

CHAPTER 3

KEY ISSUES

3.1 This chapter discusses the key issues raised in the submissions to the inquiry. The issues covered are generally those areas or amendments in the Bill that attracted comments from multiple submitters, or which relate to issues of policy, namely:

Corporations Act 1990 (Corporations Act)

- alignment of terms used in the Corporations Act and the *Personal Property Securities Act 2009* (PPS Act);
- issues relating to the PPS Act's retention of title property;
- proposed section 441EA (Sale of property subject to a possessory security interest); and
- proposed section 588FL (Vesting of PPS Act security interests if collateral is not registered within a specified period of time).

PPS Act

- definitions;
- potential issues for future review; and
- Senate Standing Committee for the Scrutiny of Bills comments.

3.2 Most of the comments received in submissions were responded to in the submission received from the Attorney-General's Department (the Department). Many of these issues were of a relatively minor technical nature, and were specifically addressed and clarified by the Department. The Department's submission is reproduced at Appendix 1.

Corporations Act amendments

Alignment of terms used in the Corporations Act and PPS Act

3.3 As noted in Chapter 2, the Bill will align a number of terms used in the Corporations Act and the PPS Act.

3.4 In its submission, Piper Alderman noted that the approach taken in the Bill means that existing references to *charges*, *liens* or *pledges* in the Corporations Act will be replaced with the broader term *security interest*. This approach was questioned on the grounds that:

...it is not appropriate that all interests in personal property that are security interests for the purposes of the PPS Act are treated, under the Corporations Act, in the same way as charges, liens or pledges.¹

3.5 However, the Department defended this approach as being consistent with the PPS Act scheme:

Section 440B, Corporations Act currently prevents the enforcement of a charge on property of the company (except in certain circumstances). This would include a charge on a book debt (or an account for the purposes of the PPS Act). Consistently with the functional approach to security interest implemented by s 440B, [the] PPS Act provides equivalent treatment for a charge on a book debt and a transfer of the same book debt.²

PPS Act retention of title property

3.6 As noted in Chapter 2, the Corporations Act will be amended to align it with the PPS Act concept of *security interests*. This will be done by including property defined as *security interests* in the PPS Act in the Corporations Act as *PPSA retention of title property*.³

3.7 The submissions to the inquiry raised a number of issues going to the concept of *PPSA retention of title property*.

Inconsistent approach to PPS Act retention of title property

3.8 DLA Phillips Fox (DLAPF) submitted that 'there appears to be a difference in relation to whether or not property includes [*PPSA retention of title property*] in various chapters of the [Corporations Act]'.⁴

3.9 The DLAPF submission noted that the general definition of *PPSA retention of title property* provides that, unless otherwise specified, a reference to property of a corporation does not include *PPSA retention of title property*. However, *PPSA retention of title property* would be included under the administration provisions. It would also be included under the voluntary winding up, deed of company arrangement and court ordered winding up provisions, if the security interest created by the retention of title arrangements has not been perfected.⁵

1 *Submission 3*, p. 4.

2 *Submission 11*, p. 4.

3 Explanatory memorandum (EM), p. 9.

4 *Submission 2*, p. 1.

5 *Submission 2*, p. 2. 'Perfection' is a technical term which means that a security interest has attached to collateral and is effective against third parties. Perfection may occur by, for example, registration, possession or control of the security interest property (Attorney-General's Department, *Submission 8, Inquiry into the exposure draft of the personal properties securities bill 2008*, 19 March 2009, p. 14).

3.10 DLAPF argued that a more consistent approach should be employed:

...a consistent approach (being that *PPSA retention of title property* only be included in the administration, winding up, deed of company arrangement and receivership provisions if the security interest created by the retention of title arrangements has not been perfected) would make it easier for people to understand the operation of the Bill and its impact on the *Corporations Act*.⁶

3.11 The Department's submission provided a number of responses outlining the particular reasoning which governs the interaction of *PPSA retention of title property* with various parts of the Bill. Together, these responses indicate that the Department considers the Bill to suitably reflect the policy and legislative intent of the Government in this area (a number of these responses are set out below).⁷

3.12 The EM to the Bill also sets out a number of examples which justify the differential approach to the approach to *PPSA retention of title property* in certain circumstances. For example, where it would not prejudice existing rights, property of the company for the purposes of the Corporations Act will include PPS Act retention of title property, so that *PPSA retention of title secured parties* could enforce their security interests. However:

...there would be circumstances where it would be important to preserve existing rights by not including *PPSA retention of title property* within the definition of *company property*. Where a company is insolvent and the property of the company is insufficient to meet the payment of unsecured creditors, employee entitlements would have preference over floating charges...If *PPSA retention of title property* were included as *company property*, it would be subordinate to employee preferences and *PPSA retention of title property* holders would lose their property. Therefore, *property of the company* would exclude *PPSA retention of title property* in this context.⁸

Proposed section 124 – secured party who has perfected a security interest in collateral by possession or control

3.13 Piper Alderman submitted that proposed section 124, which will allow a company to grant a circulating security interest over the company's property, should refer to a 'security interest' rather than a 'circulating security interest, as is proposed in the Bill.⁹ Further, it felt that the company's property in this context should include *PPSA retention of title property*.

3.14 The Department rejected this suggested approach. It stated:

6 *Submission 2*, p. 2.

7 See *Submission 11*, pp 1-5.

8 EM, p. 11.

9 *Submission 1*, p. 1; Bill, p. 22.

This proposal involves a policy change not related to PPS reform that would extend the ambit of s124(1)(f). Proposed s124(1)(f) allows a company to 'grant a circulating security interest over the company's property' and replaces existing s124(1)(f) which allows a company to 'grant a floating charge over the company's property'. By referring to 'a circulating security interest', and not applying to PPSA retention of title property, proposed s124(1)(f) maintains the effect of existing s124(1)(f).¹⁰

Proposed section 441A – secured party acts before or during decision period

3.15 DLAPF submitted that the inclusion of *PPSA retention of title property* in proposed section 441A of the Corporations Act:

...may prevent the holders of security interests in the whole or substantially the whole of the assets of a corporation from enforcing their security interest during the decision period, where a large part of the assets of the corporation are subject to PPSA retention of title arrangements.¹¹

3.16 DLAPF observed that, because *PPSA retention of title property* was to be included in the definition of *property* for the purposes of the Corporations Act administration provisions, the holders of *PPSA retention of title property* security interests would have priority over the holders of security interests in the whole or substantially the whole of the assets of the corporation. This is because *PPSA retention of title property* is a purchase money security interest.¹²

3.17 Accordingly, DLAPF called for *PPSA retention of title property* to be expressly excluded from proposed subsections 441A(1)(b) and 441(2)(b).¹³

3.18 The Australian Finance Conference (AFC) and the Australian Equipment Lessors Association (AELA), who were also concerned about this issue, called for 'further consideration of the amendments against the underlying policy of the [Corporations Act] external administration provisions and the [PPS Act] objectives'.¹⁴

3.19 In response to these submissions, the Department stated that it:

...considers that the Bill has the intended effect that the references to property of the company in s441A would not, after the registration

10 *Submission 11*, p. 3.

11 *Submission 2*, p. 2.

12 *Submission 2*, p. 2. A 'purchase money security interest' (PMSI) is a security interest in collateral created by, for example, a seller who has secured the obligation to pay the purchase price, a person who provided the value to purchase the collateral, or the interest of a consigner who delivers property under a commercial consignment. A PMSI confers 'super-priority' on the secured party (Attorney-General's Department, *Submission 8, Inquiry into the exposure draft of the personal properties securities bill 2008*, 19 March 2009, p. 15).

13 *Submission 2*, p. 2.

14 *Submission 10*, p. 3.

commencement time, in relation to a transitional security interest that is a charge, refer to retention of title property.¹⁵

Proposed section 441EA – sale of property subject to a possessory security interest

3.20 A number of submitters raised concerns in relation to proposed section 441EA of the Corporations Act, which will govern the sale of security interest property in the possession of a secured party.

3.21 DLAPF noted generally that the proposed section is 'inconsistent with the distribution rules in [section] 140 and [is] not subject to the [PPS Act] priority rules or control arrangements'.¹⁶

3.22 Clayton Utz observed that proposed section 441EA replaces existing section 441JA of the Corporations Act. However it noted that it appears 'there has been a deliberate decision to change the rights of parties under the existing law [in relation to]...proposed new section 441EA'.¹⁷ The Clayton Utz submission stated:

The proposed new section 441EA will replace the existing section 441JA...The existing section 441JA only applies if there is no higher ranking security interest. This requirement is not included in the new section 441JA. The proposed new section 441EA is not consistent with the PPS Act. Although sections 123 and 124 of the PPS Act allow a secured party to seize the secured property, section 127 provides rights in those circumstances to higher ranked secured parties. There is no corresponding provision to section 127 of the PPS Act in the new section 441EA.¹⁸

3.23 The Clayton Utz submission also observed that the PPS Act does not generally require physical possession of a possessory security interest in order to have control of that property for perfection purposes. However, proposed section 441EA would require that the secured party actually be in possession of a possessory security interest before the secured party could rely on the proposed section. Clayton Utz concluded:

The dual requirement that property be subject to a possessory security interest and also be in the possession of the secured party should be removed from all relevant sections of the Bill. It should be sufficient that the relevant security interest does in fact fall within the definition of possessory security interest.¹⁹

3.24 In response to the concerns outlined, the Department submitted:

15 *Submission 11*, p. 1.

16 *Submission 2*, p. 3.

17 *Submission 3*, p. 6.

18 *Submission 3*, p. 6.

19 *Submission 3*, p. 5.

Currently, a holder of a pledge or lien against a company may enforce their lien or pledge by selling the secured property, applying the proceeds towards the amount owed under the lien or pledge, and paying the balance to the company (see *Corporations Act 2001*, section 441JA).

However, the holder of the pledge or lien may only exercise this power if the pledge or lien is not subordinate to another security. Item 40 of the Bill proposes the substantial re-enactment of section 441JA as section 441EA of the Corporations Act, with adjustments made to reflect the enactment of the PPS Act (for example, the references to lien or pledge are replaced by the term *possessory security interest*). Proposed section [441EA] does not retain the requirement that the lien or pledge not be subordinate to another security. This is consistent with the approach taken in the PPS Act that any secured party with an interest in the collateral may enforce their security interest.²⁰

3.25 The Piper Alderman submission also commented on proposed section 441EA:

Proposed new section 441EA(1)(c) (Schedule 1, Part 3, Item 40) should refer to property being in the possession or control of the secured party to be consistent with the definition of 'possessory security interest' (new section 51D).²¹

3.26 However, the Department observed that this approach would effectively extend the ambit of section 441EA beyond its intended limits:

Proposed s 441EA(1)(c) refers to 'the property is in the possession of the secured party' and replaces existing s 440BA(c) which refers to 'the property is in the lawful possession of the holder of the lien or pledge'. The new concept of possessory security interest was premised on the assumption that its only substantive effect (apart from bundling the existing concepts of liens and pledges) would be to add in a reference to PPSA security interests perfected by possession or control. This proposal involves a policy change not related to PPS reform that would extend the ambit of s 441EA beyond that currently provided for by s 440BA.²²

Proposed section 588FL – vesting of PPS Act security interests if collateral is not registered within time

Vesting of security interests granted by a company

3.27 The EM explains that most charges currently subject to the registration requirements of Chapter 2K of the Corporations Act will be covered by the PPS Act.

20 *Submission 11*, p. 2.

21 *Submission 1*, p. 1.

22 *Submission 11*, p. 2.

These charges will be migrated to the PPS Register to be established by the PPS Act, and in future such charges will be registered on the PPS Register.²³

3.28 To achieve this, the Bill will repeal Chapter 2K, and consequential amendments will be made throughout the Corporations Act with effect from the time the PPS Act commences (expected to be May 2011).²⁴ Proposed new section 588FL will be inserted into the Corporations Act. This section will replicate, with some changes, section 266 of the Corporations Act, which prevents security interests being granted fraudulently with knowledge of an imminent administration, liquidation or deed of company arrangement and to avoid property falling into the trustee's or administrator's estate or being claimed by unsecured creditors. For security interests entered into after the commencement time, proposed section 588FL will replace section 266.²⁵

3.29 Proposed new section 588FL will also largely replicate existing section 267 of the PPS Act.²⁶ Existing section 267 of the PPS Act and associated provisions provide that:

...most security interests granted by a company which are regulated by the PPS Act will vest in the grantor if not perfected on the date that the winding up of that company commences or the 'section 513C day' (defined in the Corporations Act as, essentially, the date of commencement of administration of a company) in respect of that company...²⁷

3.30 The Clayton Utz submission drew attention to a 'key difference' between proposed new section 588FL and section 267 of the PPS Act. While section 267 would provide that most [relevant] security interests granted by a company will vest in the grantor if not perfected on the commencement of the winding up (or administration) of that company, proposed section 588FL will provide that security interests granted by a company and perfected only by registration will vest in the grantor if registered after the later of:

- 20 business days after the relevant security agreement came into force; and
- six months before the date that the winding up (or administration) of the company commences.²⁸

3.31 The effect of this would be that:

23 EM, p. 13.

24 EM, p. 13.

25 EM, p. 13.

26 *Submission 3*, p. 1.

27 *Submission 3*, p. 1.

28 *Submission 3*, p.1.

...in the case of certain security interests granted by companies, these will vest in the grantor company under the amended Corporations Act even though, under section 267 of the PPS Act, this would not occur.²⁹

3.32 Clayton Utz argued that there were 'no compelling policy reasons for [section 588FL] to apply where the regime in section 267 of the PPS act should apply'. It stated:

Section 267 (and associated provisions) of the PPS Act should apply in preference to the proposed section 588FL of the Corporations Act. It is not appropriate for the 2 pieces of legislation to deal with exactly the same issue in contradictory ways. It is also unclear why companies and individuals should be treated differently in relation to this issue...³⁰

3.33 In response to this view, the Department commented:

Section 588FL replaces existing s266 of the Corporations Act, though modified to take account of the PPS Act. It voids a security interest that has been perfected by registration shortly before the grantor company enters into certain forms of external administration. This provision is part of the preference provisions of the Corporations Act, and this is reflected in its proposed relocation to Part 5.7B—*Recovering property or compensation for the benefit of creditors of insolvent company*.³¹

Section 588FL(3) – foreign law governing security interests

3.34 Proposed subsection 588FL(3) applies when a company enters into a form of external administration, and a security interest granted by the company is enforceable under the law of another jurisdiction that provides for the public registration or notice of the security interest. This subsection will provide that the security interest will vest in the grantor company if the security interest has not been disclosed in accordance with the law of that other jurisdiction.³²

3.35 Clayton Utz argued that the purpose of this provision is 'unclear'. In particular:

This subsection purports to invalidate security interests which are not registered in accordance with a public registration regime under a foreign law. The application of this section would have the effect of invalidating certain security interests under Australian law even if those security interests may not be required to be registered under Australian law (or may in fact have been validly registered or otherwise perfected under Australian law) and are perfectly valid and enforceable under the relevant foreign law.³³

29 *Submission 3*, p. 1.

30 *Submission 3*, p. 1.

31 *Submission 11*, p. 4.

32 *Submission 11*, p. 5.

33 *Submission 3*, p. 1.

3.36 In response, the Department submitted:

Section 588FL(3) is consistent with the policy underlying s588FL that a security interest should be void if it is disclosed only shortly before the company enters into external administration.³⁴

Personal Property Securities Act 2009 amendments

Definitions

3.37 DLAPF submitted that the proposed amendment to the meaning of *grantor* in section 10 of the PPS Act 'may create uncertainty as to who can grant a security interest'.³⁵ DLAPF observed that the word *interest* is 'very broadly defined and is not limited to persons who have an equitable interest in personal property'. Its submission argued:

Accordingly, it would be possible for multiple security interests to be granted by multiple people, each of whom claims to have an 'interest' in the relevant asset.

This may then cause significant problems for the holders of the security interests in relation to priority and enforcement issues.³⁶

3.38 To address this issue, DLAPF suggested that:

...paragraph (a) of the definition of grantor in section 10 of the PPSA be limited to persons having an equitable or legal ownership interest in the relevant personal property. Alternatively, the term 'interest' could be limited in this manner.³⁷

3.39 However, the Department defended the approach taken in the Bill as being consistent with the broad approach of the new PPS regime:

Confining the 'interest' in which a security interest may be granted to legal or equitable interests in the property would not be consistent with the functional approach to security interests proposed by the Bill.³⁸

Potential issues for future review

3.40 In its submission, the Department's responses to a number of the issues raised indicated that these issues may be appropriate for consideration in the review of the PPS legislation that is required under section 343 of the PPS Act.³⁹ This section

34 *Submission 11*, p. 6.

35 *Submission 2*, p. 3.

36 *Submission 2*, p. 3.

37 *Submission 2*, p. 4.

38 *Submission 11*, p. 7.

39 PPS Act, p. 293.

requires that a review of the operation of PPS Act be undertaken and completed within three years after the *registration commencement time*.⁴⁰

3.41 The issues identified by the Department as potentially relevant to the section 343 review are:

- whether the scope of the PPS Act should be extended to cover any other type of security interest;⁴¹
- whether a guarantor should be bound by any priority agreement;⁴²
- the suitability of the notice requirements in relation to the holders of purchase money security interests;⁴³ and
- the effect of section 74 of the PPS Act (Execution creditor has priority over unperfected security interest) on the position of secured creditors, to the extent that it weakens the position of secured creditors.⁴⁴

Senate Scrutiny of Bills Committee comments

Constructive knowledge and shifting the onus of proof

3.42 The committee notes that the Senate Standing Committee for the Scrutiny of Bills (the scrutiny committee) considered the Bill in its *Alert Digest No. 4 of 2010*.⁴⁵ The scrutiny committee commented on a number of provisions in the Bill which will employ the element of constructive knowledge.

3.43 'Constructive knowledge' involves the imputation or deeming of knowledge to a person or entity. In the case of the Bill, proposed sections 588FL, 588FM, and 588FN, and proposed subsection 267A(2), will rely on provisions in the PPS Act which detail the operation of constructive knowledge for the purposes of that Act.⁴⁶

3.44 The scrutiny committee's *Alert Digest* notes that, in relation to these proposed sections and subsection:

...an additional burden is placed on the defendant when the onus in relation to constructive knowledge is shifted to the defendant by requiring him or

40 The EM notes that the *registration commencement time* is a key event in the transitional provisions. This refers to the time at which the PPS Act and the PPS Register take practical effect (p. 44).

41 Clayton Utz, *Submission 3*, p. 10.

42 Clayton Utz, *Submission 3*, p. 12.

43 Australian Securitisation Forum, *Submission 4*, p. 2.

44 Allens Arthur Robinson, Blake Dawson, Freehills Lawyers and Mallesons Stephen Jaques, *Submission 7*, p. 2.

45 Senate Scrutiny of Bills Committee reports may be accessed at <http://www.aph.gov.au/senate/committee/scrutiny/bills/2010/index.htm>

46 *Alert Digest No. 4 of 2010*, 17 March 2010, p. 7.

her to prove that property was acquired *without* actual or constructive knowledge.⁴⁷

3.45 While the EM contains an explanation of the intent and effect of the reversal of the onus of proof in relation to proposed sections 588FL, 588FM and 588FN, the scrutiny committee observed that 'there does not appear to be a clear justification for the use of constructive knowledge [in relation to subsections 588FP(7)(b) and 588FP(9)]'.⁴⁸ Similarly, there is no explanation of the requirement for the constructive knowledge element in relation to proposed paragraph 267A(2)(b).

3.46 The *Alert Digest* also noted that the PPS Act is 'complex legislation' which relates to a national scheme, but 'considers that these circumstances make it especially important that all provisions are appropriate and that they are adequately explained'.⁴⁹ Accordingly, the scrutiny committee called for the Attorney-General to provide advice about 'the need and justification for each instance of constructive knowledge in [the Bill]'.⁵⁰

Committee view

3.47 The committee notes that the inquiry into the Bill represents the culmination of a substantial reform to Australia's PPS regime. On the commencement of the new PPS Act in May 2011, stakeholders in the system will benefit greatly from the economic and administrative benefits that will flow from a streamlined national system. A defining theme throughout the development of the PPS Act has been the importance of simplifying and harmonising Australia's laws in this area, and the committee is confident that the PPS Act will achieve these outcomes.

3.48 The committee notes that the Bill is the second set of consequential amendments to the PPS Act since its passage through the Australian Parliament in 2009. A program of extensive consultation has accompanied the development of the PPS Act and the subsequent consequential amendments, and the committee acknowledges the contributions of the many groups and individuals that made submissions to, or appeared before, the committee through the course of its inquiries. Equally, the committee commends the Department for ensuring that consultation on the new PPS regime has been a comprehensive and worthwhile process. The Department deserves significant credit for having ensured that the PPS Act will commence with what appears to be broad support and understanding, particularly from the financial and legal communities which stand to be most affected by the introduction of the new PPS regime.

47 *Alert Digest No. 4 of 2010*, 17 March 2010, p. 7.

48 *Alert Digest No. 4 of 2010*, 17 March 2010, p. 8.

49 *Alert Digest No. 4 of 2010*, 17 March 2010, p. 8.

50 *Alert Digest No. 4 of 2010*, 17 March 2010, p. 8.

3.49 In its previous three reports in relation to the PPS Act, the committee made numerous recommendations to improve the consultation processes and substantive outcomes around the development and implementation of the new PPS regime in Australia. The success of these previous processes was reflected in the submissions to the current inquiry, which, in general, raised issues that were of a relatively minor or technical nature. The majority of these were able to be sufficiently addressed or clarified by the submission provided by the Department. While some matters of policy were raised in submissions, the committee did not regard any of these as warranting a recommendation for action or further consideration by the government at this point, particularly in light of the provision for a statutory review of the scheme within three years of the commencement of the PPS Act.

3.50 Finally, the committee notes the findings of the scrutiny committee in relation to the provisions of the Bill which rely on the element of constructive knowledge, and the scrutiny committee's request that the Attorney-General provide specific advice on the need and justification for each instance of constructive knowledge in the Bill.

Recommendation 1

3.51 The committee recommends that the Senate pass the Bill.

Senator Trish Crossin

Chair