



AUSTRALIAN BANKERS' ASSOCIATION INC.

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Ms Julie Dennett
Committee Secretary
Senate Standing Committee on
Legal and Constitutional Affairs
Parliament House
Canberra ACT 2600

By email: legcon.sen@aph.gov.au

Dear Ms Dennett,

**Personal Properties Securities (Corporations and Other Amendments)
Bill 2010**

The Australian Bankers' Association (ABA) is pleased to have the opportunity to make a submission to this inquiry. The ABA appreciates the Committee's continuing interest in and scrutiny of the personal property securities legislative reform program. We trust that our further submission to this inquiry will be of assistance to the Committee's deliberations.

In discussing the amendments proposed by *Personal Property Securities (Corporations and Other Amendments) Bill 2010* (Bill) with our members, there are several issues arising from the Bill which we request are taken into account.

Most of the ABA's concerns are with a lack of certainty with some aspects of the Bill and the legislative intent.

At this stage of the legislative program it is essential that any uncertainty in the legislation is resolved clearly. This can be achieved partly through discussions with the Attorney General's Personal Property Securities Branch (PPS Branch) and completed with appropriate legislative amendments. The ABA is appreciative of the efforts of the PPS Branch in clarifying its view of how the legislation will operate.

Amendments to section 436C and section 441A of the *Corporations Act*

The inclusion of "PPSA retention of title property" within the definition of "property" for the purpose of section 436C (power of a secured party to appoint an administrator) and section 441A (power of a secured party to enforce during the decision period) of the *Corporations Act 2001* (Cth) may render illusory the

rights given to a secured party which has a security interest over the whole or substantially the whole of the property of the company. In particular, it is unclear whether:

- it will ever be possible to have a security interest over the whole or substantially the whole of the property of the company if PPSA retention of title property is included in the company's property for the purposes of these sections; or
- an all present and after acquired property security interest will be sufficient to satisfy this requirement with the issue of enforcement over PPSA retention of title property the subject of a purchase money security interest as merely a matter of priority.

Sections 436C and 441A of the *Corporations Act 2001* are very important to ABA's member banks. Due to the fluid nature of corporate insolvencies and resultant inter-creditor disputes, for a major creditor to provide a company with sufficient time to renegotiate a facility it must be absolutely certain of its legal right to prevent the appointment of a voluntary administrator to enable this to occur. Otherwise, there is the risk that a financially troubled company may have to go into voluntary administration if it cannot be certain of the support of its major creditor (or especially its creditors where there is a syndicated lending facility) which holds a charge over the whole or substantially the whole of the company's property.

The PPS Branch has assisted us with its view that a security agreement will be effective according to its terms (PPS Act section 18(1)). Accordingly, a security interest that is expressed to extend to a company's retention of title property will attach to that property, in addition to any other property to which it is attached. A security interest that describes the collateral as the grantor company's *all present and after-acquired property* would, in accordance with section 18(1), attach to the whole of the company's property for the purposes of sections 436C and 441A.

It remains unclear, however, whether a fixed and floating charge over all of the assets and undertaking of a company which was entered into at a time when it was not possible to take a security interest over PPSA retention of title property (and accordingly is not expressly referred to in the charge instrument) will now extend to this property enabling a secured party to exercise rights under sections 436C and 441A of the Corporations Act.

While it seems to follow that an all present and after acquired property security interest will be sufficient to satisfy the requirements for a security interest that exists over the whole or substantially the whole of the property of the company for the purposes of sections 436C and 441A even where another secured party has a security interest which has a higher priority (such as a PMSI), the alternative interpretation above is open to debate.

Therefore, the ABA wishes to ensure that the intended interpretation of the Act is completely free from doubt.

ABA Submission

In the interests of certainty on such an important matter, the Bill should make it clear that:

- an all present and after acquired property security interest; and
- a fixed and floating charge over all of the company's assets and undertakings,

will be sufficient to satisfy the requirements of section 436C and section 441A of the *Corporations Act*.

Amendments to Part 9.4 and Section 52(1) of the *Personal Property Securities Act 2009* – transitional provisions

There are uncertainties concerning the application of the *Personal Property Securities Act* to existing security interests as set out in Part 9.4 of that Act that deals with the transitional application of the Act. The ABA understands that the legislative intention is that existing security interests (transitional security interests) will not be adversely affected during the transitional period.

This is particularly the case in relation to migrated security interests where holders of migrated security interests have little or no control over the actual migration process. Our members are concerned that the extinguishment and priority rules in the Act could erode their existing security interests.

Again, the PPS Branch has been helpful in seeking to clarify its view of how the legislation will operate.

However, the ABA has residual concerns and wishes to ensure the legislation is absolutely clear.

Example: Fixed charges over intellectual property

Presently fixed charges over intellectual property are registered on the Register of Company Charges maintained by the Australian Securities and Investments Commission (ASIC). There is no requirement at law for the security agreement or ASIC Form 309, which is the notice of creation of the charge that is lodged in ASIC's Register of Company Charges, to contain the patent number, design number, plant breeder's right number or trade mark number (collectively, the IP Serial Numbers) for the security interest to be valid.

It is not possible to update the ASIC registration to include IP Serial Numbers before migration and there is no indication as to how ASIC might extract this information (if at all) when registrations from the Register of Company Charges are migrated to the Personal Property Securities Register.

Taking free of security interest

Under the *Personal Property Securities Act* the IP Serial Numbers must be recorded in the Personal Property Securities Register otherwise a third party may take the collateral free of the security interest (section 44(1)).

PPS Branch's view is that Section 44(1) and proposed Part 9.4 of the Act preserves the existing position that the registration of a charge in intellectual

property under Chapter 2K of the Corporation Act is not sufficient to protect the chargee against a transfer of the intellectual property by its registered owner to a third person. The registration of a charge over intellectual property under Chapter 2K of the Corporations Act does not affect the registered owner of the intellectual property in its ability to give in good faith discharges for any consideration for a transfer of, for example a trade mark.

However, while this explanation of the position under the new arrangements seems clear the ABA's concern is with the position of the migration of security interests in intellectual property. It is unclear whether a secured party having its interest noted on the relevant intellectual property register (IP register) will achieve a secure outcome. If a search of the Personal Property Security Register immediately before the time of sale (or the third party deals by reference only to the security agreement) does not disclose a serial number, a third party which has *actual* knowledge of the security interest noted on the IP register will nevertheless take the collateral free of the security interest.

Ineffective registration

Additionally, there is a risk that not including the IP serial number in the registration for a migrated security interest may render the registration ineffective because this may be determined to be a seriously misleading defect for the purposes of section 164 of the Act. Where a registration is ineffective under section 164, the security interest will be unperfected and will vest in the grantor in the case of the grantor's insolvency.

The PPS Branch has advised that in its view the security interest is perfected by the act of migration with the effect that any discretion given to the Registrar to make a registration effective despite certain defects would not need to be exercised. It is unclear from the wording in section 322(2)(a) that migration will perfect a transitional security interest irrespective of a defect which would otherwise render the registration ineffective. We note that the Explanatory Memorandum to the Bill states at paragraph 10.22 that a registration will still be ineffective if there is a seriously misleading defect.

Example: Perfection by control

Transitional security interests which are either migrated or registered on the Personal Property Security Register during the two year transitional period also risk impairment where subsequent security interests over the same collateral are perfected by control. Under the *Personal Property Securities Act*, security interests in collateral which are perfected by control have a higher priority than security interests which are perfected by other means (section 57).

By way of example, under current law, where a secured party has a fixed and floating charge over all the assets and undertaking of a company and which is registered on the ASIC Register of Company Charges and a subsequent secured party takes a share mortgage over shares owned by the company (which satisfies the requirements for control), the first secured party will still have priority over the second secured party in respect of those shares. This is the case even if the second secured party has notice of the prior security interest and notwithstanding

that the second secured party has control over the secured property (although control may place the second secured party in a better position for enforcement).

Under the *Personal Property Securities Act*, a subsequent security holder who has a security interest in shares perfected by control will take priority over a secured party which has a prior all present and after acquired property security interest in respect of those shares.

From our members' perspective, transitional security agreements will have been entered into at a time where the concept of control was not determinative of priority and in many instances will not have taken the necessary steps to establish control. They may now not be able satisfy these requirements under their current security agreements.

Further, credit will have been provided to debtors based on a credit assessment, including an analysis of the security to be taken. There is a material risk of mismatch between the security coverage and debt exposure as a result of subsequent security interests taking priority where they are perfected by control.

This level of uncertainty surrounding the effectiveness of existing security interests creates significant operating risks for our members as well as implications for regulatory capital.

ABA Submission

Consistently with the objectives of personal property securities reform, the ABA submits that the extinguishment and priority provisions of the *Personal Property Securities Act* not apply to transitional security interests during the 24 month transitional period or alternatively that the legislation provides greater certainty surrounding the continuing validity of migrated security interests and transitional security interests that are registered in the transitional period.

Amendment to section 52(1) of the *Personal Property Securities Act 2009*

Item 46 of Schedule 2 Part 1 of the Bill proposes to amend section 52(1) of the Act by substituting "(or perfected by force of section 322)" for "(other than section 322)".

The effect of this amendment will mean that a purchaser or lessee for new value without actual notice that the sale or lease constitutes a breach of a security agreement with respect to a transitional security interest will take the personal property free of the transitional security interest.

This amendment will expand existing section 52(1) to all perfected transitional security interests from currently only temporarily perfected transitional security interests (see also new section 322) is a further example of the vulnerability of a bank's transitional security interests under the Bill.

ABA Submission

The ABA requests that item 46 of the Bill is removed.

Amendment of Section 8 of the *Personal Property Securities Act 2009* – further exclusion of Water Rights

While more an issue with the *Personal Property Securities Act* itself than with the Bill, the ABA is concerned that the new regime will exclude security interests over water rights from the benefits for both lenders and borrowers of personal property securities reform.

Item 14 of the Bill would amend section 8 of the Act to extend the exclusion of certain water rights from the regime to water rights provided under private water irrigation schemes operated by bodies such as water corporations, trusts and cooperatives.

These water rights and entitlements are based in corporate law rather than in land law.

Currently, a charge by way of security over water rights granted by an incorporated agricultural business can be registered on the ASIC Register of Company Charges.

The exclusion of water rights generally and in particular the proposed exclusion under item 14 of rights of a person to receive or gain access to water from, for example, a water corporation will leave a gap in the ability of a financier to register a security interest over these rights and provide protection for the financier's exposure to the customer.

This is because there will be no statutory register on which these security interests granted by a company over water entitlements issued by private irrigation entities (for example by Murray Irrigation Limited, Renmark Irrigation Trust and Ord Irrigation Co-operative Limited) to secure the provision of financial accommodation can be registered. Financiers will be unable to protect their security interests under the law with consequential implications for credit risk.

ABA Submission

The ABA submits that item 14 of the Bill is deleted.

The ABA looks forward to early resolution of these issues to ensure the maximum time is available for our members to move forward with their implementation arrangements with certainty about the legislation and its effect.

Yours sincerely

Ian Gilbert