Corporate Insolvency- Submission

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Corporate Insolvency- the PPSA's Perspective

1. PPSA

Personal Property Securities Act 2009 (Cth) (PPSA) came into force in 2012. The PPSA applies to transactions in which the debtor (called the 'Grantor') provides (i.e. 'grants') certain pieces of personal property (called 'collateral') to secure their obligation towards the creditor (called 'Secured Party'). The so-called 'substance' test[1] lies at the heart of the PPSA. According to this test, a significant number of commercial transactions may 'in substance' reflect a situation under which the Grantor 'grants' certain personal property as a security of their obligation towards the Secured Party.

Prior to the start of the PPSA, owners of leases and commercial actors providing goods on 'retention of title' (ROT) terms, were not subject to the corporate charge provisions of the *Corporations Act* and were not required to register any interest to protect themselves and neither were they required to register on other state or federal registers. With the PPSA's legislation, a significant number of transactions could potentially be classified as meeting the requirements of the 'substance' test: hire-purchase agreements, various leases, subleases, various consignments, ROTs and many others.

Stated in these terms, the PPSA epitomises a new era of secured transactions in Australia. It is relevant for almost every commercial transaction. Furthermore, given the phenomenon of digitalisation and the multilayered complexity of modern commercial activity and dealings, many types of personal property could serve as 'collateral': various physical items, financial property (bonds and shares), intellectual property and so on. This points to the growing popularity of the PPSA in the years to come.

The requirement of registration is a key concept of the PPSA. With some minor exceptions,[2] the Secured Party must register on the Personal Property Securities Register (PPSR)[3] their security interest in the collateral. Through the online registration process the Secured Party publicises their right to the collateral and

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[1] PPSA S 12.
[2] S 8 (6).
[3] https://www.ppsr.gov.au/.

makes it visible to others. The requirement of registration is especially important in disputes between the Secured Party and third parties who may interact with the Grantor and the collateral: other secured parties, buyers/subleases of the collateral and, of course, the insolvency liquidator.

2. The Relevant Provisions

The interplay between the PPSA's provisions and corporate insolvency is critical. In fact, since its inception, PPSA's case law has significantly evolved around the interplay between the two.[4] Thus, section 267 of the PPSA provides that an unregistered security interest 'vests' (i.e. moves) to a corporate grantor upon its winding up, voluntary administration or where a deed of company arrangement is entered into.[5] This is a harsh provision. It means that the collateral and its value moves to the pool of the Grantor's assets to be distributed amongst the creditors. There is nothing in the PPSA allowing a Secured Party to petition the court to extend the time for registration once the insolvency proceedings commence. If the Secured Party is late and non-registered at the time of the insolvency, the security interest will automatically move to the Grantor.

Section 588FL of the *Corporations Act* (brought in as an amendment alongside the commencement of the PPSA) applies if a Secured Party's security interest is not registered within 20 business days of its creation, and the Grantor (being a company) is placed into liquidation or voluntary administration within six months of registration. In that event the Secured Party's security interest vests in the corporate grantor. In this case there is registration but it is void because it does not meet the time requirements.

The former s 266(1)(d) of the *Corporations Act* expressly allowed a charge holder (a security regime which applied prior to PPSA) a period of 45 days to register a charge, even if a liquidation or voluntary administration occurred prior to the time period expiring. However, section 588FL(2)(b)(ii) of the Corporations Act has removed this entitlement of the Secured Party and is consistent with the strict policy of s 267 of the PPSA under which unregistered security interests will automatically move to a Grantor in insolvency administrations.

Under the old regime, ownership could not be lost in the corporate grantor's insolvency owing to the operation of the *nemo dat quad non habet* principle (Nemo Dat Rule). That is, the corporate grantor, who never had title in the leased goods or assets under ROT, could not take ownership in insolvency and other secured

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[4] See eg *Power Rental v Forge Group Power [2017] NSWCA 8*; *OPS Screening & Crushing Equipment Pty Ltd v Gold Valley Iron Pty Ltd (In Liq) [2020] WASC 412.*

[5] PPSA s 267 (b) which also applies to a non-corporate grantor that has become bankrupt.

creditors could not share in realisation of those assets because a person 'cannot give what they do not have'. Such assets were treated as sitting outside of the insolvent grantor's estate because they were owned by someone else. However, by legislation, the PPSA overturned this fundamental equitable principle allowing the Grantor to gain that title at the point of its insolvency where the new rules were not satisfied.

3. The Suggestion

The key and dramatic change brought in by the new rules was that lack of registration and late registration of security interests by a Secured Party could lead to the loss of ownership of the collateral, moving the security interest from the Secured Party to the insolvent grantor. The principal policy reason for this new rule was to create certainty in the PPSR so that all security interests are registered to ensure the PPSR provides a full and complete picture of security interests. This policy outcome was meant to act as a spur to action to register correctly and in time.

However, as mentioned, the PPSA dramatically widened the scope of what is considered a security interest and in doing so substantially increased the number of businesses and corporations covered by capturing them by the substance test and classifying them as 'secured parties' when they were not, prior to the commencement of the PPSA, considered as such.

Accordingly, the policy of the PPSA has caught many businesses (especially small to medium enterprises (SME) unaware that the new rules apply to them and their operations. These SMEs have been globally recognised as the driving force of the modern economy, playing a determinative role in the present post-pandemic recovery and economic growth.[6] Furthermore, many of the SMEs are unaware of the added danger they face if their Grantor is a corporation. In that case, as we have seen, *Corporations Act* imposes further provisions and timeframes, making certain registrations void and thus, again moving ownership in the collateral to the insolvency liquidator at the expense of the SME.

The Nemo Dat Rule, being fundamental to law and commerce for centuries, also meant it became 'common sense' among those businesses dealing in leased and ROT assets and, expectedly, such parties, especially SMEs, have the strong expectation that their title would live on, even if the Grantor was to go under. The PPSA critically upset those basic and well understood business expectations and, for SMEs

[6] For the significance of the SMEs' see eg *OECD SME and Entrepreneurship Outlook 2005* (OECD Publishing, 2005); *World Trade Report 2015 Levelling the Trading Field for SMEs* (WTO Publishing, 2016); International Trade Centre, 'SME Competitiveness Outlook 2020: COVID-19: The Great Lockdown and its Impact on Small Business' No P32.E/DMD/RSE/20.VI International Trade Centre; *Financing SMEs and Entrepreneurs 2022* (OECD Publishing, 2022), *Australian Consumer Law* (Schedule 2) ss 23-28.

that do not generally have the luxury of legal teams or resources to understand this change, the risk of loss for them became unreasonably dramatic and strongly outweighed the policy intention behind having a complete PPSR.

Furthermore, such owners of these goods cannot argue that the Grantor has been unjustly enriched by a 'vesting' under s 267 of the PPSA or s 588FL of the Act because it occurs due to the operation of legislation, that is, there was no conduct of the Grantor that facilitated the vesting to give rise to such a claim. It is the owner's failure to comply with the PPSA or the *Corporations Act* caused the vesting.[7]

It is submitted that the new rules overly expose the position of these newly minted SMEs secured parties especially for those dealing with security interests that were not covered prior to the commencement of the PPSA. Many SMEs simply do not know they are caught by the new rules and/or lack the necessary and sufficient legal resources to understand their exposure and correctly mitigate their risk.

Reform is desperately needed to better protect the interests of SMEs being unnecessarily exposed to the operation of the new rules, namely it is suggested that the following reforms be considered:

(a) Removal of the title 'vesting' provisions in the PPSA and *Corporations Act* to the extent that they apply to secured parties that are SMEs; or

(b) Allow for secured parties that are SMEs, whose title has moved in an insolvency liquidator, to be compensated by allowing their claim to be retained as a secured claim but rank in priority behind all other registered securities (and critically still rank in front of any unsecured creditors);

(c) Allow for another head of compensation to be included in the PPSA and *Corporations Act* for such owners by statutorily recognising their loss as a form of unjust enrichment and giving such claims priority over unsecured creditors and equity.

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[7] There are rights to compensation for those owners who lose title to their goods as a result of the PPSA or the *Corporations Act*. Under section 269 of the PPSA and section 588FN(1) of the *Corporations Act*, such parties have the right to recover damages or compensation for loss of title in property under a security interest that vests in a grantor. However, this amounts to little value as the right to such compensation is provable as an unsecured creditor in the insolvency of the grantor and therefore shares alongside the claims of each other unsecured creditor. Realistically this can mean that once all secured creditors are dealt with there may well be nothing left over from the estate and such compensation may be worthless.