherwise the grantor's name as provided for in its constitution.[35] A possible drawback of this approach is that it increases the burden on register users to identify which grantor details they should be registering and searching against, but the system may provide some assistance to register users in this regard. The advantage of the Australian

30 See Anthony Duggan and Jacob Ziegel, *Secured Transactions in Personal Property: Cases, Text and Materials* (Emond Montgomery Publications, 5th ed, 2009) 217.

31 Ibid.

32 Subject to the concession in *Personal Property Securities Regulations 2010* (Cth) reg 5.8 ('*PPSR*') which allows for case insensitive searching.

33 Canadian Bar Association – Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act* (1998) 21–2.

34 Section 153(1) is the provision governing the details required to be included in a financing statement. According to item 2(c) in the table attached to s 153(1), except in consumer transactions the required details are as prescribed by the regulations. The relevant provisions in the regulations are reg 5.5 and sch 1 para 1.3.

35 *PPSR* sch 1 [1.3]. ARSN is short for 'Australian Registered Securities Number' and means the number given by ASIC to a registered scheme under s 601EB of the *Corporations Act*: *PPSR* reg 1.6; ACN is short for 'Australian Company Number' and means the number given by ASIC to a company under the *Corporations Act*: *PPSR* reg 1.6; ARBN is short for 'Australian Registered Body Number' and means the number given by ASIC to a registrable body under *Corporations Act* pt 5B.2: *PPSR* reg 1.6.

approach is that it largely avoids the kind of problem that led to the *Fairbanx* case. For example, assume a similar set of facts under the new Australian laws. If there is no ARSN, but the debtor has an ACN, the ACN is the main registration and search criterion and the debtor's name becomes largely irrelevant.

Of course, the secured party must put the correct ACN in the financing statement, otherwise the security interest will be unsearchable against the correct ACN and, as the *Fairbanx* case indicates, this may result in a seriously misleading error. Likewise, the searcher must use the correct ACN otherwise the search will not retrieve the entry. On the same basis, if the financing statement discloses the wrong grantor details (for example, the ACN instead of an ARSN), this will be a seriously misleading error. And, in the residual case where the prescribed grantor's details include the grantor's name, mistakes like the one in the *Fairbanx* case will continue to matter.

VI THE *PPSA*'S EXTENDED APPLICATION

Finally, the *Fairbanx* case is interesting because it draws attention to the expanded application of the personal property securities legislation. By and large, the statute applies only to agreements that in substance create security interests. But it also applies to some non-security agreements.[36] The application at issue in the *Fairbanx* case was the non-security assignment of accounts receivable. The governing provision is *OPPSA* section 2(b), which provides that the Act applies to the transfer of an account or chattel paper even though the transfer may not secure payment or performance of an obligation. There is a similar provision in the *PPSA*.[37] The Court in *Fairbanx* explained the reason for bringing non-security assignments under the statute by saying that the potential for third-party deception is the same whether the transaction is an outright assignment or a security assignment. This is because the assignor retains apparent control of the account even though he no longer owns it. Bringing outright assignments under the statute means that they are subject to the registration scheme and this gives third parties a mechanism for finding out about them.[38]

There are two other considerations the Court did not mention. One is historical: before the arrival of the personal property securities legislation, Ontario had legislation, similar to part IX of the then *Instruments Act 1958* (Vic), requiring registration of assignments of book debts.[39] This legislation applied to both outright and security assignments and the *PPSA* continues the policy. The other consideration is that an outright assignment of accounts on a recourse basis is functionally similar to a security assignment: in both cases, the risk of non-

36 *OPPSA* ss 2(b), (c); *PPSA* s 12(3).
37 *PPSA* s 12(3)(a).
38 *Fairbanx* (2010) 319 DLR (4th) 618, 622–3 (Feldman JA).
39 See also *Bills of Sale and Other Instruments Act 1955* (Qld).

payment by the account debtor is on the assignor.[40] Given this functional similarity, it would be strange if the *PPSA* applied in one case but not the other.[41]

While on the subject of the personal property securities legislation's extended application, its treatment of leases should be noted, even though this was not an issue in the *Fairbanx* case. *OPPSA* section 2(c) provides that the statute applies to a lease of goods for a term of more than one year even though the lease may not secure payment or performance of an obligation. There is a similar provision in the *PPSA* and *NZPPSA*.[42] Until recently, the *OPPSA* applied to a goods lease, but only if the transaction in substance secured payment or performance of an obligation. In the United States, Article 9 continues to take this approach.[43] In practice, this means the *OPPSA*, as originally drafted, applied to finance leases but not to true lease agreements. The justification for making finance leases subject to the personal property securities legislation is that a finance lease is functionally the same as a conditional sale agreement or a hire-purchase agreement. The justification for excluding true leases is that they are not in substance security agreements.[44]

The problem lies in the absence of a bright-line rule for distinguishing between a finance lease and a true lease. Over the years, the distinction generated a considerable amount of litigation.[45] To avoid this litigation, the non-Ontario provinces extended their personal property securities legislations to all lease

40 More specifically, in the case of a security assignment, the assignor bears the risk of non-payment by the account debtor because, in that case, the assignee can rely on the assignor-debtor's personal obligation to repay the loan for which the security was given. Similarly, in the case of an outright assignment with recourse, if the account debtor does not pay, the assignee can rely on the recourse provision and claim payment from the assignor: see further, Duggan and Ziegel, above n 30, 55.

41 Ibid.

42 *PPSA* s 12(3)(c) provides that, for the purposes of the statute, 'security interest' includes the interest of a lessor or bailor of goods under a PPS lease, whether or not the transaction in substance secures payment or performance of an obligation. Section 13 defines PPS lease in part to mean a lease or bailment of goods for a term of more than one year and also a motor vehicle lease for a term of 90 days or more. *NZPPSA* s 17(1)(b) provides that, for the purposes of the Act, 'security interest' includes 'a lease for a term of more than 1 year' and s 16 defines 'lease for a term of more than 1 year' to mean, in part 'a lease or bailment of goods for a term of more than 1 year'.

43 *UCC* § 9-109(a).

44 For discussion, see Duggan and Ziegel, above n 30, 55–9.

45 See Jacob S Ziegel and David L Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis* (Butterworths, 2nd ed, 2000) [2.2.3].

agreements for a term of more than one year and Ontario has now followed suit.[46] The reason for the one year cut-off rule is to exclude short-term rentals, such as the hire of a car for a weekend. The premise is that short-term rentals are typically not financing transactions whereas longer term rentals are more likely to be.[47] There is a possible alternative policy reason for bringing true leases within the scope of the statute. A true lease, in common with a finance lease, raises ostensible ownership concerns that would be addressed by the personal property securities legislation registration requirements. But if this was really the explanation, it would make no sense to limit the statute's application to leases for a term of more than one year; on this reasoning, other transactions involving separation of ownership and possession, such as trusts and bailments at large should also be subject to the statute. As it happens, both the *PPSA* and *NZPPSA* do extend beyond leases to bailments at large, provided the transaction is for a term of more than one year. This suggests that, in these jurisdictions at least, the lawmakers were attempting to address ostensible ownership concerns.[48]

The following example illustrates the main practical implication of the personal property securities legislation's application to lease agreements. Suppose a lessor sells and rents heavy equipment. A contractor wins a two-year government contract to build a new road. The contractor leases a bulldozer from the lessor for the duration of the contract at a monthly rental of $500, on the understanding that the contractor will return the bulldozer to the lessor at the end of the two years.

In a case like this, the lessor should register a financing statement. If it does not do so, it will be at risk if, for example, the contractor wrongfully sells the equipment during the term of the lease. The lessor has a security interest under sections 12 and 13 of the *PPSA*, while section 43(1) provides that a buyer of

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46 The reform implements a recommendation made by the Canadian Bar Association – Ontario in 1993 and the reason for the recommendation was, as stated in the text, to avoid litigation on the true lease/finance lease distinction: Canadian Bar Association – Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act and the Repair and Storage Liens Act* (June 1993) 3–7; for discussion, see Duggan and Ziegel, above n 30, 55–9. The reform does not eliminate the true lease/finance lease distinction completely. The distinction remains relevant in the context of the default and enforcement provisions of the statute; *OPPSA* s 57.1 provides that *OPPSA* pt V (Default – Rights and Remedies) applies to a security interest only if it secures payment or performance of an obligation. This means, among other things, that pt V applies to a lease only if it is a security lease. The reason is that the pt V provisions presuppose an underlying debt obligation and so they would be inappropriate for true lease agreements. The *PPSA* and *NZPPSA* take the same approach: *PPSA* s 109(1)(c); *NZPPSA* s 105(b)(ii).

47 See Duggan and Ziegel, above n 30, 57. In the case of a lease for a term of one year or less which, as it happens, does secure payment or performance of an obligation, the statute applies on the basis that the transaction is an actual security agreement: *OPPSA* s 2(a)(ii); *PPSA* s 12(1)(i).

48 The *PPSA* also extends to motor vehicle leases for a term of 90 days or more: s 13(1)(e). In the recent New Zealand Court of Appeal decision, *Rabobank New Zealand Limited v McAnulty* [2011] NZCA 212 (23 May 2011), the Court explained that the concept of bailment is much broader than lease, before going on to note that there is no explanation in New Zealand Law Commission, *Reform of Personal Property Security Law*, Report No 8 (1989) for extending the application of the statute to bailments at large: at [21], [22] (O'Regan P). Likewise, there is no explanation in the *PPSA* Explanatory Memorandum for the corresponding Australian approach.

personal property takes free of an unperfected security interest. Failure to perfect may also put the lessor's interest at risk if the contractor goes into bankruptcy or liquidation during the term of the lease because under section 267 of the *PPSA,* an unperfected security interest is invalid against the grantor's trustee in bankruptcy or liquidator and, in effect, the secured party is reduced to the status of an unsecured creditor in the insolvency proceedings. This issue emerged as a trap for unwary players in the early days of the *NZPPSA* and it may cause some angst in Australia as well.[49]

VII CONCLUSION

The *PPSA* is scheduled to commence in early 2012. In many respects, the statute represents a major advance on the previous law. It does away with the numerous registers for security interests at the state and federal levels and replaces them with a single national register, which will be fully electronic and capable of remote access. Furthermore, under previous law the secured party's rights against both the debtor and competing claimants frequently turned on the form of the transaction between the debtor and the secured party (mortgage, charge, pledge, hire-purchase agreement, and so on); the personal property securities legislation eliminates these formal distinctions and enacts a more or less common set of rules for all transactions, regardless of their form, that in substance create a security interest. In this respect, the reforms substantially simplify the law and place it on a more rational policy basis.[50]

The *PPSA* also improves the law in numerous, more detailed respects. For example, it replaces the floating charge and its attendant conceptual baggage with a statutory security interest which gives the secured party a fixed security interest in present and after-acquired collateral, switching to proceeds as and when the debtor disposes of the collateral in the ordinary course of business.[51] It also substantially simplifies the rules governing future advances, abolishing the equitable doctrine of tacking[52] and substituting the straightforward rule that a lender's priority for its initial advance extends to all future advances.[53] These examples can be multiplied.

On the other hand, it cannot be denied that this is a major reform and that it will take time for stakeholders to become familiar with the new regime. These transition costs might have been reduced if the *PPSA* had more closely followed the Canadian Model Act because then, at least, stakeholders would have had a

49 See, eg, *Graham v Portacom NZ Ltd* [2004] 2 NZLR 528; *Waller v New Zealand Bloodstock Ltd* [2004] 2 NZLR 549.

50 For further discussion, see Cuming, Walsh and Wood, above n 3, ch 1; Duggan and Ziegel, above n 30, ch 1; Commonwealth of Australia Standing Committee of Attorneys-General, *Options Paper: Review of the Law on Personal Property Securities* (April, 2006) <http://www.ag.gov.au/pps>.

51 For a fuller account, see Anthony Duggan, 'Some Canadian PPSA Cases and Their Implications for Australia and New Zealand' (2010) 38 *Australian Business Law Review* 161, 171–3.

52 See, eg, *West v Williams* [1899] 1 Ch 132 (CA).

53 *PPSA* s 58.

body of learning they could routinely turn to for guidance on the new laws. Even so, there are significant points of correspondence between the *PPSA* and its international counterparts so recourse to overseas case law and secondary literature is not entirely ruled out.