

**THE PROPOSED COMMONWEALTH
PERSONAL PROPERTY SECURITIES ACT 2008**

SUBMISSION

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Introduction

Inspired by similar reforms introduced in New Zealand, Canada and the United States, the Commonwealth, with the co-operation of the States, seeks in the *Personal Property Securities Bill 2008* (the Bill) to introduce a central repository of recorded information reflecting particular security interests in personal property in Australia.

Specifically, the interest recorded is an interest in personal property provided for by a transaction that in substance secures the payment or the performance of an obligation.¹

In addition to providing a notification of the use of the personal property as collateral to secure the payment of monies or the performance of an obligation, the Bill proposes to introduce a regime of prioritising interests in the same collateral.² Central to this prioritisation are the concepts of a 'perfected security interests' and 'unperfected security interests'. Relevantly, a perfected security interest in collateral has priority over an unperfected security interest in the same collateral.³

The proposed mechanisms rely on the fundamental integer of personal property, which is defined as any property other than land.⁴ Recognising that property may take a tangible as well as an intangible form, the Bill reflects an appreciation of the fact that some property may have a tangible form which may act as collateral, and simultaneously the same property may involve other property, intangible property in the form of intellectual property rights, which in their own right may be the subject of a 'security agreement'.⁵

An example set out in the Commentary on the Consultation Draft of the Bill (the Commentary), indicates the practical implications involving certain property which have multiple profiles for the purposes of the Bill.⁶

This submission is concerned with the presumptions made in relation to the interphase between tangible property and intangible property arising from the same personal property, as set out in s 30 of the Bill.

¹ See definition 'security interest' (ss 19 and 21 of the Bill).

² Part 6 of the Bill.

³ S 92(2) of the Bill.

⁴ S 19 of the Bill.

⁵ S 30 of the Bill.

⁶ Page 24 of the Commentary.

The relevant provision

Section 30 of the Bill states:

Description of tangible property includes intellectual property etc.

(1) This section applies if tangible property is described (within the meaning of section 29) in a security agreement, notice or registration relating to a secured party and a grantor.

(2) For the purposes of this Act, the description is taken to include a description of any intellectual property, or intellectual property licence, relating to the tangible property, that reasonable persons in the position of the secured party and grantor would have included in the description had they considered whether such a description should be included.

(3) Subsection (2) applies subject to a contrary intention in the security agreement, notice or registration.

The provision reproduced above concerns the description of tangible property in a security agreement, notice or registration between a secured party and a grantor.⁷ It introduces the prima facie position that a security agreement involving tangible property will automatically include any intellectual property (or a licence of it), in the description of the tangible property in certain circumstances.⁸

The prima facie position:

- will apply where reasonable persons in the position of the grantee (secured party) and the grantor would have included the intellectual property in the description of the subject matter of the security agreement.
- will be superseded in circumstances where a contrary intention is contained in the security agreement, notice and registration.⁹

⁷ S 30(1) of the Bill.

⁸ S 30(2) of the Bill.

⁹ S 30(3) of the Bill.

Submission

My submission has four concerns with the draft provision:

1. The regime does not reflect a public policy which requires the imposition of the prima facie position by implication of law.
2. The implication that the intangible property is included in the description of the tangible security given, is not one that is required to give business efficacy to the security agreement;
3. The imposed limitation that the prima facie position is only replaced by a contrary intention *as 'contained in the security agreement, notice or registration'* is an unreasonable and unnecessary limitation on the clarification of the intention of the parties, which is inconsistent with analogous law in the intellectual property area; and
4. In certain circumstances, the provision may be unconstitutional.

Explanation

1. *The regime does not reflect a public policy which requires the imposition of the prima facie position by implication of law.*

The prima facie position reflects an objective test. The test does not involve a subjective examination of what the parties intended and the intellectual property will be included in the description of the tangible property if the parties acting reasonably with reasonable expectation would have included it in the description.

The intention of the parties is not relevant. The imposition of this implication, if it is reasonable for the parties to have considered that intangible property was included in the description of the tangible property, amounts to an implication of a term at law.

In this regard the Federal Court has said:¹⁰

¹⁰ *South Sydney District Rugby League Football Club Ltd v News Ltd* [2000] FCA 1541 (Finn J, 3 November 2000) at [392.2].

Distinct from implication in fact, a term may be implied as a matter of law as a legal incident of a particular class of contract: see *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd* (1998) 43 NSWLR 104 at 122-123. This implication does not depend upon the intention of the parties: *Breen v Williams*, above, at 103. Its imposition can in the end be explained as resulting from when "the law thinks that policy requires it": *Simonius Vischer & Co v Holt & Thompson* [1979] 2 NSWLR 322 at 348; (underline added)

It is my submission that the implication contained in s 30(2) cannot be said to be of such a nature that policy requires it. It is a preferential position for the secured party, and respectfully, there is no justification for giving one party to the agreement such an advantage based on an objective evaluation.

By way of comparison, public policy has required that '[w]here a literary, dramatic or artistic work ...or a musical work, is made by the author in pursuance of the terms of his or her employment by another person under a contract of service or apprenticeship, that other person is the owner of any copyright subsisting in the work...' ¹¹ This position is understandable. Public policy cannot tolerate an employee having fiduciary duties to his or her employer and making a work pursuant to a contract of employment placing his or her interests above those of the employer.

No such fiduciary considerations exist in the security agreement context. The secured party and the grantor are commercial arms length parties and I respectfully submit that the advantage given to the secured party is not justifiable on public policy grounds.

2. *The implication that the intangible property is included in the description of the tangible security given, is not one that is required to give business efficacy to the security agreement;*

It is a starting position for this submission that the security agreement is essentially a commercial agreement between parties who are at arms length and

¹¹ *Copyright Act* s 35(6).; In *Sterling Engineering Co Ltd v Patchett* [1955] AC 534 at 547, Lord Reid said:

There are cases where it has been said that the employer's right to inventions made by an employee in the course of his employment arises from an implied term in the contract of employment. Strictly speaking, I think that an implied term is something which, in the circumstances of a particular case, the law may read into the contract if the parties are silent and it would be reasonable to do so: it is something over and above the ordinary incidents of the particular type of contract. If it were necessary in this case to find an implied term in that sense I should be in some difficulty. But the phrase "implied term" can be used to denote a term inherent in the nature of the contract which the law will imply in every case unless the parties agree to vary or exclude it. I think that it has probably been used in that sense in the cases founded on by the respondent, and I am of opinion that it is only in that sense that the appellants' right in this case can be said to arise from an implied term.

should be considered as any other contract. As such, if a term is to be implied, it is to be implied in fact and the test for the implication of a term in this situation is far more strict¹² and stringent¹³ than the test set out in s 30(2) of the Bill.

Halsbury's Laws of Australia states in relation to the implication of a term in formal contracts as follows:¹⁴

The five strict requirements for implication in respect of terms implied in fact, which govern factual implications in formal contracts, are:

- (1) *the term must be reasonable and equitable;*
- (2) *the term must be necessary to give business efficacy to the contract;*
- (3) *the term must be obvious;*
- (4) *the term must be capable of clear expression; and*
- (5) *the term must not contradict any express term of the contract.*

It is my submission that:

- the test stipulated in s 30(2) of the Bill is a much easier test than the requirements for the implication of a term in fact;
- that the inclusion of the intangible property in the description of the tangible property is not necessary to give business efficacy to the contract;
- the term is not as an objective proposition obvious. Further the fact that s 30(2) raises a reasonable test is an acknowledgment that the inclusion of the term in all cases is not obvious;
- the appropriate test involves consideration of these five requirements rather than a more relaxed test where consideration is limited to what is reasonable and made with the benefit of hindsight.

Finn J confirmed these requirements in *South Sydney*:¹⁵

Where a term is implied in fact rather than in law, the implication is based upon the presumed or imputed intentions of the parties. Where the contract is a formal one complete on its face, if a term is to be implied it must be reasonable and equitable; necessary to give business efficacy to the contract so that no term will be implied if the contract is effective without it; so obvious that "it goes without saying"; capable of clear expression; and must not contradict any express term of the contract: *BP*

¹² *Wright v TNT Management Pty Ltd* (1989) 15 NSWLR 679 at 697 (Clarke JA – CA(NSW)).

¹³ *Vroon BV v Foster's Brewing Group Ltd* [1994] 2 VR 32 at 68 (Ormiston J).

¹⁴ Halsbury's Laws of Australia at [110-2125].

¹⁵ *South Sydney District Rugby League Football Club Ltd v News Ltd* [2000] FCA 1541 (Finn J, 3 November 2000) at [391.1].

Refinery (Westernport) Pty Ltd v Shire of Hastings [1977] HCA 40; (1977) 180 CLR 266 at 283; *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* [1982] HCA 24; (1982) 149 CLR 337; *Byrne v Australian Airlines Ltd* [1995] HCA 24; (1995) 185 CLR 410 at 441-442. Where the contract is an informal one that has not been reduced to any complete written form, the test for implying a term is whether the implication of it is "necessary for the reasonable or effective operation of the contract" in the circumstances of the case: *Breen v Williams* [1995] HCA 63; (1996) 186 CLR 71 at 123-124. In such a case, though, it is necessary to arrive at some conclusion as to the actual intention of the parties before considering any presumed or imputed intention: *Byrne v Australian Airlines Ltd*, above, at 422; on the apparent differences between the tests for formal and informal contracts see Tolhurst and Carter, "The New Law of Implied Terms", (1996) 11 CLJ 76; Tolhurst and Carter, "Implied Terms: Refining the New Law" (1997) 12 CLJ 152; and see generally Cheshire and Fifoot, *Law of Contract*, 7th Aust Ed, 1997, para 10.43ff.

The question of whether the intellectual property rights in copyright were included in the sale of a business where the goodwill was sold. It was raised because the respondent claimed that the applicant had no right to bring the action for copyright infringement as copyright had not been specifically included in the sale. The requirement of 'business efficacy' is clearly shown in the approach by his Honour in *Greenfield*:¹⁶

It is my view that, had the transaction been one at arm's length, an assignment of copyright would have been implied. It is absurd to suppose that the true intention was to assign the business including goodwill and patents, but leave copyright with the assignor. Looking at the agreement broadly, in the way one is encouraged to construe commercial documents, there can be no doubt that its general intention was that all the assets used in the business should go over...

The issue was resolved through an analysis of what the parties *intended* and whilst it might be argued that the test in s 30(2) would achieve the same result, it is submitted that the s 30(2) test will find in favour of the extended definition of tangible property than would be the case if the five (5) requirements for an implication in fact.

¹⁶ *Greenfield Products Pty Ltd v Rover-Scott Bonnar Ltd* [1990] FCA 111.

3. *The imposed limitation that the prima facie position is only replaced by a contrary intention as 'contained in the security agreement, notice or registration' is an unreasonable and unnecessary limitation on the clarification of the intention of the parties, which is inconsistent with analogous law in the intellectual property area;*

Section 30(3) introduces a factor which could potentially vary the prima facie position. By way of a broad analogy the presumption as to copyright ownership by an employer contained in s 35(6) of the *Copyright Act 1968*, is also superseded by any contrary agreement between the employer and the employee.

If there were a comparable qualifier in the Bill, there would be some confidence that true intention of the parties would be examined. The qualifier contained in s 30(3) will only claw back the intangible property from the description of the tangible property in cases where there is contained an intention not to include intangible property in the description of the tangible property, a 'contrary intention'. The inquiry, however, is not an open inquiry as to whether there is a contrary intention, but rather limited only to an examination of the security agreement, notice or registration.

It is submitted that this will only operate not to include intangibles or the intellectual property, where there is an express exclusion in the agreement, notice or registration.

However, if the parties did not in fact intend the intangibles to be included and there is no reference to the intangibles in the agreement, notice or registration but at the same time there is an objective determination that reasonable parties would have expected its inclusion, then contrary to the intention of the parties the Bill will include it. In this circumstance, the secured party enjoys a windfall. So if the advance was in fact made based on the valuation of the tangible property only, the secured party has, without paying a single dollar more, acquired additional property without any additional cost – that is, the additional property is included in the security for no additional outlay by the secured party.

There may be situations where there could be an examination of the wider intentions of the parties. For example, if there is some oblique reference which may be interpreted to be a contrary intention. In *Greenfield* the question was whether it could be implied that copyright was included in the sale of business. The relevant provision in the contract stated:

The goodwill, motor vehicles, plant and equipment, patents, loose tools, trade debtors and stock of the business conducted by the vendor as manufacturer and distributor of industrial mowers conducted by the vendor at 1101 Beaudesert Rd, Archerfield.

As stated above, it was considered copyright must have been intended to be included.

Using the example in the Commentary on the Bill,¹⁷ let us assume that rather than saying something obvious such as:

- “the patent rights attaching to the robot arm are not included in the security offered in this agreement”;

what is stated in the agreement is the following:-

- “the robot arm is the only asset offered as the security in this agreement.”

Is that a contrary intention? Could it not be argued that in a portfolio of numerous inventions of this R & D company, that a reference to the robot arm as an asset includes the intangible rights attaching to it? Similarly, could not the reference to the robot arm as the only asset, mean the tangible robot arm as an asset distinct from the patent rights which are *another* asset?

Of course, s 30(3) may be read literally to the extent that *only* a contrary intention appearing in the security agreement, notice or registration will operate so as to not include intangible property in the description of the tangible property. Anything less will not constitute a contrary intention and no further inquiry will be made.

In that case, the limitation will clearly only prevent the inclusion of the IP where it is in the clearest terms and under s 30(2), it is objectively determined that the IP should be included.

It is submitted that the limitation of inquiry only to the documents named in s 30(3) of the Bill is an unreasonable limitation providing an ‘insurance’ policy for the secured party. The absence of inclusion in the security agreement, notice or registration will, by the combination of s 30(2) and s 30(3) of the Bill, mean that even if the absence of reference in those documents to exclusion of the IP reflects the parties’ agreement, if an objective evaluation under s 30(2) deems that they should have been intended the grantor will be penalised unnecessarily and the secured party benefits unjustifiably.

It is therefore possible, that even in cases where the actual intention stated in a letter between the parties was not to include the IP, the sections would operate to give the secured party a windfall by adding the IP to the collateral if the documents named in s 30(3) contain no reference to the contrary intention and it was deemed reasonable to include it in the collateral, regardless of a clear statement of intention in a separate letter.

¹⁷ Page 24 of the Commentary.

4. *In certain circumstances, the provision may be unconstitutional.*

Government has and does, through different departments invest from time to time in research and development with private companies. The arrangements also include joint ventures where the product of the investment will be, it is envisaged, exploited through the private co-venturer, whilst the government receives return on investment. There is no fixed model as to ownership and distribution rights, with all these matters being negotiable.

Assume the following scenario:

- The State government agrees to advance monies to construct the robot-arm;
- The advance is made not as a co-venturer documented in a joint venture agreement but rather as a loan documented in a security agreement;
- The cost of building the robot arm is \$1 million and the advance is for \$1 million.
- The security agreement provides that if there is default in the repayment, the State will acquire title to the robot arm.
- Nothing in the security agreement notes that any IP attaching to the robot arm is included or excluded from the agreement, the agreement simply notes the collateral as: 'The robot arm in its final constructed state'.
- The private company receives advice that the robot arm might be patentable and/or attract design rights under the designs legislation. It proceeds to apply for and acquire those rights.
- It writes a letter to the government that it has acquired those rights and offers the government an opportunity to purchase those rights.
- The private company defaults under the security agreement and the government acquires the robot arm asset.

The provisions of the Bill will operate to include the patent rights and the design rights in the description of the tangible property offered as collateral, notwithstanding the advance was only for the cost of constructing the robot arm. It is likely that the objective test in s 30(2) will find in favour of the secured party, as the example in the Commentary at page 24 has been included to highlight the mischief sought to be overcome by the inclusion of the prima facie presumption.

In these circumstances, the government will acquire the IP assets for no more money than the cost of construction of the robot arm.

The *Constitution of Australia Act* states at s 51(xxxi):

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws;

The acquisition of the intangible property at no further cost to the government will, in my respectful opinion, offend this subsection of the Constitution.

The situation is further exacerbated by the fact that the letter written by the company cannot be considered because:

- The test in s 30(2) is an objective test relative as to what was reasonable at the time the parties went into the security agreement; and
- The prima facie inclusion of the IP as collateral is only ousted by a contrary intention in the security agreement, notice or registration, which in the above scenario is not recorded in any of those documents or notifications.

Recommendation

It is my recommendation to widen the scope of s 30(3) of the Bill by:

- Removing the limitation to the documents listed in the sub-section;
- Make the prima facie inclusion of the IP in s 30(2) subject to any contrary agreement between the parties (without limitation to specific documents), in terms similar to s 35(6) of the *Copyright Act*.