Legal Professional Training on Modern Secured Transactions Legal Principles

A workshop designed for Legal Professionals

04th - 05th December 2019
Multipurpose Room 2, level 3,
Ministry of Finance and Economy
Secured Transactions Order 2016

Workshops for the legal profession

Day 1

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December 2019
# Workshop outline

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## Day 1, in more detail

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*End of day 1*
Secured Transactions Order 2016

Background and context
Availability of credit is vital to economic growth

“It is well accepted that access to credit is crucial for economic growth and is the engine for private sector development”

(World Bank, Secured Transactions Systems and Collateral Registries, 2010)
An example:

Hussin is a very good baker. Some restaurants near his shop want to buy his products for their menus. To be able to supply the restaurants, however, Hussin would need to buy a portable electric oven. At the moment, he doesn’t have the money to buy one.
Ability to use assets as collateral is key

“unavailability of collateral is frequently not the problem; rather, it is the inability to utilize…assets as collateral.”

Prior law in Brunei

- Companies Act
- Bills of Sale Act
- Islamic law
- Hire-Purchase Act
- Common law and equity
Hussin again:

If Hussin can give the bank security over the new oven:

- the bank will be more prepared to make the loan; and/or
- the loan could be for a longer period, and at a lower cost.

This is good for Hussin’s business, and for the economy as a whole.
Background (cont)

And that, in a nutshell, is what the *Secured Transactions Order 2016* is all about.
Secured Transactions Order 2016

Guiding principles
Foundations of a best-practice secured transactions law

- Functional approach
- Comprehensive approach
- Unitary approach
- Clear, flexible rules
- Survive insolvency
Guiding principle #1

The “functional” approach

If a transaction achieves the same commercial effect as a security transaction, then it should be regulated as a security transaction.
Guiding principle #2

The “unitary” approach

All transactions that are security interests (under the functional approach) should be governed by the same set of rules, regardless of their technical legal form.
Some examples

Ways in which Hussin could finance the oven:

1. **Secured loan, eg from a bank**

Hussin could borrow the money from a bank, buy the oven and give the bank security over it.

This is clearly a security transaction.
2. **Hire-purchase**

Hussin could arrange for a bank to buy the oven, and to lease it to him on the basis that he can buy it from the bank at the end of the transaction.

This arrangement has the same commercial effect as a secured loan.
Some examples (cont)

3. Financial lease

Hussin could arrange for a bank to buy the oven, and to lease it to him for a term that reflects the likely useful life of the oven (e.g., 5 years). This time there’s no purchase option, but the unspoken expectation is that the bank will transfer the oven to Hussin when he pays the final rent instalment.

Again, this arrangement has the same commercial effect as a secured loan.
4. **Vendor finance – retention of title**

The vendor could finance the purchase for Hussin with finance, by agreeing that Hussin can pay for the oven in instalments. This is on condition, however, that title to the oven does not pass to Hussin until he has paid out the balance.

Again, this arrangement has the same commercial effect as a secured loan.
Some examples (cont)

**Functional approach:**
All these arrangements are security transactions.

**Unitary approach:**
They are then all regulated in the same way, as if Hussin had purchased the oven and given security over it back to the bank/vendor.
Some examples (cont)

Two key consequences:

<table>
<thead>
<tr>
<th>Hussin is treated as if he were the owner of the oven from the outset</th>
<th>Bank/lessor is treated as if it only had security over the oven</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ He can give security over it to another financier, or sell it</td>
<td>➢ The rules ignore the fact that the bank/lessor is technically the owner – within the statute, this does not matter</td>
</tr>
</tbody>
</table>
“Deemed” security interests

Some important types of transactions are commonly included as security interests, even though there’s no secured obligation:

- Operating leases
- Commercial consignments
- Outright transfers of receivables

There are a range of policy reasons why this might be done.
Guiding principle #3

Comprehensive scope

| It should not only apply to all transactions that serve a security purpose (the functional approach), but also to all assets (other than land) |

- whether tangible (e.g., motor vehicles) or intangible (e.g., receivables, rights under contracts, intellectual property)
- whether the grantor is a natural person or a company
- whether the asset is for private or business use
Guiding principle #4

Clear, flexible rules

The rules for creating and enforcing a security interest, and for regulating competitions between security interests, should be clear and internally consistent

- As far as possible, the rules for creating and enforcing a security interest should respect the principle of freedom of contract
Guiding principle #5

Security interests should survive insolvency

The law should provide that a security interest that has been created in accordance with the law can survive an insolvency of the grantor.
How does the STO score?

As we will see over the next two days, the STO scores well on all these measures (although the way in which its rules work is not always clear).
Secured Transactions Order 2016

Structure of the legislation
Legislative package has four components

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<tr>
<td>Secured Transactions (Amendment) Order, 2016</td>
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# Structure of the STO

11 Parts, 102 sections:

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<td>II - Administration</td>
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<td>III - Security agreements</td>
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<td>IV - Perfection of security agreements</td>
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<td>V - Security agreements in personal property</td>
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<td>VI - Priority between security interests</td>
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<td>VII - Special priority rules</td>
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<td>VIII - Registration</td>
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<td>VIII - Enforcement of security interests</td>
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<td>IX - General</td>
<td>85-92</td>
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<td>X - Repeals and transitional provisions</td>
<td>93-102</td>
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## Sources of the STO

<table>
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<td>Canada</td>
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<td>New Zealand</td>
<td>Personal Property Securities Act 1999</td>
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</table>
Secured Transactions Order 2016

“Security interests”
What the STO is all about

“security interests”

in

“personal property”
"security interest" means a property right in personal property that is created by agreement and secures payment or other performance of an obligation,

[regardless of whether the parties have denominated it as a security interest, and includes the right of a seller in an instalment sale or a sale with retained title, but it does not include a personal right against a guarantor or other person liable for the payment of the secured obligation;]

(Section 4(1))
“[This Order applies to] every transaction that in substance creates security interests, without regard to its form and without regard to the person who has title to the collateral,

[including -
   (i) conditional sale agreements (including agreements to sell subject to retention of title);
   (ii) hire-purchase agreements;
   (iii) consignments;
   (iv) operating and financial leases; and
   (v) outright assignments of intangibles.]”

(Section 2(1)(b))
Para (i):

conditional sale agreements (including agreements to sell subject to retention of title);

Example:

Hussin agrees to buy the oven, and takes possession. The vendor gives him time to pay the purchase price, and in return the sale agreement says that the vendor retains title to the oven until Hussin has paid for it in full.

The vendor’s retained ownership interest in the oven is treated by the STO as a security interest.
Para (ii):

hire-purchase agreements;

Example:

Hussin finances the oven through a hire-purchase financier. The financier buys the oven from the dealer, and leases it to Hussin for a 3-year lease, at the end of which Hussin has the right to buy the oven for a nominal amount.

The financier’s ownership interest in the oven is a treated by the STO as a security interest.
Para (iii):

consignments;

Example:

Rose is a successful artist. She sells her works through a gallery. The gallery does not buy her works, but displays them to prospective buyers on her behalf, and then sells them as her agent.

Rose’s ownership interest in her artworks is a treated by the STO as a security interest, with Rose as the secured creditor and the art gallery as the debtor.
Para (iv):

[operating and] financial leases;

Example:

Hussin finances the oven through a leasing company. The leasing company buys the oven from the manufacturer, and leases it to Hussin under a 5-year finance lease. The rentals over the 3 years cover the leasing company’s cost of buying the oven from the manufacturer, and its return for financing the transaction.

The leasing company’s ownership interest in the oven is treated by the STO as a security interest.
Para (iv):

operating [and financial] leases;

Example:

The Brunei Government engages a construction company to build a road through a remote region. The company rents demountable housing units from a supplier for 2 years, after which it is required to return the housing units back to the supplier. (The supplier will then rent them to somebody else.)

The supplier’s ownership interest in the housing units is a treated by the STO as a security interest.
Some examples (cont)

Para (v):

outright assignments of intangibles;

Example:

A clothing manufacturer sells its products to a number of retail outlets. It gives its buyers 60-day credit terms. In the meantime, though, it needs cash to pay its employees and suppliers, so it sells the receivables to a specialist receivables finance company.

The finance company’s ownership interest in the receivables is a treated by the STO as a security interest.
Section 2(1):

"purchase money security interest" means –

(a) a security interest taken in collateral by a seller that secures the obligation to pay any unpaid portion of the purchase price of the collateral;

(b) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;

(c) the interest of a financial lessor or a lessor of goods under a lease for a term of more than one year; or

(d) the interest of a consignor who delivers goods to a consignee under a commercial consignment,

but does not include a transaction of sale and lease back to the seller;
Broadly, security for finance that enables the debtor to acquire the asset being financed:
- vendor finance
- purchase money finance
- lease finance
- consignments

➢ Get special treatment in a priority competition with other secured creditors
Security interests - exclusions

<table>
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Secured Transactions Order 2016

Case Studies
Primaplas, a manufacturer of resin, supplied some of its resin to Gelpack, a company operating in Australia. Gelpack used the resin to manufacture plastic products. Primaplas supplied the resin on terms that Primaplas retained title to the resin until it had been paid for it. Primaplas registered a financing statement on the PPS register to perfect its interest in the resin.

Gelpack went into liquidation. Primaplas claimed that it had a perfected security interest in the resin it had supplied.
Much of the argument in the case turned on whether the retention of title clause had been validly incorporated in the agreement between the parties. (The court held that it had.) The court also needed to decide, however, whether Primaplas could lay claim to the resin on the basis that it was still the owner, or whether Primaplas had to rely on the fact that it was a secured creditor.
Did the retention-of-title clause in the supply agreement give rise to a security interest?

*In the matter of Gelpack Enterprises Pty Ltd (in liquidation) [2015]*
NSWSC 1558.
Maiden Civil was a civil construction company operating in northern Australia. In 2010 it leased a number of large Caterpillar earthmoving vehicles from a company called Queensland Excavation Services. It made regular payments of rent to QES that reflected QES’s financing costs plus a profit margin. This arrangement continued until 2012. QES did not do anything under the PPSA (such as register a financing statement on the Australian PPS Register) to perfect its interest under the leases. (We'll talk about “perfection” later.)

In 2012, Maiden Civil needed short-term finance. A finance company called Fast Financial Solutions agreed to provide the finance, on condition that Maiden Civil gave it security over all its assets. The security agreement stated that the collateral for the loan included the Caterpillars. Fast registered a financing statement on the PPS Register to perfect its security interest in the Caterpillars.

Maiden Civil defaulted under the loan from Fast. Fast sought to enforce its security by taking possession of the Caterpillars, so that it could sell them. In the meantime, Maiden Civil had defaulted under the leases as well, so QES terminated the leases for default. QES sought to re-lease the Caterpillars to another user.
The arguments

Case Study 2

QES argued that it was the owner of the Caterpillars, and that it was entitled for this reason to repossess the Caterpillars after Maiden Civil defaulted. It further argued, as it was the owner of the Caterpillars, that it was then entitled to re-lease them or otherwise deal with them as QES saw fit. QES argued that Maiden Civil was only a lessee of the Caterpillars. This meant that Maiden Civil could give security to Fast over its rights as lessee under the leases, but could not give security over the Caterpillars themselves.

Fast argued that as far as the PPSA’s rules were concerned, QES only had a security interest over the Caterpillars, despite the fact that it was the owner of them for the purposes of the general law. Fast went on to argue that this meant that Maiden Civil needed to be treated under the PPSA as if it (and not QES) were the owner. This meant in turn that Maiden Civil could also give security over the Caterpillars to Fast.

(Fast then went on to argue that QES had not taken the steps required under the PPSA to protect its security interest in the Caterpillars, and that its security interest and title were therefore ineffective as against Fast. We’ll come back to that on Day 2.)
Who is right: QES, or Fast?

*Re Maiden Civil; Albarran v Queensland Excavation Services* [2013] NSWSC 852.
Dura, a construction company, was required by a court order in Australia to pay a judgment debt to a company called Hue. Dura wanted to appeal the order. One of the court-ordered conditions for Dura being allowed to appeal was that Dura had to deposit an amount of $1m into a solicitors’ account. Under Australian law, this gave Hue an equitable charge over the funds in the account. Hue took no steps under the PPSA to perfect its interest in the funds. Shortly after, Dura went into insolvency.
The insolvency administrators argued that Hue’s interest in the $1m was a security interest under the PPSA. They said, as Hue had not perfected its security interest in accordance with the PPSA, that Hue’s interest in the funds vested in Dura when Dura went into liquidation. (This is one of the consequences under the Australian PPSA if a security interest is not perfected when the debtor goes into liquidation.) Hue argued that the PPSA didn’t apply.
The question

Who is right: Dura’s receivers, or Hue?

*Dura (Australia) Constructions v Hue Boutique Living* [2014] VSCA 326.
Secured Transactions Order 2016

“Personal property”
Personal property

Section 2(2):

"personal property" includes goods, chattel paper, documents of title, intangibles, investment securities, money and negotiable instruments;

Effectively, anything that is “property” in the eyes of the law, unless it is excluded by s 2(2) (eg interests in land)
Personal property (cont)

1. **Personal property** is divided into two overarching types:
   - goods, and
   - intangibles.

2. **Goods** is then divided into three sub-categories, for some purposes:
   - equipment,
   - inventory, and
   - consumer goods.
Personal property – “goods”

Section 2(1):

"goods" means tangible personal property

[and include farm products, inventory, equipment, consumer goods, trees that have been severed, and petroleum or minerals that have been extracted, but does not include chattel paper, document of title, negotiable instrument, investment security or money;]
Section 2(1):

“equipment” means goods that are held by a debtor other than as inventory or consumer goods;
Personal property – “inventory”

Section 2(1):

“inventory” means goods that are –

(a) held by a person for sale or lease;
(b) to be provided or have been provided under a contract for lease;
(c) raw materials or work in progress; or
(d) materials used or consumed in a business;
Personal property – “consumer goods”

Section 2(1):

“consumer goods” means goods that are used or acquired for use primarily for personal, domestic or household purpose;
Personal property – “intangibles”

Section 2(1):

"intangible" means personal property other than [everything else];
Personal property – “documents of title”

Section 2(1):

"document of title" means a writing issued by or addressed to a bailee-

(a) that covers goods in the possession of the bailee and are identified or are fungible portions of an identified mass; and

(b) in which it is stated that the goods identified in it will be delivered to -
   (i) a named person, or to a transferee of that person;
   (ii) a bearer; or
   (iii) the order of a named person;

Essentially, warehousing certificates.
Personal property – “investment securities”

Section 2(1):

Long, technical definition.
Personal property – “negotiable instruments”

Section 2(1):

Generally, reflects general law meaning
Personal property – “chattel paper”

Section 2(1):

"chattel paper" means one or more writings that evidence both a monetary obligation and a security interest in, or lease of, specific goods or specific goods and accessions;

Some issues:

- Peculiarly North American concept.
- Query relevance here.
Secured Transactions Order 2016

How to create a security interest
Section 10:

Except as otherwise provided by this Order or any other written law, a security agreement is effective according to its terms.
How to create a security interest (cont)

Section 11(1):

A security agreement is enforceable and a security interest created in respect of the collateral only if –

(a) a security agreement contains an adequate description of the collateral, which description may be generic or specific;
(b) [deleted]; and
(c) the debtor has rights in the collateral.
Description of the collateral

Section 11(2):

A description of the collateral is adequate if the collateral is described by –

(a) item, kind, type or category;
(b) a statement that a security interest is taken in all of the debtor’s present and after-acquired property; or
(c) a statement that a security interest is taken in all of the debtor’s present and after-acquired property except for specified items or kinds of personal property.
Some examples

Hussin’s van:

- “Hussin’s van”
- “2018 Toyota HiAce van, registration number 123456”
- Delivery van with vehicle identification number ABCDEF6789”.

For a corporate financing:

- “all the company’s present and after-acquired property”
- “all the company’s present and after-acquired property, except for [describe the excluded assets]”
“Rights in the collateral”

<table>
<thead>
<tr>
<th>Not defined in the STO</th>
<th>What about title-based security interests (RoT sales, HP, leases)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Ownership will always be enough</td>
<td>➢ Buyer/lessee has “rights in the collateral”, because Act treats them as if they were the owner</td>
</tr>
</tbody>
</table>
How to create a security interest (cont)

A very flexible regime

- Security agreement is effective according to its terms (s 10)
- Secured party does not need to take possession
- Security agreement can cover more than one asset
- Security agreement can cover future assets, unless consumer goods (s 14)
- Security interest will attach automatically to proceeds (s 15).
# How to create a security interest (cont)

## A few questions

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<thead>
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<th>Question</th>
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<tr>
<td>Does a security agreement need to be in writing?</td>
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<tr>
<td>Does a security agreement need to be signed by the debtor?</td>
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</table>
Secured Transactions Order 2016

How to make a security interest as robust as possible – “perfection”
Perfection

Creating a security interest will give the secured party a right *in rem* in the asset

- But:
  It may still be vulnerable to competing claims by third parties

To make a security interest as robust as possible, the secured party needs to “perfect” it
Perfection (cont)

Note: “perfected” is not the same as “perfect”!

Even a perfected security interest can be vulnerable, eg as against another perfected security interest
A security interest can be perfected in different ways at different times.

It will be “continuously perfected” (e.g., for priority purposes) as long as there is no gap.

(Section 22(2))
Perfection by possession

Reflects the most traditional method of taking security (the possessory pledge)

The fact that the secured party has possession solves the “publicity” problem, ie it can’t be a “secret” lien
Section 2(1):

"possession", in relation to a secured party, means possession of a collateral that is [not] in the actual or apparent possession or control of the debtor or the debtor's agent;

Definition does not include the word “not”, but it should. Clear drafting error.
Goods in hands of a bailee

If goods are held by a bailee (eg a warehouse) and the bailee issues a document of title for the goods, a secured party can perfect its security interest over the goods by perfecting over the document of title instead.

(Section 20)
Ahmed asks Big Bank for a loan to pay for his honeymoon.

Ahmed inherited a number of very fine antique rugs from his father some years ago. He doesn't use them at home, but keeps them in secure storage with a local carpet dealer. He offers the rugs up as security for the loan. Big Bank arranges for the dealer to issue it with a document of title that states that the dealer will deliver the carpets to Big Bank on demand.

Big Bank's possession of the document of title will perfect its security interest over the carpets.
Perfection by control

Available only for deposit accounts and investment securities

- The equivalent of possession, but for intangible assets
Section 2(1):

“control“:
- automatically, if the secured party is also the bank or financial institution that maintains the bank account or securities account (para (a)); or
- if there is a “control agreement” between the bank/financial institution, the debtor and the secured party (para (b)).
Perfection by control – some examples

Bank accounts

A farmer has some money on a long-term deposit in a bank account with Big Bank. The farmer needs a loan to expand his farm. Big Bank makes the loan, and takes security over the bank account. Big Bank’s security interest is automatically perfected, and Big Bank does not need to register.

Shares

A share investor wants a loan to buy another investment. Big Bank makes the loan, and takes security over the investor’s existing shares in a number of listed companies. Big Bank enters into a control agreement in relation to the shares with the investor and the [financial institution that maintains the securities account in which the shares are recorded?]
What happens if a security interest over collateral is perfected and the collateral produces proceeds (e.g., sold)?

- The security interest attaches to the proceeds (s 15, discussed earlier).

- If the proceeds is cash, the security interest is automatically perfected, even nothing is done to publicise it (s 16).

Will discuss proceeds in more detail tomorrow.
Available only in limited situations, eg:

- Where collateral produces proceeds other than cash – deemed perfected for up to 10 working days (s 17).

- Where the secured party is perfected by possession, and hands the collateral back for a limited purpose such as preparation for a sale – again, deemed perfected for up to 10 working days (ss 18, 19)
Temporary perfection – some examples

Proceeds other than cash

Hussin has financed his van with Big Bank. Big Bank’s financing statement describes the collateral as “Hussin’s van”. After a year, Hussin exchanges the van, without Big Bank’s consent, for a sports car.

Big Bank’s security interest will extend to the sports car, as proceeds. It will be temporarily perfected for up to 10 working days.
Security interest perfected by possession, and goods returned for sale

Ahmed has given Big Bank security over the carpets, and Big Bank has perfected by possession (via the document of title issued to it by the dealer). Ahmed now wants to sell the carpets, and Big Bank agrees to return them temporarily to Ahmed, so that he can have them cleaned ahead of the sale.

Big Bank’s security interest is no longer perfected by possession. However, it will be temporarily perfected for up to 10 working days.
Perfection by registration

The method that gets used almost all the time.

More on this tomorrow.
End of Day 1

Thank You!