Explanatory Memorandum
Personal Property Security Act

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Personal Property Security Act (PPSA)

Contents of this Explanatory Memorandum

This memorandum contains a short summary of each of the Sections of the PPSA. Examples are provided that illustrate in greater detail the workings of the Act and the relationships between overall policy goals and each Part of the Act.

Background to the Development of the PPSA

The 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 that incorporated many suggestions.

Drafting Methodology

There are various iterations of PPSAs that are used by jurisdictions around the world. The principles of the PPSA were first developed in America in the 1940s and implemented state by state in the 1950s and 1960s. Canadian provinces followed closely in the 1960s and 1970s. With the advent of electronic registries and online capabilities, the PPSA in America[1] was reformed in the early 1990s to take advantage of these technologies. This reform also updated substantive provisions of the law to account for new approaches to credit and the use of creative financial products so as to expand the scope of movable property-based lending.

Canada soon followed the USA in reforming its PPSA, with Saskatchewan being the first province to enact the new law with all others (except Ontario and Quebec) following its approach. However, being a Commonwealth country, the Canadian version of the PPSA differs from the America approach in drafting style and with regard to how some issues are addressed. Nevertheless, from a substantive perspective, the core elements of the Saskatchewan and American PPSAs are similar.

New Zealand passed its PPSA in 1999, and the Saskatchewan PPSA was the model for the New Zeland legislation. The drafters of the Australian PPSA which was passed in 2009 also relied on the Saskatchewan PPSA. In the south Pacific PPSAs have been enacted in Vanuatu, Tonga, Solomon Islands, and Samoa. These southern Pacific jurisdictions generally follow the New Zealand model, though all countries have enacted streamlined versions of the Act. The northern Pacific countries of Palau, Federated States of Micronesia and The Republic of Marshall Islands all have PPSAs but they tend to follow the American-based language. Reforms modelled on PPSA principles have been adopted in a wide range of other countries as well, including such disparate places as Cambodia, Vietnam, China, Slovakia, Romania, Palestine, Jamaica, and even Afghanistan, to name just a few. This is not some new reform: it is tried and tested in a variety of jurisdictions.

[1] The American version is called the "Secured Transactions Act" and is a matter of state, not national, law. It has been enacted in all 50 states.

The PPSA Papua New Guinea used the Saskatchewan, Canada law as its primary model. 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 PNG PPSA is not, however, a mere copy of Canadian legislation. Special circumstances in PNG frequently required drafters to add, delete, or modify provisions to fit PNG circumstances.

Explanation of Overall Reform

A Memo titled "Personal Property Security Act and Registry: Overview of Reform" dated November 2015, provides a narrative summary of the impact of the reform from an economic perspective. Researchers are encouraged to review that Memo first, then turn their attention to this Explanatory Memorandum, the contents of which focus on a legal analysis of each section of the PPSA. That document can be found on the PPSA Registry website under the "Law and Regulations" tab on the home page.

B. SUMMARY OF EACH PART & DIVISION

PART I. – PRELIMINARY

1. Compliance with Constitutional Requirements. This is a standard recitation for laws in PNG. Note that the commencement is delayed until the Minister publishes a notice in the Gazette. The intent is to make certain that the Act, the regulations and the registry all commence on the same day.

2. Interpretation. Key terms are defined where a special understanding of the terms is necessary for the purposes of the Act. 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. The definitions are crucial as any priority analysis of an issue under the PPSA begins with determining what sort of property is serving as collateral as different rules can apply based upon the collateral's classification. Thus, the definitional section is long and detailed.

Example: consider how a motor vehicle could be classified depending upon its status-in-time—

- A car sitting on a car dealer's lot for sale is "inventory."
- A car used by a construction company could be "equipment."
- A car owned by an individual is just a car.

3. Meaning of "Control" of a Deposit Account. There are instances where a secured party may obtain priority in certain collateral by exercising "possession" of the collateral. For example, 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. This Section defines what it means to have "control."

The most common situation involved deposit accounts in licences financial institutions, i.e., banks. If the secured party is the bank itself in which the account is located, then it has control under subsection (a). In all other cases, the debtor, secured party and bank can enter into an agreement under which the outside secured party has control of the account. This allows second-tier lenders to obtain "control" over an account held by a bank, an important tool for secondary lenders in financing ongoing operations of a business. This analysis should be cross-referenced with Section 65 of the Act which sets out the priority rules governing deposit accounts.

4. <u>Meaning of "Control" of Investment Property</u>. There are special rules regarding when people have control over stocks and bonds. This section defines what constitutes "control" of this type of property.

5. <u>Meaning of "Knowledge"</u>. The results of several priority rules depend on whether or not buyers and others have "knowledge" of certain facts. The PPSA states how one may determine whether individuals, partnerships, and companies have "knowledge" of a fact or an event.

6. <u>Description of Collateral in a Security Agreement or Notice</u>. Security agreements (i.e., the loan documents) and registered notices must describe the collateral. The Act provides that collateral descriptions may be general or specific. This means that a description which merely states that "all of the debtor's movable property now owned or hereafter acquired" is valid without the need to detail every individual piece of movable property. This section also introduces three specific rules for filing in the registry based upon collateral type.

i. If a specific motor vehicle is part of the collateral, its VIN should be included.

ii. If movable property that is to be attached to land is included, or consists of timber or collateral extracted from land, then the notice needs to contain a description of the land on which it is located for the lender to achieve the highest protection. Note that this provision should be cross-referenced with Section 79, which states that to achieve the highest priority protection where collateral is fixtures, timber or minerals to be extracted, then the notice filed in the registry must contain "the real property identification number" of the pertinent land.

iii. If collateral includes consumer goods, a specific description is required, such as a serial number for a refrigerator used when financing the sale of that refrigerator. The effect here is to disallow blanket charges over all of a household's domestic property to stand good for a business loan.

7. <u>Determination of Classification of Goods</u>. Some goods can be classified differently depending on the circumstances. For example, motor vehicles can be consumer goods when used by a family, equipment when used in a construction business, and inventory when held for sale at a car dealership. Priority rules vary, depending on the classification-in-time of the goods. The PPSA states that the classification of goods is determined at the time the security interest attaches to the collateral.

8. Proceeds Traceable Regardless of Fiduciary Relationship. Secured parties gain priority in both collateral and the proceeds (money or exchanged property) of the sale of collateral. Therefore, proceeds of collateral must be traceable by secured parties. There is conflict in some common law jurisdictions regarding whether proceeds are traceable when they are held by someone in trust for another. The PPSA makes clear that a trust (fiduciary) relationship does not prevent collateral from being considered traceable

9. Time of Possession of Certain Securities. 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 PPSA states how one determines the exact time of possession.

PART II. – APPLICATION OF THE ACT

10. Transactions that are Subject to this Act. The PPSA applies to traditional borrower-lender transactions. However, the Act will also apply to other transactions that have traditionally been used to create security in personal property despite not being called loans. These transactions include title retention, hire-purchase, pledge, chattel mortgage, and company charges. Note that the terminology used no longer matters: if the reality of the transaction is that movable property is used to secure payment or performance, this Act applies.

Sellers of goods sometimes retain ownership of the goods until they are paid for under the belief that the retention of ownership prevents this arrangement from being considered a use of property as collateral. This is a legal fiction in that in substance it is the same as a loan secured by collateral given: (1) a debt is owed, (2) the debtor is in control of the property, and (3) the "owner" (the creditor) has the right to reclaim the property upon default. A transaction that, in substance, provides for security in personal property is subject to the PPSA no matter the technicalities of the legal form.

For purposes of notice and priority, the PPSA also applies to the lien obtained by an "execution creditor," defined as "a person who causes or may cause personal property or fixtures to be seized under legal process to enforce a judgment or legal obligation…." This includes court judgment holders, bankruptcy trustees, taxing authorities and company liquidators.

11. Transactions that are not Subject to this Act. There are several categories of transactions and/or collateral that this law will not apply to. These include:

i. Transactions where land is used as collateral, but it does apply to an interest in fixtures (goods attached to land), timber to be cut, and minerals and petroleum once removed from the land;

ii. The creation of transfer of an interest in a Mining tenement or an oil/gas licence, but it will apply to mineral and gas once the goods are removed from the land;

iii. Loans secured by a pledge of wages, salary or superannuation fund benefits;

iv. A sale of accounts receivable as part of the sale of a business.

12. Act binds the State. The PPSA will "bind the state." This means that future governments are obligated to implement the law as enacted, unless it is amended or repealed.

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

13. Effectiveness of Security Agreement and Security Interest. The PPSA makes clear that a security agreement is effective against not only the debtor but also third parties, no matter what types of rights the debtor has in the collateral.

14. Attachment of Security Interest to Collateral and Proceeds. A security interest is enforceable when it "attaches" to the collateral. Attachment occurs: i) when the secured party gives something of value to the debtor; ii) the debtor owns or acquires rights in the collateral; and iii) the debtor has signed a security agreement or transferred possession or control of the collateral to the secured party. Attachment of the secured party's rights to the collateral allows the lender to enforce the obligation against the debtor, including seizing the collateral upon default. Later in the PPSA the related concept of "perfection" is addressed. "Perfection" is the term that marks when a secured party's superior claim in the collateral against 3rd parties arises.

15. Obligations Secured by After-Acquired Property. A security agreement may provide that it is to apply to all property then owned by the debtor and any future property acquired by the debtor. In order to resolve conflicting common law authority, a security attaches to future-acquired property even if the debtor has not set aside funds or made special arrangements for the acquisition.

Example

Lender A and Borrower have entered into a security agreement, which provides that Lender A has a security interest in all of Borrower's present and after-acquired property.

After the security agreement has been entered into, Borrower purchases a computer for the office. Lender A's security interest in Borrower's computer attaches when Borrower buys the computer.

The concept of "after-acquired property" also applies to proceeds from the sale or exchange of collateral.

Note that mere attachment of a secured party's rights in collateral is enforceable against the debtor, but may not be enough to give the secured party priority over third party claims in the collateral. To obtain priority, the secured party must also achieve "perfection" of its interest, discussed later in the PPSA. The most common method of perfection is to register a Notice in the PPSA online registry.

Example

Lender advances $5,000 to Borrower in return for a security interest in Borrower's boat and Borrower has signed a written security agreement in respect of that boat. The agreement is enforceable against

Borrower, but Lender A may not have priority over third parties given that there has been no registration (perfection).

16. Obligations to Make Future Advances. A security agreement that calls on the secured party to make future advances is enforceable even if the future advances are not made.

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

17. Secured Party's Duty to Preserve Collateral. Debtors usually have possession of collateral in modern commercial circumstances, but there are times when the secured party takes possession of collateral, including after a default by the debtor. When the secured party has possession, the secured party must take reasonable care of the property, but may charge the expenses to the debt owed. The secured party may also keep any profits related to the collateral that arise during its possession, though the parties may agree otherwise

18. Rights and Duties of Secured Party in Control of Investment Property. This section sets out special rules for when the secured party is in possession of "investment property," defined as things like stocks and futures contracts. Sometimes such property is held by third parties, such as a clearinghouse for stocks in publically-traded companies where this is no actual certificate, and rules must be set out for how a secured party acts against such collateral.

19. Duties of Secured Party in Control of Deposit Account. Sometimes a secured party will require the debtor to establish a deposit account with a bank naming the secured party as the person with control of the account, and then have all payments received by that to that debtor paid/deposited into that account. This is a way for the secured party to make sure it is paid back first before the debtor takes money from the account. The PPSA provides that when the debt is paid, the secured party with control of the account must release it back to the debtor.

20. Duties of Secured Party if Account Debtor is Notified of Assignment. A secured party may instruct people that owe the debtor money, "account debtors," to pay the secured party directly. When the debt has been paid, the secured party must notify these account debtors to stop paying the secured party and instead send future payments to the debtor.

21. Debtor's Request for Accounting or Statement of Account. The debtor is entitled, from time to time, to request the secured party to provide clarifications regarding the current status of the loan, including the payoff amount, then then-current list of collateral, and other details about the status of the secured obligation. The secured party has 14 days to respond. A debtor may make such a request once every 6 months free of charge, though of course the secured party is not obligated to charge for this service

22. Acceleration or Payment or Performance. 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. If challenged, the burden of proving that the loan is at risk is upon the secured party. For example, a company may be current on its debt

payment obligations but enter into receivership. A secured party may have grounds to accelerate the debt in this situation even though there has not yet been a default.

PART V. – PERFECTION OF SECURITY INTERESTS

23. Perfection of Security Interest. Security interests can be "perfected." A security interest is perfected when it has attached to collateral and a method of perfection has been completed. A perfected security interest is a security interest that has maximum enforceability against third parties, such as buyers of collateral and other creditors. Normally a secured party must take a positive step to achieve "perfection," and by far the most common step is to file a Notice in the PPSA registry. There are a few occasions where perfection can be achieved by other means: the secured party taking possession of the property subject to the charge, or where the PPSA grants "automatic" perfection and in such instances the secured party need not take any positive step but rather the law provides automatic protection against third party claims. These instances are detailed in the next 3 sections of the PPSA.

24. Perfection by Registration of a Notice. Filing a Notice in the PPSA registry perfects a secured party's interest as of the moment of registration. However, the PPSA provides rare instances when another means of perfection can trump a filing.

25. Perfection by Taking Possession of Collateral. A secured party may take possession of goods, money, and other types of tangible collateral to perfect its interest. In practical terms this means of perfection almost never applies to traditional lender-borrower transactions as the borrower usually needs the item for its business. However, this method can be important when dealing with instruments or documents of title.

Example

Lender A's security interest in the stream of payments to made under all of Borrower's hire purchase agreements ("chattel paper" under the Act) has attached. Lender A takes possession of the hire purchase agreements.
Lender A's security interest is perfected.

In this example, if a later lender registered an interest in all of the debtor's movable assets, Lender A would have priority over these hire-purchase agreements.

26. Perfection by Control of Deposit Accounts and Investment Property. A lender may perfect an interest in a deposit account and investment property by taking control over them. This allows a secondary lender to perfect an interest in a deposit account held with a bank so long as proper instructions are made to the bank concerning the account. It also allows a lender to perfect an interest in publically traded securities held by a brokerage house.

27. Continuity of Perfection. 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. If the secured party assigns its interest to a new secured party, that new secured party obtains the same perfection as had the old secured party. This is important if one lender acquires another.

28. Temporary Perfection. 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 for up to 7 days, after which time other provision of the Act concerning priority would apply. However, Section 49 also pertains to this situation, and it provides that a legitimate buyer acting on the collateral during this 7-day window takes the collateral free of a temporarily perfected security interest. Therefore, secured parties holding a document of title should be cautious in delivering it to their debtor.

29. Perfection of Security Interest in Goods Held by Bailee. A "baliee" is a person or party to whom goods are delivered for a purpose, such as custody or repair, without transfer of ownership. It is possible to perfect an interest in goods in this case both by registering a notice covering the goods and/or by taking possession of the document of title issued by the bailee.

Example
Lender has a security interest in Borrower's fruit, which is held in cool storage on behalf of Borrower. Lender's interest has attached and becomes perfected when Lender has registered a financing statement in respect of the fruit.

However, note that under subsection (3), perfection of an interest in the document of title covering the goods takes priority over another security interest in the goods that is perfected *after* the goods are covered by a document of title. The two lessons here are: i) lenders should perfect against the document of title when goods are held by a bailee, and the best way to do this is to take possession of the document of title; and ii) if considering making a loan secured by collateral already held by a bailee, if the debtor cannot produce a document of title, the lender should be very wary as a prior lender may have possession of it and be perfected without registration.

30. Perfection of Security Interest in Proceeds. A security interest in collateral extends to proceeds (property or money received in exchange for collateral). If the security interest is perfected, the security interest in proceeds is also perfected.

Example
Lender has a security interest in Borrower's car. Borrower sells the car without Lender's consent. Lender has a security interest in the car and in the money received by Borrower's from the sale of the car.

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.

31. Perfection of Security Interests in Supporting Obligations and Other Property Rights. Frequently, a secured party takes a security interest in receivables that are, in turn, secured by other property such as goods, promissory notes, or letters of credit. A perfected security interest in such a receivable is also a perfected security interest in the underlying item.

32. Perfection of Security Interest in Goods Returned or Repossessed. Sometimes security interests in goods are extinguished when the goods are taken away by buyers or

lessees, and the goods are then returned to the seller or lessor, who is still the debtor. The PPSA 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. Most importantly, under subsection (7), if another perfected interest arose in goods while in the possession of the buyer that other interest prevails over a lender asserting its rights under this Section 32.

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

Secured parties may encounter situations where 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. Further, 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 PPSA 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

33. 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.

Example
Lender 1 registers a financing statement in respect of Borrower's present and after-acquired property. Later, Lender 2 registers a financing statement in respect of the same collateral. Lender 1's perfected security interest has priority over Lender 2's perfected security interest in the same collateral.

34. Time of Priority of security Interests in Proceeds. The priority date for proceeds dates back to the date of registration of the notice that perfects the security interest in the original collateral.

35. Priority of Execution Creditor.

An execution creditor (judgment holder, tax authority, bankruptcy trustee or company liquidator) is treated as any other secured party: it has priority over a different security interest if the execution creditor's interest is registered by notice in the registry before the other security interest is perfected.

36. Priority in Future Advances and the Interests of Execution Creditors. 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. This means that a lender need not make a new filing (or amendment to the original filing) each time it extends a new advance. However, Subsection (3) contains one exception to this rule. If an execution creditor has filed a notice then the execution creditor gains priority over any future advances made from that date forward. So, lenders should always do a search of the online registry before extending new money under a future advance clause.

37. Priority in Future Advances and the Interests of Transferees of the Debtor. A secured party maintains its priority in collateral over any other security interest granted by its debtor before the debtor transfers the collateral to a third party under subsection (1). However, subsection (2) recognizes that collateral can be sold to third parties pursuant to an agreement *with the secured party* by which the buyer becomes the new debtor. In such cases, the secured party must file an amendment to its Notice within seven days of the transfer naming the buyer as the new debtor in order to maintain its priority in any future advances. Subsection (3) notes that subsection (2) does not apply to situations where the buyer is a "buyer in the ordinary course" and thus takes free of the security interest.

38. Agreement to Subordinate Priority. 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.

Division 2 – Priority of Purchase-Money Security Interests

A "purchase-money security interest" (PMSI) 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, if a construction company borrows money to purchase a bulldozer and the lender takes a security interest in that bulldozer, then a PMSI has been created. In general, the PMSI interest will take priority over a prior charge by another lender even if that prior charge was over "all the debtor's equipment now owned or later acquired." Why? There are two main justifications for this "super-priority" status. The first is that as new money is being provided to the debtor for new property, any prior lender would not have relied on this new property serving as collateral when it made its loan. Therefore, the old lender is not put at a material disadvantage. The second reason is that this rule allows debtors to shop around for lower interest rates when they need new financing for new capital expenditures. Without such a rule, debtors would be at the mercy of their existing lenders. Therefore, this rule promotes the free-flow of commerce at a macro-economic level.

39. Meaning of "Possession" in this Division. This section states that when goods are being shipped by a common carrier to the debtor, the debtor does not obtain possession until the debtor (or its agent) actually obtains physical possession itself of the goods or a document of title representing the goods. This is important as there are certain timeframes within which filings must occur, and the clock starts ticking once the debtor obtains "possession."

40. Status of Purchase-Money Security Interest. A PMSI has special priority 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.

41. General Rules on Priority of Purchase-Money Security Interests. 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. Why? The reason for this "super-priority" is to promote financing of goods such as equipment and livestock.

Example
Lender has a perfected security interest in all of Borrower's present and after-acquired property. Borrower buys a bulldozer on hire purchase from Seller, and Seller finances the deal. Seller registers a financing statement in respect of the bulldozer 7 days after Borrower took possession of the bulldozer.
Seller's security interest in the bulldozer has priority over Lender's prior general security interest in all of Borrower's property.

The super-priority in Section 41 applies to goods other than inventory, which is discussed in Section 42.

42. Priority of Purchase-Money Security Interests in Inventory. As to inventory, the same general rule applies, that a PMSI transaction can gain priority over a pre-existing general security interest. However, Section 42 requires the PMSI secured party to provide written notice of its PMSI interest to the pre-existing 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 that a new super-priority in some inventory has been created.

43. Conflicting Purchase-Money Security Interests. If there are multiple PMSIs over the same collateral, the PMSI granted for the purchase price has priority over any granted to allows the debtor to merely use the collateral. Otherwise, the general rule of "first to file" under Section 33 wins.

44. Priority of Purchase-Money Security Interests Against Execution Creditors. In general, perfected PMSIs also have prior over the interests of execution creditors if filed within 7 days after the debtor obtains possession of the particular collateral subject to the PMSI.

Division 3 – Buyers and Other Transferees of Collateral

45. Special Terms Used in this Division. This section defines certain terms, such as "ordinary course of business" and "seller or lessor."

46. When Transferee takes Collateral Free of a Security Interest. The general rule is that people take collateral subject to any security interest in the collateral. 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 may repossess it from Buyer if Debtor does not pay off the debt. This is justified in that buyers can protect themselves by checking the registry to determine the existence of a prior, perfected security interests.

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.

Example
Lender has a security interest in person Borrower's car. Borrower sells the car to Buyer, and Buyer acquires the car before Lender registers a financing statement in respect of the car.
Buyer takes the car free of Lender's security interest

There are important exceptions to this general rule which are discussed in different sections in the PPSA. One of the most important exceptions is found in Section 47, "Buyer or Lessee in the Ordinary Course of Business."

47. Buyer or Lessee in the Ordinary Course of Business. An example will best illustrate this exception. Assume a lender has a security interest in all of the inventory of a hardware store. Obviously the store is selling inventory each day. Buyers of that inventory, the customers of the store, take their goods free of the security interest as these goods were purchased "in the ordinary course of business." In this case, the lender's security interest in the inventory automatically converts to a security interest in the proceeds of the sales, in other words, the cash. This allows commerce to flow without any interruption.

48. Buyer of Lessee of Consumer Goods. A buyer of consumer goods (or goods used in farming) takes the goods free of a perfected security interest, unless the purchase price is higher than PGK 5,000. The net macro-economic effect of this rule is to disallow householders from effectively pledging household assets to stand good for a business loan. If a business loan lender took a general pledge of "all household assets" that pledge would not grant the business loan lender priority over third party buyers of the household assets. However, PMSI financiers of household goods may retain priority in the good acquired with the PMSI funds if the good acquired with the PMSI funds exceeds a K5,000 purchase price.

49. Buyer or Lessee of Goods Subject to Temporarily Perfected Security Interests or which are Returned. Sections 28(1), 30(3), and 32(4) contain rules where a lender is "temporarily perfected." For example, 30(3) says that where a good is subject to a security interest and that good is sold, the security interest attaches to the proceeds of the sale for 14 days, after which the security interest in the proceeds lapses unless the lender takes some affirmative action. This Section 49 then addresses a potential conflict between the secured party that is temporarily perfected and a buyer during the period of temporary perfection. The rule states that the buyer's claim in the good will defeat the temporarily perfected secured party if the buyer i) gave value for the collateral and ii) obtained to collateral without knowledge of the security interest.

50. Buyer or Lessee of Serial Numbered Vehicles. There is a special rule for automobiles. In order to have maximum priority in a motor vehicle, then the serial number (also commonly known as the VIN, or chassis number) must be entered into the registry, otherwise a third party will take the car free of a security interest. For example, suppose a Buyer wants to buy an automobile advertised by a Seller in the newspaper. The Buyer should find the serial number of the car and search the registry for that serial number. If the serial number is not found in the registry, the Buyer will be sure that they can purchase the auto without fear that it is subject to a security interest. The registry will have a specific search field for serial numbers making it very easy to determine if a vehicle has a charge over it. Searches are free.

Further Discussion of "serial number" and "buyer in the ordinary course" rule

Suppose a lender is financing a car dealership. It would be very difficult for a lender to constantly update its Notice to include the serial number for every car that comes on the lot. In this case, the cars on the lot are "inventory." When the dealer sells these cars the transaction is "in the ordinary course of business" and the buyer's take free of the security interest. Here, the lender's charge automatically attaches to the proceeds of the sale.

51. Buyer or Lessee of Minerals, Petroleum, and Timber. A buyer of minerals or timber (after extracted or severed) in the ordinary course of business also takes free of any encumbrance on the land from which the goods were extracted or severed. Mortgage holders that also seek to have a charge over minerals, petroleum or timber after they have been extracted or harvested can easily protect their interest by simply making a filing in the PPSA registry.

52. Buyer, Lessee of Mortgagee of Fixtures. 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. The PPSA registry contains a specific field in which to enter the Volume and Folio number of the land to which the fixture is attached.

53. Priority where Liens Arise upon Furnishing of Materials or Services.

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 tractor repair shop has possession of the tractor, it has an automatic lien on the tractor it holds to secure payment for repair services, and that lien has priority over any other security interest in the tractor.

Example

Lender has a perfected security interest in Borrower's car. Borrower takes the car to a garage for repairs. The garage repairs the car but keeps possession of it until the garage receives payment for those repairs.

The garage's lien has priority over person A's security interest

54. Rights of Debtor to Transfer Interests in Collateral. This provision makes clear that debtors are permitted to sell collateral even if the security agreement prohibits it. The buyer would take the collateral subject to the perfected security interest, and the debtor may be liable for a breach of contract claim, but the sale is still valid.

Division 4 – Persons to Whom Negotiable Collateral is Transferred

There are special rules for "negotiable" collateral, which is collateral that is very liquid, like cash, or which is transferable by endorsement, such as a share certificate or a document of title.

55. Priority of Holder of Money that is Proceeds. This section 55 pertains to cash

proceeds from the sale of collateral. It resolves a potential dispute between a secured party that has rights in proceeds from the sale of collateral and a third-party that obtains the cash through its own transaction with the debtor.

> **Example**
> Lender has a perfected security interest in a cars held by a car dealer as inventory. Dealer sells a car. Lender has a perfected security interest in the cash proceeds from the sale of the car. Dealer now uses some of the cash proceeds from the sale of the car to buy an office computer from Seller.
>
> Seller takes the money free of Lender's security interest in the money.

In this case the inventory lender can protect itself by making the car dealer deposit all cash proceeds at the end of each day into a deposit account controlled by the lender. The lender can monitor this account to make sure deposits are consistent.

56. Priority of Creditors Who Receive Funds Subject to a Security Interest. The same rule stated immediately above in Section 55 with regard to cash also applies to cheques and other payment mechanisms.

> **Example**
> Lender has a perfected security interest in a cars held by a car dealer as inventory. Lender sell a car and deposits the cash proceeds into a deposit account. The car dealer draws a cheque and pays an unsecured creditor.
>
> The unsecured creditor's interest in the cheque has priority over Lender's security interest in the cheque.

57. Priority of Purchasers of Instruments or Securities. In some rare cases possession of certain types of collateral can trump a prior registered notice. Section 57 states that for instruments and for securities possession of the collateral is required to achieve maximum priority protection.

> **Example**
> Lender 1 has registered a financing statement in respect of all of Borrower's shares in a company. Lender 2 also takes a security interest in all of Borrower's shares, but does not know about Lender 1's security interest. Lender 2 perfects its security interest by taking possession of Borrower's share certificates.
>
> Lender 2's security interest in Borrower's shares has priority over Lender 1's prior registered security interest in the same shares.

58. Priority of Holders of Negotiable Documents of Title. This section repeats the same rule set forth in Section 56 and 57, but applies it to documents of title.

> **Example**
> Lender has registered a financing statement in respect of person Borrower's document of title to fruit held in a refrigerated warehouse. Borrower sells the fruit to Buyer who takes possession of the document of title to the fruit without knowledge of Lender's perfected-by-registration security interest in the document of title.
>
> Buyer's interest in the document of title has priority over Lender's perfected security interest in the same document of title.

59. Priority of Purchasers of Chattel Paper. This section basically mirrors the same

rule set forth in Sections 56-58, but applies it to chattel paper (writings that evidence both a monetary obligation and a security interest in specific goods).

> **Example**
> Lender has registered a financing statement in respect of a car dealer's inventory. Car dealer sells a car to Buyer under a hire purchase agreement, which is chattel paper. Car dealer then sells the hire-purchase agreement to a regular dealer in the secondary market, Paper Purchaser.
>
> Paper Purchaser's security interest in the hire purchase agreement has priority over Lender's security interest in the same agreement as proceeds of inventory.

The lesson here is that if a secured party is financing inventory that is sold via dealer financing, the secured party should take steps to take physical possession of any paper each day. As an alternative, in some cases in other jurisdictions the secured party has required the dealer to use a hire-purchase form that clearly shows the secured party's interest stamped on it so that a secondary purchaser cannot claim it acquired the paper without knowledge.

Division 5 – Assignments and Other Transfers of Accounts

An account debtor is a person who owes payment on an account, and that account may be assigned or otherwise pledged as collateral by a debtor to a secured party. For example, suppose Bank has a security interest in Dealer's inventory 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.

As will be seen later in this EM, when the debtor goes into default the secured party may direct the account debtor to pay it directly, bypassing the debtor. In anticipation of this, the following provisions detail the relationship between the three parties.

60. <u>Applicability of this Division</u>. The term "assignee" as used in this Division 5 includes a secured party.

61. <u>Notice to Account Debtor</u>. Under this Section it is unnecessary to notify an account debtor of an assignment, 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. There are special rules under subsection (2) regarding payment arrangements where the collateral is an intangible or chattel paper. Basically, an account debtor who is making payments to their seller is to continue to do so until a notice is delivered to them to pay the secured party.

62. <u>Account Debtor's Right to Assert Defenses and Claims</u>. An account debtor continues to enjoy its rights under an account, even though it has been assigned. So, regardless of any assignment or pledge of the payment right, the underlying contract between the Dealer and the Customer remains in place. Thus, in the example above, the Customer retains its right to assert any contract claims against the Dealer arising out of the substance of the underlying sale even if the payment right has been transferred to a secured party. One such situation could be that if it turns out the item sold is defective and it is returned for a refund, then the Customer will no longer be an account debtor and the Bank can't collect any payments from it.

63. Modified or Substituted Contracts Effective Against Assignee. The ability of account debtors and assignors to modify existing contracts can be important, especially in the case of government contracts and other complex contractual arrangements (like construction contracts). Good faith modifications to the contract between the assignor/debtor and an account debtor—the original parties to the contact—are generally enforceable against the secured party that has been assigned payment rights under the contract.

64. Enforceability of Non-Assignment Clauses. Suppose Bank has a security interest in Dealer's accounts receivables, where 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/assignor, and Customers are account debtors.

In order to promote the free assignability of accounts, and thereby promote cash flow financing, an agreement between the Dealer and the Customer that restricts the assignment of accounts is generally unenforceable. Thus, this Section 64 is intended to protect the Bank that has received the assignment of the account. Even if the Customer had a provision in its contract with Debtor that prohibited Debtor from assigning the account to the Bank, that provision would be unenforceable against the Bank under (b). Thus, the Customer would have to pay the Bank in the event the Debtor defaults and the Bank instructs the Customer to pay the Bank directly.

Division 6 – Priority in Deposit Accounts and Investment Property

65. Priority of Security Interests in Deposit Accounts Perfected by Control. 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. What constitutes "control" is defined earlier in the Act in Section 3.

Under (1), 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. Further, under (2), multiple security interests in accounts that are perfected by control have priority according to the date control was achieved. Under (3) and (4), the institution that holds the account (the bank) has priority over other secured parties, unless the other secured party controls the account by becoming a signatory on the account (i.e., becomes the bank's customer with respect to the account).

66. Effectiveness of Right of Recoupment or Set-Off Against Deposit Account. 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.

67. Priority of Security Interests in Investment Property. Security interests in stocks and bonds may also be perfected by registration or control. However, a security interest perfected by control has priority over a security interest perfected by registration. Further, where a share is evidenced by a certificate, then possession of the certificate trumps perfection by control.

Division 7 – Priority in Special Classes of Tangible Collateral Fixtures

68. Priority of Security Interests in 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 PPSA 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 in the PPSA:

- 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. [§67(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. However, if at the time Dealer sold the generator the building was under construction financed via a construction mortgage, Dealer would not have priority.

69. Secured Party's Right to Remove Fixtures. If a secured party has priority in a fixture, the secured party may remove the fixture upon default, subject to appropriate court orders. The secured party must exercise this right in a manner that minimizes harm to the land. Under subsection (2) the secured party must reimburse the land mortgage holder for any damage caused by the removal, but not for the loss of value to the land interest caused by the absence of the fixture. Under subsection (3) the land interest holder may require that the secured party give "adequate security" for reimbursement for damages before removing the fixture.

70. Application to Court. This section allows a secured party to bring a court action to enforce its right to remove fixtures. The court is empowered to make such orders as deemed appropriate to address any issues that arise, including granting access to the land.

71. Retention of Fixtures by a Person with an Interest in Related Land. A mortgage holder may pay the secured party and retain the fixtures on the land. The amount to be paid is the lesser of the amount of the debt secured by the fixtures, or the fair market value of the fixtures if removed.

72. Priority of Security Interests in Crops. The Act provides that a perfected security interest in crops has priority over a conflicting interest of a person with an interest in the land, even if the land interest arose prior to the STA crop interest. The PPSA 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.

73. Priority of Security Interest in Accessions. An "accession" is a good that become fixed to other goods, while retaining its original identity. For example, a motor is an accession when installed on a boat because even though fixed to the boat, the motor retains its original identity. Under the PPSA, a security interest in an accession continues in the goods after they become an accession.

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 an auto that eventually needs a new engine, and Lender #2 finances a new engine by taking a purchase-security interest in the engine. Lender #2 would have priority in the engine over the interest of Lender #1.

Example 1
Lender has a security interest in person Borrower's car. Engine dealer sells a replacement motor to Borrower and registers its interest in the motor. The motor is subsequently installed in Borrower's car.

Engine dealer's security interest in the motor has priority over a claim to the motor made by Lender.

Example 2
Engine dealer sells a motor to Owner under a retention of title agreement, but fails to register their interest in the STA registry. The motor is installed in Owner's car. Lender later takes a security interest in Owner's car and perfects its security interest by registering.

Lender's perfected security interest in Owner's car, including the motor, has priority over dealer's security interest in the motor.

Subsections (6)-(9) set out the rules for how a secured party with an interest in an accession may proceed in the event of a default.

74. Priority of Security Interests in 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 others.

Under (1), and 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.

Example
Lender has registered a financing statement in respect of all of Baker's sugar. Baker's sugar is subsequently combined with other ingredients to become ice cream.

Lender's perfected security interest continues in the ice cream.

With certain provisos, in the case of separate security interests in goods that become commingled, the priority of each security interests is shared with others in the proportion that the secured obligation bears to the sum of obligations secured by all security interests. [§73(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. [§73(6)]

75. Priority of Security Interests in Certain 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.

PART VII. – REGISTRATION

76. Personal Property Security Registry Established. An online, fully electronic registry is established by this section. The registry receives notices of security interests and the interests of execution creditors (such as judgment holders, bankruptcy trustees, and liquidators). Filers submit their own filings online which are fed directly to the database, meaning, the Registrar does not review the notices for accuracy or completeness. Filers control their own destiny. All information entered into the registry is public information and may be searched. Searches are free.

77. Regulations. Regulations set out the filing fees and other administrative matters, including how to become a registered used of the system so as to be able to make filings. The registration process amounts to providing biographical information sufficient to identify the party that will be dealing with the Registry. There is no fee to register as a client of the Registry.

78. Notice of the Interest of an Execution Creditor.

Various persons can be an "execution creditor," including anyone who may seize personal property under legal process to enforce a judgment or legal obligation, a holder of a landlord's lien, a bankruptcy trustee and a liquidator. These parties are subject to the PPSA with regard to priority claims in collateral and therefore may cause a Notice to be filed in the Registry to secure their priority position in the affected property as of the date of filing.

Under subsection (b) an execution creditor may request the court to file the Notice on its behalf. Note that the PPSA Notice can be filed no earlier than the time of entry of a money judgment or the filing of a petition in bankruptcy or insolvency.

79. Initial Notice. This section tells what must be included on an initial filed notice to make it legally sufficient. The information required is not voluminous: i) debtor name and address; ii) secured party name and address; iii) a description of the collateral. No information concerning the underlying loan amount, payment terms, credit rating of the borrower, etc. are to be included in the filing.

If the notice covers fixtures, timber or minerals to be extracted from the land, the real estate identification number of the land is required to give the secured party the highest level of priority protection.

80. Notice Prior to Security Agreement or Attachment. Notices may be registered prior to the conclusion of a security agreement. This allows a lender to make certain it has priority in collateral by registering a notice both prior to disbursing funds and even prior to the debtor obtaining the collateral.

81. Notice May Apply to Multiple Agreements. A notice may relate to one or more security agreements.

82. Notice is Effective Unless Seriously Misleading. 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.

83. Name of the Debtor. It is absolutely critical the debtor's name be entered correctly into the register, for this is the key data under which future searchers can determine if a particular person has already pledged their collateral. The failure to enter the proper name of the debtor—with no typing errors—will render it "seriously misleading" under Section 82 and jeopardize priority.

The PPSA sets out standards for what name to use depending upon whether a debtor is a citizen of Papua New Guinea, a foreign national, or a registered business entity (like a company). For PNG citizens, the notice must contain "the name of the individual." For individuals that are not citizens, then the name shown on the person's passport. For business entities registered with the Company Registrar (such as companies, associations, and business groups) then their registration number.

Subsection (3) makes clear that a trade name of a debtor, such as a d/b/a, or other alias, is insufficient. Therefore, if the debtor is operating under a "Business Name" registration, it is imperative that the owner(s) of the business name be listed on the Notice as the "debtor(s)" and not just the business name itself. The business name can be included, but not standing alone.

Subsection (4) states that a filing may have more than one debtor. Subsection (5) authorises parties such as lawyers and accountants to file on behalf of their clients.

84. Effect of Change of Circumstances. Debtors sometimes change their names. The general rule is that 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 will continue to be effective if the secured party, within this four month window, amends the notice to correct the debtor's name.

Note that if the debtor is a business entity registered with the Company Registrar in PNG then the registration number is the debtor identifier. Given that this registration number does not change, then even if there is a change in the "name" of such a debtor the notice will not be rendered misleading.

85. Duration of Notice and Effect of Lapse. When filing a Notice, the secured party may select how long it is to remain effective. If a loan is to be repaid within 2 years, then the filer should select an effective duration of 2 years. A notice remains effective for the period within which the filer has selected. However, if the debt has not been repaid, the secured party may file a continuation to extend the effectiveness of the notice.

If the filings lapses, then the secured party loses its "perfection" (highest priority) in the collateral. If the security interest lapses it is deemed never to have been perfected.

86. Amendment of Notice. Situations change over time, and often a filed Notice needs to be amended to keep up with current events. This section sets forth the procedure for making amendments such as address and name changes, and releases of specific collateral in

the event it is sold. Note that under subsection (6) any amendment that adds collateral or adds a debtor is only effective as to that new collateral or new debtor from the date of the amendment.

Amendments do not extend the effective duration of a notice beyond the initial 5-year term. To accomplish this a "continuation" must be filed under Section 87.

87. Continuation of Notice. Six months prior to lapse of the initial term the secured party may extend the Notice. The time period for all such extensions is set to 5 years. If there are multiple secured parties the continuation is only effective with regard to the secured party that filed it. So, each secured party should file its own continuation. If no continuation is filed the notice lapses.

88. Termination of Notice. Once a debt is paid the secured party should terminate the notice so as to "clean up" the debtor's record. A notice may easily be terminated and there will be no fee for doing so. Under subsection (2) a secured party must terminate a notice if there is no further secured obligation and the debtor makes a written demand upon the secured party to do so.

89. Effectiveness of Notice. Any notice filed in the registry is effective as of the moment it is available to public searchers. Given that the registry is fully online, once the filer submits the notice it is added to the database in a few short seconds (dependent only upon internet speed).

90. Registrar's Refusal to Register a Notice. This section sets forth the criteria under which a notice can be rejected, including such things as the failure to name a debtor, the failure to name any collateral, and the failure to pay the filing fee. As a practical matter, given that the registry is online only, the software system will manage these rejection reasons in a manner that immediately alerts the filer if there is a problem so that it can be corrected on the spot. Note, however, that the software does not perform a substantive check on things like proper spellings or other data entry errors: it is up to the filer to review their own work.

91. Effect of Secured Party's Notice on Other Secured Parties on the Notice. If there are multiple secured parties on one notice, each secured party is free to submit its own amendments, continuation and terminations, and each such filing is legally effective only as to the secured party that filed it.

92. Duties of the Registrar. This section relates to the duty of the Registrar to properly operate the online registry. It also makes clear that the Registrar's duties are administrative only: the Registrar does not undertake a substantive review filings for accuracy.

93. Public Access to Registry Records. All information on all notices (and subsequent amendments) is a public record and available to searchers for free. If required for court, a certified search result can be produced for a fee to be set by regulations. A certified search result may be introduced into evidence in the courts without the need for other evidence as to its authenticity (such as requiring the Registrar to appear).

94. Notice Does Not Constitute Constructive Notice. 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. This requires some explanation as it seems

counter-intuitive given the emphasis placed on filing in the registry.

The bright line rule should be that the first person to file a notice in the registry obtains priority, end of discussion. Under this rule, there is no question of whether a particular notice did or did not constitute “constructive notice” to the world: the mere fact of making the filing secures the lender’s position.

Compare this certain result with an alternative that includes a “constructive notice” concept in the Act. The term “constructive notice” is a judicial doctrine and therefore falls under the power of a court to interpret as to whether the notice given is sufficient. Thus, if the Act included a concept of “constructive notice” then that would give a court more room to apply its own rules of interpretation. This can lead to uncertainty in the commercial world.

Clever lawyers in other jurisdictions trying to fight this bright line rule on behalf of an unsecured creditor have tried to attack it on the grounds that the filed notice was defective in some way. The unsecured creditor will argue to the judge (in expensive litigation) that secured creditor’s notice contained some little mistake (such as the notice’s collateral description isn’t specific enough, or that the notice failed to give the debtor’s right address, etc.). This is where the concern over including a judicial doctrine enters, because judges have power to grant exceptions to judicial doctrine, including the doctrine of constructive notice. Judges could be persuaded to grant an exception, saying that while notices constitute constructive notice, “in this particular case with these parties and facts, the unsecured creditor was misled.”

In short, if notices are considered to be constructive notice, litigation will be more likely in any situation where two creditors compete for collateral. It only takes one adverse ruling to undermine the certainty otherwise found in a secured transaction act. Good law says: “If you file a notice with the minimal information, you have priority, regardless of the quality of constructive notice.”

Both New Zealand and Canadian law contain this exact same text. In both countries, registration of a financing statement in the registry is not constructive notice or knowledge of its existence or contents to any person. While U.S. law is not explicit on the subject, the official commentary accompanying the text is that filing is not constructive notice

PART VIII. – ENFORCEMENT OF SECURITY INTERESTS

General

The PPSA contains its own enforcement mechanisms. In general, after a default by the debtor, the secured party is allowed to seize the collateral, sell it, and apply the sale proceeds to the debt. There are numerous rules around how this works in practice that are set out in the following sections, including allowing the secured party to act against certain collateral types without first having to obtain court permission.

This Part also includes provisions to protect debtors that find themselves in difficult times by giving them a means to buy-back their seized collateral before it is sold to 3rd parties. There are also remedies set forth for when a secured party violates its obligations under the law.

95. Application of this Part. 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. Other laws and/or procedures already in place are better suited for these situations. Under subparagraph (c) a secured party may pursue any or all rights under the PPSA simultaneously or in any order.

96. Scope or Rights and Remedies upon Default. 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.

97. Collection Right of Secured Party. Upon default, certain types of collateral may be acted upon by the secured party without the need for prior court approval. With respect to accounts that are collateral, the secured party may collect the 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. If collateral is a license, the secured party may seize the collateral and obtain value by re-licencing the collateral.

98. Secured Party's Right to 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 the goods are such that they cannot be readily moved, the secured party may take control of goods at the debtor's premises and later conduct a sale there. 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.

99. Manner of disposal of collateral. The sale or other disposal of the collateral may be by private sale, public sale, or auction, in whole or in part, or by lease or credit sale or other commercially reasonable means. The sale may also be delayed so as to gain a better price. Under subsection (2), the collateral may be sold "as-is" or after repair or preparation, in which case the expense of the repairs or preparation are added to the debt. As will be seen later in Section 102, the secured party may purchase the collateral at a public sale.

100. Duty to Act in a Commercially Reasonable Manner. 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.

101. Obligation to Give Notice of Disposition of Collateral. The secured party must provide notice of disposition, 20 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. Subsection (2) sets out what is required to be in the notice. Subsection (4) states that this prior notice is not required where collateral is perishable, in imminent danger of decline in value, where it is sold in an organized market that handles large volumes of transactions, or under other circumstances that make notice impracticable or unreasonable.

102. Secured Party May Purchase Collateral at Public Sale. The secured party may purchase the collateral, if the sale is a public sale and the purchase price is reasonable.

103. Rights of Purchasers of Collateral. It is imperative that purchasers of collateral that has been seized obtain clear title else they would not bid on it. This section provides that a purchaser of the collateral takes free of any interest of the debtor or any other person with an interest that was junior to the foreclosing secured party. A person with a security interest second-in-line to the foreclosing creditor can protect its interest by purchasing at the sale, thus stepping into the shoes of the senior secured creditor.

104. Secured Party's Disposition of a Licence. If the collateral is a licence, the secured party may only act in accordance with the licence terms.

105. Surplus or Deficiency. Proceeds from the disposition of collateral are applied first to the secured debt and the expenses of enforcement. Any surplus then goes to persons with subordinate interests in the collateral if such person has filed a Notice or otherwise has a properly documented claim on the collateral. Any remainder is paid to the Debtor. If there is a deficiency, the debtor remains liable for that deficiency – the difference between the secured debt and the proceeds of the sale of the collateral. Under subparagraph (2) the secured party must provide the debtor and subordinate creditors with an accounting of the sale within 30 days after receipt of a request for an accounting. If there is any question as to who should receive proceeds of the sale, the secured party may pay the amount into the court and any person alleging a right to the money may submit an application to the court under Section 109.

106. Secured Party's Right to Retain Collateral. The secured party may propose retain the collateral in satisfaction of the secured obligation. The secured party must give notice of this proposal to the debtor and other qualified interested persons. If no objection is received within 14 days, then the secured party may proceed to keep the collateral. If an objection is made, then the secured party may either proceed per the normal procedure in accordance with Sections 99-102, or may challenge the objection under subparagraph (6), in which case the court would sanction a plan for the secured party to retain the collateral.

107. Debtor's right to redeem collateral. This Section allows a debtor to redeem—buy back—collateral that has been seized by a secured party prior to it being sold by the secured party. This right to redeem extends to other persons so that junior creditors or other secured parties of record may also buy back the collateral. The amount that must be paid is the amount of the debt plus any expenses incurred by the secured party in seizing the collateral

108. 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. This section provides that a secured party that must enforce mortgage rights may do so without limiting its rights to pursue any other personal property that secured the obligation.

109. Applications to the Court. Courts may issue appropriate orders to enforce rights of the secured party, the debtor, and in certain cases other interested parties under the PPSA.

110. 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, under subparagraph (8) the court may issue various orders governing the receivership.

111. Manner of Notification to Debtors, Secured Parties, and Other Persons. In some places the PPSA calls for a notice to be sent to various parties. This section details how notice is to be delivered depending upon whether the party to be notified is an individual or a corporate entity.

PART IX. – CONFLICT OF LAWS

Collateral and debtors may move from one jurisdiction to another, and rules are required to account for this movement. This Part sets out such rules. These rules are closely aligned with the law of New Zealand and similar language has been used in Australia.

112. When Papua New Guinea Law Applies. 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. If the collateral is investment property that is not in the form of a certificate, then the law of the location where the clearing house or securities depository is located governs.

113. Continuity of Perfection Where Goods are Moved to Papua New Guinea. If goods are outside of Papua New Guinea when a security interest in them is perfected under the law of another country, and the goods are then brought to PNG, the security interest may be deemed “continuously perfected” under the PNG PPSA under certain circumstances.

114. Temporary Perfection of Security Interest in Collateral Moved to Papua New Guinea. 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 relocation. Of course, this is not a 100% guarantee that the secured party will be able to seize the collateral as the law of the other jurisdiction might prove problematic and the collateral will be located there.

115. Location of the Debtor. This section determines how the home jurisdiction of a debtor is determined for purposes of Sections 116-119. For corporate debtors it is the country of incorporation.

116. Validity and Perfection of Security Interests in Intangibles and Certain Goods. If the collateral is an intangible or goods that are normally used in more than one jurisdiction, then the law of the jurisdiction where the debtor is located applies.

117. Position Where Debtor Relocates. If a perfected security interest exists in collateral located in PNG and the debtor relocates to another country, the security interest will continue to be perfected for up to 60 days from the relocation under the law of PNG or 14 days after the day when the secured party learns of the move. Of course, this is not a 100% guarantee that the secured party will be able to seize the collateral as the law of the other jurisdiction might prove problematic and the collateral will be located there.

118. Priority where there is no Public Record of a Perfected Security Interest. This section addresses the situation where the law of another jurisdiction where collateral is located has no PPSA-like registry. 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 collateral situated in PNG.

119. Perfection of Security Interest in As-Extracted Collateral. 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 PNG PPSA.

PART X. – TRANSITION PROVISIONS

Overview. 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). The PPSA establishes transition rules governing the changeover period between existing law and the new regime under the PPSA. There will be literally thousands of pre-existing transactions that will now fall within the PPSA, and those existing transactions must be filed in the PPSA registry in a fair way so as not to prejudice the rights of the parties to these earlier transactions.

119[2]. Transitional. The general rules is that if a secured party in a prior secured transaction files a Notice within the transition period, that Notice will continue the lender's priority in the collateral as it stands under pre-existing law. In other words, *the new PPSA will not affect priority of prior transactions so long as they are filed within the transaction period*. This is proper: it would be unfair to pass a law today that adversely affects anyone related to a transaction made in the past. If the Notice is filed after the transition period ends, priority will date from the date of filing under the PPSA. Finally, if a Notice of a prior transaction is not filed under the PPSA, it will be considered to not have priority against a security interest that has been filed within the transition period.

Example

> Assume the transition period begins January 1, 2016, and extends for six months. Borrower approaches Bank 1 on February 1 seeking new money. Bank 1 conducts a search of the PPSA registry and does not find any evidence of prior charges being filed against Borrower, and thus provides money to Borrower. Later, on March 1, Bank 2 files a notice of a prior security interest against this same Borrower.
>
> Bank 2 would have priority in Borrower's collateral as Bank 2's priority is adjudged under pre-existing law, one that pre-dates Bank 1's new loan.

Importantly, note that it is still possible to lend during the transition period using PMSI financing as the PMSI rules in the PPSA allow new value given for the purchase price of goods to achieve priority over pre-existing charges.

120. Repeal. The Instruments Act and the Hire-Purchase Act are repealed. Note that in accompanying legislation the provisions of the Companies Act pertaining to Company Charges are also repealed upon commencement.

[2] Note that the final PPSA appears to have a mis-numbered section. Normally, this would be Section 120.