Response to Attorney-General's Department

By

Professor Anthony Duggan

1. Introduction

The Department's response to my submission concentrates on matters of detail and overlooks the main point I was trying to make in paras 4 and following of the submission. The point is that some of the Bill's provisions raise competing policy considerations and there is no indication in the Explanatory Memorandum or elsewhere of how extensively – if at all – the Department weighed these factors before arriving at the position represented in the Bill. In para. 5 of my submission, I suggest it would be helpful to a proper understanding of the Bill if the Department were to explain publicly its position on key policy matters and the reasons behind the Bill's main departures from overseas models. The Department's response fails to address this suggestion.

2. Perfection by control of security interests in deposit accounts

(a) My main objective in raising this issue was to draw attention to the lack of transparency in the drafting process on key policy questions, a point which the Department's response overlooks (see para.1). My criticism is not that the provisions in question are necessarily misconceived but that the underlying policy considerations might not have been fully identified and debated.

(b) According to the Department's response, "it would be anomalous if an ADI had a super-priority under its right of set-off, but not under the Bill." But this does not follow because the two sets of rights are not equivalent. A security interest gives the bank a property right in the disputed account and puts it in a stronger position *vis-à-vis* competing lenders than a right of set-off does. Consequently, giving banks super-priority for security interests goes beyond preservation of the *status quo* and substantially strengthens the bank's position. In any event, this explanation does not appear in the Explanatory Memorandum and, to my knowledge, this is the first time it has been publicly stated.

(c) The Department's response suggests that the issue "is controversial in Canada because the Supreme Court of Canada … has opened up an argument that an ADI may not be able to rely on its right of set-off". This statement is disingenuous. It implies the controversy is a recent one but, in fact, the issue has been on the table in Canada right from the emergence of Revised Article 9: see, *e.g.*, Catherine Walsh and Ronald CC Cuming, "Revised Article 9 of the Uniform Commercial Code: Implications for the Canadian Personal Property Security Acts?" (2001) 16 *Banking and Finance Law Review* 339. Writing 8 years before the recent SCC decision, Cuming and Walsh argued that "the experience with the existing PPSA regime likewise does not justify

awarding privileged priority status to security interests in deposit accounts taken by the depository bank, nor for awarding them a legally entrenched veto over the right of a debtor to give a security interest in the account to a third party. The existing law, including the depository bank's rights of set-off, would seem to offer adequate protection against interference with ordinary banking practices". This view is not universally held in Canada (see the Appendix to my submission) but, if it is to be rejected, the reasons for doing so should be publicly stated.

3. Consumer goods, inventory and equipment

The main point in para.6 of my submission is that "there is a danger that the failure to distinguish clearly between inventory and equipment as a matter of taxonomy may produce mistakes in the body of the legislation." The Department's response misses the point. It says is that "unlike other PPS legislation, [the bill] only makes the distinction when to do so is necessary to achieve a particular policy outcome". But this statement simply reaffirms my concern: how can the Department be sure it has identified and addressed all the instances where the distinction matters?

4. Low-value goods

Again, the Department's response misses the point: why limit clause 47 by reference to property that the buyer intends to use predominantly for personal, domestic or household purposes rather than simply saying the provision only applies to "consumer property" as defined in clause 10?

5. Priorities: priority time

My example here was faulty. Let me correct it by adding the missing component. Assume that on Day 4, SP1 reperfects by registering a new financing statement. On Day 5, Debtor defaults against SP1 and SP2 and they both claim the widget. *On these facts*, SP1 would have priority under all the Canadian PPSAs (including Ontario), but under the Australian Bill SP2 would have priority because SP1 was not continuously perfected. In summary, the Canadian position is that SP1 has priority provided it re-registered before Day 5, whereas the Australian position is that SP2 has priority regardless. The Canadian position attempts to balance two policy considerations: (1) preventing SP2 from obtaining a windfall due to the accidental discharge of SP1's registration; and (2) providing an appropriate incentive for SP1 to reperfect as quickly as possible. The Australian position, I assume, reflects a view that the second of these considerations is the only one that matters. It may also have something to do with a desire to avoid the potential for circular priority disputes in cases where a third secured party, SP3, acquires a competing security interest during the period of SP1's unperfection. But I can't really be sure because the Explanatory Memorandum does not address the point. The Australian position may well be defensible on either or both these grounds. My criticism goes not so much to the substance of the provision as to the failure to spell out publicly the reasons for it. The need for this is perhaps more acute than in the other PPS jurisdictions because, as clause

55 is drafted, readers are bound to ask the question my example raises and, in the absence of any assistance from the promoters of the legislation, they may well be mystified.

6. Inventory purchase-money security interests and the notice requirement

According to the Department's response, requiring the prospective pmsi holder to notify the earlier secured party "would be an onerous obligation for small businesses". But this does not seem to have been a concern in Canada or the United States. In any event, omission of the notice requirement increases the costs of the earlier secured party and a proper policy analysis would require weighing these costs against the claimed costs to small businesses if the notice requirement was included. In any event, all this may be moot because the Department's response goes on to reveal that consideration is being given to a system under which the Registrar would provide the notice. This may be an appropriate solution but, so far as I can see, it is not mentioned in the Explanatory Memorandum and, in common with other stakeholders, I can only respond to the Bill on the basis of information the Department chooses to make available.

7. Accounts financier in competition with pmsi holder

My concern with clause 64 is not necessarily with the rule itself, but with the absence of publicly stated policy reasons for preferring the accounts financier over the pmsi-holder in the circumstances. In other words, once again, the point goes to process rather than substance. The Department's response claims that clause 64 "has been strongly endorsed by the Australian Finance Conference", but the public is surely entitled to know what the arguments are. The second point in para. 10 of my submission is that clause 64 contains a notice requirement but clause 62 does not and the distinction seems anomalous: why is it excessively onerous for the pmsi-holder to provide the earlier financier with a notice, but not excessively onerous for the accounts financier to do so in parallel circumstances?

8. "Collateral": clauses 151, 160, etc

Again, it would have been helpful if the Explanatory Memorandum had addressed the apparent drafting discrepancies I identify in para.11 of my submission. As stated above, I can only respond to the Bill on the basis of the publicly available information. Expecting respondents to second-guess the Department's thinking on key aspects of the legislation strikes me as unreasonable. In any event, I have some misgivings about the explanation in the Department's response. I have no problem at all with designing the PPS register so it can be used for multiple purposes, such as recording proceeds of crime orders (or "hoon liens", whatever they are), but I'm not sure it is appropriate to make provision for these different uses in the PPSA itself. These are not PPS issues and, it seems to me, the appropriate place for requiring their registration is the legislation that governs them (the Crimes Act, or whatever). This is the approach the Canadian provinces take. For example, the Ontario PPS register doubles as the register of repair and storage liens under the Repair and Storage Liens Act. However, the provisions governing registration of repair and storage liens are contained in subordinate legislation made pursuant to the Repair and Storage Liens Act itself, not the PPSA. The PPSA provisions are limited to

registration in the PPS register of personal property security interests. Adoption of the same approach in Australia might facilitate removal of the apparent drafting discrepancies I identify in para.11 of my submission.

9. Enforcement provisions not to apply to receivers

The Department's response does not address the policy concerns I raise in para.15 of my submission. The Australian Bankers' Association submission also draws attention to the apparent anomaly of having "two differing enforcement regimes, one for companies under the Corporations Act and another for other entities" and so I'm not sure it is accurate to say that "Australian stakeholders have generally supported this outcome". In any event, that is not a policy argument.

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