

CHAPTER 3

Specific issues

Introduction

3.1 The committee has been able to briefly examine some of the key issues that emerged as a result of the inquiry. Fortunately, the committee was familiar with most of the background to them from its previous consideration of the proposed PPS reform.

3.2 Once again it has been relevant to the inquiry process that this reform is underpinned by a referral of powers from participating states and territories. This has had an impact on the committee's approach to considering the content of this Bill: the committee supports the passage of this Bill and the primary legislation (the PPS Bill 2009), but recommends that the government continues to identify further amendments to the reform in response to the matters raised with the committee and the Department.

3.3 Because of the nature and process of the PPS reform, the committee has not limited itself to only considering matters directly arising from the Consequential Amendments Bill currently before it. Issues that are not the subject of amendment in the Consequential Amendments Bill were raised with the committee as part of this inquiry because of their omission from this bill. It is on this basis that the committee has considered them.

3.4 If the process did not involve a referral of powers and consultation with the states and territories the committee might have taken the more usual course of recommending changes to this Bill to amend the primary legislation or amendments directly to the primary legislation.

3.5 As discussed in the previous chapter, it seems to the committee that there are likely to be several opportunities to make further amendments to the PPS legislation before the scheme commences in May 2011 and these could include matters relating to both the PPS Bill 2009 and the Consequential Amendments Bill 2009.

Outstanding issues raised with the committee

Purchase Money Security Interest (PMSI)

Registration of a PMSI – proposed section 62 of the PPS Bill 2009

3.6 The Australian Finance Conference (AFC), with its related associations, the Australian Equipment Lessors Association and Australian Fleet Lessors Association, represents more than 100 financial institutions operating in Australia, which finance all types of plant and equipment in Australia and have a total portfolio 'of about 100 billion'.¹

3.7 The AFC totally supports the concept of a purchase money security interest (PMSI – pronounced *pimsey*), which will be a new concept in Australian personal

1 Mr Bills, *Committee Hansard*, 10 November 2009, p. 5.

property securities. However, the AFC has a major concern about the detail of the registration requirements for a PMSI contained in the Personal Property Securities Law Bill 2009.² Put concisely, the problem as explained by the AFC is:

For goods that are not inventory, a...PMSI must be registered within 10 days after the grantor acquires **possession** of the goods. But...to enable PMSIs to fulfil their purpose this should be changed to within 10 days after **attachment**.³

3.8 The concern arises because of the AFC's view that:

Attachment is the time the financier provides the funds. The financier always knows when this occurs, but does not know when possession occurs. Manufacturers/sellers will sometimes give possession prior to funding if the finance has been conditionally approved, but the financier will not know in which cases. Financiers also provide corporate customers with a finance facility under which the grantor is authorised to draw upon to acquire equipment as required; the financier will not be aware of the transaction or the equipment until the relevant documents arrive from the grantor.⁴

3.9 It is the AFC's submission that there is much support from its members for the PMSI concept if the problem about whether the 10 day timeframe starts from the time of possession or the time of attachment can be resolved:

Financiers really want to utilise the PMSI mechanism because of the super-priority it promises, but if the trigger date is possession they cannot be absolutely sure they will validly register, in which case they will have no priority let alone a super-priority.⁵

3.10 Mr Patch outlined to the committee why he believes there would be 'unintended practical consequences' for the consumer if this approach were adopted:

Perhaps it would help to outline the factual scenario that this works on. We have someone looking to buy a piece of equipment—just say it is a car from a motor vehicle dealer. Under the bill, the finance company has 10 days to make their registration on the register after the purchaser of the car takes possession. So, after the car goes out of the yard and the paperwork goes to the finance company, they have 10 days to make their registration. They could make their registration before it goes out of the yard. That is open to them. What the AFC are asking for is that the 10 days start when the finance company approves the loan. So the car goes out of the yard and the paperwork is sent to the finance company, and sometime later the finance company approves the loan and then has 10 days to make the registration.

2 The relevant provision is in proposed Division 3- Priority of purchase money security interests, section 62 of the Personal Property Securities Bill 2009.

3 Australian Finance Conference, *Submission 8*, p. 2. For a detailed explanation of this issue see *Submission 8*, pp 1 to 4.

4 Australian Finance Conference, *Submission 8*, p. 2.

5 Australian Finance Conference, *Submission 8*, p. 3.

What that means is that there would be, in a practical sense, an unlimited period of time during which the register would not disclose that the finance company will have an interest in this car. Someone else may acquire an interest in this car in the meantime, yet the later registration by the finance company will trump the interest of someone who has quite properly searched the register and discovered nothing.⁶

3.11 While the committee appreciates the government's reasoning behind its policy approach, the AFC is not persuaded that it is fully justifiable. It particularly troubles the AFC that the 'consequence of incorrect PMSI registration is extreme, ie the financier is unsecured.'⁷ The AFC has noted that members will 'not be confident in utilising the PMSI mechanism'⁸ and that in New Zealand a similar provision is undermined because financiers 'do not rely on PMSIs, but instead use subordination agreements, a costly and much less efficient mechanism.'⁹ The AFC believes that the Australian market will also 'rely heavily on subordination agreements.'¹⁰

3.12 The Department does not share the view that the provision will be avoided in Australia. Mr Patch explained that:

...we doubt that we would end up with an approach where Australian financiers were taking subordination agreements. The size of the market in New Zealand and the number of participants make it practicably convenient for them to have subordination agreements with each other as a matter of course, but when the market and the volume of transactions become large it becomes more difficult to have that sort of arrangement routinely establishing subordination agreements.¹¹

3.13 Mr Glenn confirmed the Department's analysis of this issue and his confidence that the PPS register will be utilised:

Ultimately, with the size of the New Zealand economy they seem to have reached a position where they have a moderately efficient workaround to the problem. In Australia that opportunity is not going to arise, and a more efficient way would be to use a register.¹²

3.14 The Department has also articulated a number of ways in which a financier can ensure that its PMSI interest is effective under the proposed arrangement even if it is not aware of the exact date of possession. For example:

- the financier can register the PMSI in anticipation of the arrangement being finalised; or

6 *Committee Hansard*, 10 November 2009, p. 20.

7 Australian Finance Conference, *Submission 8*, p. 3.

8 Australian Finance Conference, *Submission 8*, p. 2.

9 Australian Finance Conference, *Submission 8*, p. 1.

10 Australian Finance Conference, *Submission 8*, p. 4.

11 *Committee Hansard*, 10 November 2009, p. 23.

12 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 23.

- the merchant (such as a car dealer) can register its interest in the goods and can then transfer it to the financier.

Committee view

3.15 The committee notes the Department's view that there could be 'unintended practical consequences' for consumers if the AFC's approach is adopted and agrees that a policy balance in favour of the accuracy of the register is appropriate.

3.16 The committee also notes that although it may involve some 'double handling' for financiers, it appears that there are ways in which the AFC's members (and others seeking to rely on this provision) can, relatively easily, avoid the extreme consequences of missing the 10-day timeframe.

3.17 However, given that ineffective registration can arise because of circumstances beyond the immediate knowledge of the financier (for example, that the grantor has obtained early possession of the goods) the committee is concerned that the consequences are potentially extreme: in these circumstances the financier can lose its security entitlement and become an unsecured creditor. The committee suggests that the government considers mitigating the severity of this situation. Failure to do so could give rise to the risk that industry will seek alternatives to the PMSI system, which could be to the detriment of those requiring finance and could undermine the usefulness of the PPS register.

Recommendation 3

3.18 That the government considers mitigating the severity of the consequence of a defective PMSI registration in goods.

3.19 That this issue is the subject of consideration during the (proposed) statutory review of the PPS legislation.

Meaning of purchase money security interest - Section 14(2) of the PPS Bill 2009

3.20 The current proposal in the PPS Bill 2009 is to exclude PMSIs for a security interest in collateral that 'the grantor intends to use predominantly for personal, domestic or household purposes'.¹³ Piper Alderman has proposed that PMSIs should be able to be obtained for finance for consumer goods:

The effect of paragraph (c) in sub-clause 14(2) is that it will not be possible to have a purchase money security interest in collateral that the grantor intends to use for personal, domestic or household purposes except as now proposed under sub-clause 14(2A). One consistent approach for purchase money security interests for both commercial and consumer finance would make the legislation less complex.¹⁴

13 Paragraph 14(2)(c).

14 Piper Alderman, *Submission 1*, p. 1.

3.21 The AFC and the combined law firms also support this approach.¹⁵

3.22 The Department explained that the proposed approach is the result of a policy decision taken after careful thought:

There is no doubt that it does add complexity and that in doing that it is not something that is done lightly, because the bill does give a very high emphasis on consistency of approach. To depart from that was something taken by the government in a very measured decision to favour the commercial financier over the consumer financier in the very restricted circumstances of that subparagraph.¹⁶

Committee view

3.23 The committee appreciates the argument that consistency is desirable and that this provision is an exception to the usual PMSI rule and the government's usual 'high emphasis on consistency of approach.'¹⁷ The committee also notes the Department's comment that:

Clause 14(2)(c) represents a policy choice preferring all-assets security granted to secure commercial finance over consumer purchase money security interest (which the Department understands are rarely enforced).¹⁸

3.24 The Explanatory Memorandum describes the policy intention behind this approach:

Section 14(2)(c) is intended to promote [the] availability of finance to small business, by ensuring that general [PPS Act] security interests are not eroded by later PMSIs granted to acquire personal use assets.¹⁹

3.25 It seems to the committee that although the government's approach is one that may appear to favour a commercial financier's interest, the policy actually takes into account the interests of the consumer and is intended to support them. The committee therefore supports the approach taken in proposed paragraph 14(2)(c) of the PPS Bill 2009 and the proposed inclusion of sub-clause 14(2A) of this Consequential Amendments Bill.

3.26 If industry or its advisers have a different understanding of the enforcement of consumer PMSIs (which form part of the basis for the government's approach) or has evidence that a contrary outcome is likely for consumers, the committee requests that this is brought to the Department's attention for possible future reform.

15 For the Australian Finance Conference view see *Committee Hansard*, 10 November 2009, p. 7 and the combined view of Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques is discussed at: *Committee Hansard*, 10 November 2009, p. 12.

16 Mr Patch, *Committee Hansard*, 10 November 2009, p. 18.

17 Mr Patch, *Committee Hansard*, 10 November 2009, p. 17.

18 Attorney-General's Department, *Personal Property Securities Bill 2009 Comments and Responses Table - All*, entry for clause 14(2)(c), p. 27.

19 Personal Property Securities (Consequential Amendments) Bill 2009, *Explanatory Memorandum*, p. 27.

Recommendation 4

3.27 The committee recommends that the operation of section 14(2)(c) is the subject of particular consideration during the (proposed) statutory review of the PPS legislation.

Competition between agricultural PMSIs - proposed sections 85 and 86 of the PPS Bill 2009

3.28 A concern raised with the committee was that the legislation provides for agricultural PMSIs but does not indicate which interest takes priority and these sections appear to allocate priority equally.²⁰

3.29 During evidence to the committee, Mr Patch identified that it is likely that there is a mechanism already in the PPS Bill 2009 that will resolve this concern:

The structure of the bill is that we have the default priority rules, which provide the priority rules if another provision in the bill does not give someone an outcome. You will go to clauses 85 and 86. If they do not give you an outcome then you go back to the default priority rules and they give the first people who were claiming the agricultural PMSI to register the priority.²¹

3.30 It appears to the committee that this potential problem has been addressed. The combined law firms have also confirmed to the committee that they 'accept that no further amendment is necessary to address this point.'²²

Vesting provisions in section 267

3.31 Clause 267 of the PPS Bill 2009 provides that: 'An unperfected security interest will vest in the grantor of that interest if the grantor subsequently becomes insolvent.' The problem with this as explained by Mr Whittaker representing the combined law firms is that:

While the amending bill goes some way towards dealing with the structural issues that we saw in those provisions it still does not deal with the fact that the clause could make it impossible for an all-assets security to attach to assets after a grantor becomes insolvent, because they will not have attached until after insolvency which means that they cannot be perfected. That means that, under clause 267, that they would disappear into the hands of the liquidator. We believe that this is probably an unintended consequence of the drafting but it is a very important consequence and could have very serious ramifications for not just the taking of security but also the orderly conduct of liquidation processes. We would urge the

20 For example, see the evidence of Mr Whittaker, *Committee Hansard*, 10 November 2009, p. 14.

21 *Committee Hansard*, 10 November 2009, p. 21.

22 Allens Arthur Robinson, Blake Dawson, Freehills, Mallesons Stephen Jacques, *Additional Information*, 16 November 2009, p. 1.

committee to consider whether this provision could be finetuned in the amending bill.²³

3.32 During this inquiry the Department advised the committee that:

In relation to 267 we are happy to acknowledge that there is room for improving 267 to address an issue raised by the law firms and by Piper Alderman. Where we think further work needs to be done is in identifying how the problem should be fixed. We have had some discussions with, I think it is the group of four, and they have suggested one way of resolving it. We are not sure that that is the way so we need to think further about how the problem should be fixed.²⁴

3.33 The committee commends the government for continuing to respond to this issue, and notes that it intends to involve relevant stakeholders in this process as much as possible.

Commingled goods – proposed sections 101 and 102 of the PPS Bill 2009

3.34 In this inquiry the combined law firms maintained their recommendation that the law in relation to commingled goods should be altered. The issue relates to the provisions for valuing each party's interest in an undifferentiated mass of goods. The view of the combined law firms is that:

...the bill would work—and work well—if it said that if security were enforced over that undifferentiated mass then each party would be able to participate according to the amount that they put in, whereas at the moment it looks at participating according to the amount secured and the value at the time they put it in. If you think about one person putting in 5,000 tonnes of wheat and another person putting in 1,000 tonnes which was subject to their security, and there is now a parcel of 6,000 tonnes of wheat that is sold, the easy and fair solution would be to say that they should share in the ratio of five to one; one should get five-sixths of the whole and one should get one-sixth of the whole. That is not the way it works at the moment, but we think it would be a great advance if it were done that way.²⁵

3.35 The Department disagrees with this alternative policy approach and maintains that it is appropriate that when someone is being accounted to for the value of his or her contribution to the undifferentiated mass the value should be calculated on the basis of the terms of the contract for the supply of the goods. As Mr Patch explained:

...the bill says that when it comes to divvying up the goods, you are not entitled to receive more than what you are owed...²⁶

23 *Committee Hansard*, 10 November 2009, p. 12. Piper Alderman also expresses concern about this: *Submission 1*, pp 1 and 2.

24 Mr Patch, *Committee Hansard*, 10 November 2009, p. 17. See also, for example, Clayton Utz, *Submission 9*, p. 5.

25 Mr Loxton, *Committee Hansard*, 10 November 2009, pp 13 and 14.

26 *Committee Hansard*, 10 November 2009, p. 23.

3.36 In continuing to consider this issue the law firms and the Department provided further material to the committee, which appears at Appendix 3. Put simply, the combined law firms' view is that a party can be disadvantaged if his or her secured property becomes mixed with other property as compared to identical secured property that is kept separate.²⁷ The Department is not convinced that the view of the law firms is accurate and also notes that the provisions in the PPS Bill 2009 'now reflect as closely as possible the provisions in the New Zealand Personal Property Securities Act 1999.'²⁸

Committee view

3.37 The committee is concerned about the issues raised by the combined law firms and would like to ensure that the policy justification for proposed sections 101 and 102 is appropriate. However, in the time available the committee has not been able to assess the relative merits of arguments before it.

3.38 The committee notes the Department's point that the proposed provisions were adopted to reflect overseas legislation (in this instance the New Zealand provisions) in accordance with the committee's previous recommendation to this effect.²⁹ The committee acknowledges this, however, emphasises that the relevant recommendation was to use overseas provisions 'as often as possible...'³⁰ It appears that this area of the proposed law could be one in which departing from the overseas model is warranted.

3.39 In making this observation, the committee's preference is that the legislation is varied as little as possible and only to address any unfairness arising from the operation of the proposed approach. For example, the government could consider altering clauses 101 and 102 to remove the limit of the priority in the goods to the value of the goods on the day in which they became part of the product or mass.

Recommendation 5

3.40 The committee recommends that the government assess and respond to the issues raised by the combined law firms in relation to proposed sections 101 and 102 of the PPS Bill 2009.

3.41 That this issue is the subject of consideration during the (proposed) statutory review of the PPS legislation.

27 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, Supplementary Submission, 23 November 2009.

28 See generally *Answers to Questions on Notice* provided by the Attorney-General's Department 18 November 2009, and see p. 5 in relation to the comparison with the New Zealand provisions.

29 *Answers to Questions on Notice* provided by the Attorney-General's Department 18 November 2009, pp 4 and 5.

30 Recommendation 1, *Exposure draft of the Personal Property Securities Bill 2008*, Senate Legal and Constitutional Affairs Committee, March 2009, p. 29.

Corporations Act amendments

3.42 Concern about the approach to amendments to the Corporations Act related to the PPS reform was raised with the committee. Issues brought to the committee's attention included:

- whether all PPS related provisions will be co-located in the PPS legislation rather than split between the PPS legislation and the Corporations Act; and
- why proposed amendments to the Corporations Act are not included in this bill or the PPS Bill 2009.³¹

3.43 As to the first point, the combined law firms expressed the view that:

The opportunity should be taken to have all security interests, from whatever grantor, dealt with in the one spot, in which case the Corporations Act, other than giving a nod to the PPS Act, should remain silent on it.³²

3.44 The Department explained that 'it would be a tidier outcome for the Corporations Act to be amended [but] it is not strictly necessary for the new scheme to operate.'³³ The Corporations Act amendments are being dealt with in a separate bill because:

...there are in fact separate consultation arrangements and governance arrangements around amendments to the Corporations Act which arise under the corporations agreement between the Commonwealth and the states. We have developed those amendments and they will shortly go through the Ministerial Council on Corporations for agreement by the states and the Commonwealth before being released for public consultation. The amendments are with the Attorney at the moment, before being released.³⁴

Committee view

3.45 The committee is satisfied that this issue is being progressed appropriately, but as this is part of a separate process it appears that it would benefit stakeholders to be kept informed about the progress of this issue. The committee suggests that the Department should give consideration to using a PPS newsletter, a copy of which was tabled during the committee's first inquiry, to achieve this.

Recommendation 6

3.46 That the government regularly provides information to stakeholders about the progress of the Corporations Act amendments relevant to the personal property securities reform.

31 Mr Loxton, *Committee Hansard*, 10 November 2009, p. 15. See also, for example, Clayton Utz, *Submission 9*, covering letter, p. 1.

32 Mr Loxton, *Committee Hansard*, 10 November 2009, p. 15. Clayton Utz also supports this approach: *Submission 9*, covering letter, p. 1.

33 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 19.

34 Mr Glenn, *Committee Hansard*, 10 November 2009, p. 16.

Privacy

3.47 There have been a number of concerns raised about privacy issues relating to PPS reform, which were canvassed in the committee's PPS reports. While protecting individual privacy was always a government priority, there were a number of ways in which submitters, and the committee, thought the approach should be improved.

3.48 This has already occurred to a significant degree, and in relation to this Bill the federal Office of the Privacy Commissioner advised the committee that:

The Office supports the amendments to the *Privacy Act 1988* (Cth) made under Schedule 5 of the Consequential Amendments Bill. The Office also welcomes the Bill's clarification that section 157 of the Personal Property Securities Act 2009 (Cth), if enacted, will provide for interferences with privacy in relation to individuals only, not to corporations (Schedule 4 of the Bill, item 40).³⁵

3.49 Nonetheless, there are still issues of concern raised by the Office of the Victorian Privacy Commissioner. In brief, the issues raised with the committee in that submission are that:

- the proposed clause 26 amendment is too broad: consideration should be given to including an express provision addressing the issue of credit profiling and prohibiting the use of the PPS for direct marketing;³⁶
- the proposed clause 30 amendment may inadvertently result in substantial delays for a complainant: consideration should be given to ensuring that individuals retain the right to seek a personal remedy under the Privacy Act for a breach of section 172(3);³⁷ and
- small businesses should not be exempt from complying with the authorised search requirements of the PPS Register: an amendment similar to that made recently *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) should be included in the PPS Bill.³⁸

3.50 The committee notes the federal Office of the Privacy Commissioner supports the amendments to the *Privacy Act 1988* (Cth), but recommends that the concerns of the Office of the Victorian Privacy Commissioner be considered in detail by the government before the PPS reform commences.

Recommendation 7

3.51 The committee recommends that the concerns of the Office of the Victorian Privacy Commissioner submitted to the committee be considered in detail by the government.

35 Office of the Privacy Commissioner, *Submission 2*, p. 1.

36 Office of the Victorian Privacy Commissioner, *Submission 3*, pp 1 and 2.

37 Office of the Victorian Privacy Commissioner, *Submission 3*, p. 2.

38 Office of the Victorian Privacy Commissioner, *Submission 3*, pp 2 and 3.

Other matters

3.52 Once again, the committee has received substantially more material than it was possible to discuss in detail in this necessarily brief report. The committee notes that even in the short timeframe available for this inquiry the following submitters identified a number of concerns additional to those discussed above:

- Australian Securitisation Forum: raised a number of issues of concern (some matters raised previously that 'remain outstanding' and some new matters arising from this Bill);³⁹
- Clayton Utz: supports this Bill, but do not believe the amendments 'are sufficient to address the problems raised by stakeholders.'⁴⁰ The submission identifies a number of major issues and a table of typographical or minor errors;⁴¹ and
- the combined submission of Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques: identifies three categories of issues – continuing concerns, matters they have recently identified and further issues that will come to light.⁴² The law firms have consolidated the issues of concern to them into three schedules which are attached to their submission.⁴³

3.53 The committee commends all of these issues to the government for consideration and action where appropriate. The committee also considers that it would greatly assist businesses and their advisers if as much information as possible about policy decisions can be made publicly available.

Recommendation 8

3.54 That the government consider and respond to all of the issues raised in the submissions made to this inquiry to which it has not already responded.

Recommendation 9

3.55 The committee recommends that the Senate pass the Bill and urges the government to act on the other recommendations in this report.

Senator Trish Crossin Chair

39 Australian Securitisation Conference, *Submission 7*.

40 Clayton Utz, *Submission 9*, covering letter, p. 1.

41 Clayton Utz, *Submission 9*, pp 1 to 7.

42 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, p. 1.

43 Allens Arthur Robinson, Blake Dawson, Freehills and Mallesons Stephen Jacques, *Submission 10*, schedules 1 to 3, pp 1 to 8.

