

3 December 2020

Attorney-General's Department
4 National Circuit
BARTON ACT 2600

By email: PPSAREform@ag.gov.au

Dear Sir/Madam

Agribusiness industry consultation and the *Personal Property Securities Act 2009* (Cth)

1. The Law Council of Australia (**Law Council**) welcomes the opportunity to make a submission to the Attorney-General's Department in relation to the agribusiness industry consultation regarding the *Personal Property Securities Act 2009* (Cth) (**PPSA**) and the associated Public Consultation Paper published in October 2020 (**Consultation Paper**).
2. The Law Council is grateful to the Financial Services Committee and the Insolvency and Restructuring Committee of the Law Council's Business Law Section (together, the **BLS Committees**) and the Queensland Law Society (**QLS**) for their contributions to the Law Council's submission.
3. The BLS Committees and the QLS have provided divergent views on some of the issues raised in the Consultation Paper. Therefore, in this submission, the Law Council provides the views of each of the contributors separately to ensure clarity of message.

Submission of the BLS Committees

4. Set out below are the BLS Committees' responses to the issues for consideration that were raised in the Consultation Paper:
 - (a) The BLS Committees believe the decision to retain or delete sections 85 and 86 of the PPSA should depend on the views of the agribusiness industry as to the relevance of those provisions to that industry. However, the BLS Committees note that some members are aware that these sections have been relied upon by various suppliers to the agribusiness sector.
 - (b) If section 85 is retained, then the words '(other than a purchase money security interest)' should be inserted after 'other security interest' as per Recommendation 255 of the Final Report of the Review of the PPSA published in 2015 (**Final Report**). As noted at [7.7.11.1] of the Final Report, a supplier of nursery plants may well hold a purchase money security interest (**PMSI**). This amendment would make section 85 consistent with section 86, so that security interests to which either section applies would rank after a purchase money security interest.

- (c) If retained, each of subsections 85(b) and 86(b) should be amended to make it clear that it is the funding or credit secured by the security interest (not the security interest itself) that enables the crop to be produced or the livestock to be fed or developed.
- (d) If sections 85 and 86 are retained, the BLS Committee submit that section 64 (dealing with the priority of security interests in accounts) should refer to security interests to which sections 85 and 86 apply as well as purchase money security interests. This issue was also noted in [7.7.11.1] of the Final Report.

Submission of the QLS

- 5. The submission of the QLS has been compiled by members of the QLS Water and Agribusiness Law Committee and the QLS Banking and Financial Services Law Committee. The QLS appreciates the consultation on this important policy issue.

Responses to questions in Consultation Paper

Relevance to Australian context	
Question 1 – Is it industry practice to finance a specific crop or herd of livestock?	<p>Yes.</p> <p>The QLS also understands that this is common practice in the sugar industry, with financiers putting in place PPSA securities of crops, farm plant & equipment and consumables (eg fertiliser, chemicals etc).</p> <p>These securities are put in place on a season-by-season basis. The cane season each year is between June and December, when the harvesting, cultivating, fertilising etc are undertaken. After this, the sugar grows too high to drive a tractor through, and so the work on the sugar crop drops away in January to May each year (out of season).</p>
Question 2 – Is industry aware of the special priority interests available under sections 85 or 86?	<p>Generally, yes, but not sufficiently to take maximum benefits.</p> <p>A QLS Committee member acting for farmers and graziers advises that issues do arise with clients having difficulty obtaining finance to grow/continue to grow/harvest crops or to feed livestock, shear sheep etc. One example given is where legal assistance was required to gain consent from a bank for the sheep farmer to grant security to the wool buyer for the 'wool on the sheep's back' where the bank already held security over the sheep but would not advance further money to finance the costs of shearing the sheep and delivering the wool. The ability to grant this type of security allowed the farmer to shear the sheep, repay the cost of shearing and apply the balance to reduction of the bank debt.</p> <p>The QLS has also received comments regarding the sugar industry. The QLS understand that special priority interests are not used much in the sugar industry. However, a mechanism that is used, when a default arises, is financiers</p>

	<p>serving notices under section 120 of the PPSA on the grower.</p> <p>The area of enforceability of PPSA securities over crops/plants and equipment (P&E) and consumables is very unclear. For example, if a financier serves a section 120 notice on a grower (enforcement of PPSA security), the legislation is not clear as to whether this gives the financier an irrefutable right to receive the proceeds of the sugar cane crop. The buyer of the sugar crop is then in an unclear position – should they pay the sugar crop proceeds to the grower or should they pay the sugar crop proceeds to the financier?</p>
Question 3 – Are sections 85 and 86 relevant to the Australian agricultural finance industry?	Yes. Highly relevant given potential droughts and other issues.
Question 4 – Would greater awareness of the availability of priority interests under sections 85 and 86 increase the likelihood of financiers taking such interests?	Yes. This might also provide more clarity as to the enforceability of PPSA securities.
Priority of interests granted under sections 85 and 86	
Question 5 – Should an interest granted in livestock under section 86 rank ahead of an earlier PMSI interest?	<p>Yes.</p> <p>If the security interest is a PMSI, it is likely the holder will automatically 'go to the front of the queue' even if the PMSI was registered on the Personal Property Securities Register last. This does not seem to be an equitable outcome and causes some confusion as to which PPSA securities rank ahead of other PPSA securities.</p> <p>The difficulties are illustrated as follows:</p> <ul style="list-style-type: none"> (a) A PMSI interest provides security to the bank/pastoral house who provides finance to purchase the livestock. (b) While the bank/finance house may not necessarily enforce the security, it is not unusual for them to refuse to provide further finance for animal welfare/feed/shearing when these are necessary to keep the animal alive or get them ready to be sent to market. (c) Obviously if money is advanced under s 86, it will tend to preserve the value of the security over which the PMSI is registered e.g. if the

	<p>cow/sheep is not kept alive/in good health the value of the security held under the PMSI is more likely to be maintained (i.e. a dead cow/sheep is worth nothing to the original PMSI holder and it seems fair that the cost of feeding maintaining the animal is a cost that should be borne in priority to the PMSI holder.</p> <p>(d) The PMSI holder actually has the ability to force the sale of the livestock or to make further advances, but often in practice finds neither of those solutions politically acceptable or financially acceptable and prefers to force the farmer to make a decision to dispose of the livestock in a forced sale situation by refusing further finance.</p>
<p>Question 6 - Is it appropriate that an interest granted under section 85 in crops has priority over an earlier PMSI interest?</p>	<p>Yes, with similar logic to the above. For example, if acquisition of a crop, say at the same time as the acquisition of the land, was funded by a bank, it is usual for the farmer to have to spend money on the crop to maintain its value or potential (e.g. purchase of the additional irrigation water in an unusually dry season, application of fertiliser or herbicides etc, all of which will tend to maximise the potential of the crop and preserve the security value of the PMSI interest).</p> <p>At a practical level, most trading banks do not have the skill levels necessary to properly assess the need to spend money on a growing crop or the impact of not spending the money.</p> <p>Often the rural produce/chemical/grain trading/cotton trading businesses have the skill set which permit these businesses to lend money on security of the growing crop. It is in their interest to ensure that the crop proceeds will cover the costs of keeping the crops alive and well performing, which in turn will maintain the value of the PMSI in circumstances where the value would otherwise 'evaporate' or disappear if the crop fails.</p> <p>If at the time of purchase of the crop, usually with the land, the crop has only just emerged, its value is negligible. It is the finance provided to grow the crop that creates the value. Without priority being given to the entity that has provided that finance, there would be nothing to stop the bank taking the full proceeds of the crop and applying it to reduce the debt owing on the balance of the property originally financed, which would result in a straight transfer of wealth from the crop financier to the bank. This is a disincentive to financiers lending money to growers to grow crops. If this happened, the crop financier would not lend money to the grower.</p> <p>Background information:</p>

	<p>(a) In a conventional trading bank financing arrangement, the trading bank will lend money based on the security value of land, but will take additional security over livestock and crops on a 'make good basis'.</p> <p>(b) In high input cost crops (e.g. cotton), the cost of the input is very high relative to the cost of the land. Because of the bank's inability to assess the risk in respect of cropping and its value as a security, the banks will not attribute significant value to the growing crop or be capable of assessing them on the ground.</p> <p>(c) This results in only specialised finance providers being able to assess the risk and being able to lend the money, but they will only do so if they are protected by having adequate security.</p>
<p>Question 7 - Does your experience support a section 85 interest having priority over a separate interest perfected by control in the same crops?</p>	<p>Yes.</p> <p>This may be relevant where a financier has advanced money to a person/share farmer growing a crop on land belonging to a different person who happens to be the registered proprietor of the land.</p> <p>In the above case, the share farmer will need the ability to grant a security interest even though the crop is growing on land belonging to another person - note it is common for a share farmer not to have a formal lease and therefore not to have exclusive possession of the land.</p>
<p>Consistent rules</p>	
<p>Question 8 - Should an interest granted under sections 85 and 86 be subject to the same priority rules?</p>	<p>Yes.</p> <p>The complex priority rules in the PPSA should be clarified and streamlined.</p>
<p>Question 9 - Should sections 85 and 86 be retained?</p>	<p>Yes, but not in their current form.</p> <p>(a) The PMSI priority exception in section 86 (as to PMSI's in livestock) ought to be removed. The effect of this change would also enable a substantial opportunity for 'drought finance' for livestock by third parties, who could obtain priority ahead of PPS PMSI's in the livestock.</p> <p>(b) The whole of the provisions pertaining to a six-month rule contained in subsections 85(c) and 86 (c) should be removed.</p> <p>If recommendation 255 is implemented, the QLS suggests that the priority be limited to the</p>

	market value of the security interest in the collateral at the time it was granted to prevent a bank benefiting from an ever increasing value in the crop generated by the party who financed the growing of the crop.
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Summary

6. The PPSA is complex legislation. The issues of enforcement and priority of securities is not clear and leads to confusion and engagement of lawyers to work through the complexity.
7. The regime for enforceability and priority of any securities over crops, livestock, farm P&E and consumables (e.g. fertiliser and chemicals) should be streamlined and clarified.
8. The finance industry is generally aware of the special priority interests available under sections 85 and 86 PPSA, but mainly as to livestock herd finance only.
9. Sections 85 and 86 of the PPSA are relevant to the Australian agricultural finance industry, especially given severe drought conditions experienced from time to time in Australia.
10. QLS submits that:
 - greater awareness of the availability of priority interests under ss 85 and 86 would likely increase the likelihood of financiers/ credit providers of Agri Inputs taking such interests;
 - the PMSI priority exception in section 86 (as to PMSI's in livestock) ought to be removed. The effect of this change would also enable a substantial opportunity for 'drought finance' for livestock by third parties, who could obtain priority ahead of PPS PMSI's in the livestock; and
 - the whole of the provisions contained in subsections 85(c) and 86 (c) of the PPSA be removed, so as to remove reference to the 6 month rule.
11. Financiers of 'Agri Inputs' (eg invoice and supply debtor finance) would also likely be more willing to provide capital if these changes were made.

Background

Generally

12. In agriculture there are often multiple providers of input for the production of crops (e.g. providers of fertiliser) and livestock (e.g. providers of grazing agistment or feedlots) (**Agri Inputs**).
13. In the USA, there are numerous state statutes which create 'agricultural liens' in favour of those who provide Agri Inputs, there is no need for a consensual security agreement, and generally no 'six-month' rule applies as in subsections 85(c) and 86(c) of the PPSA.

14. In Australia, however, 'agricultural liens' are not created in favour of those who provide Agri Inputs, except by a consensual security agreement under the PPSA, and must satisfy the 'six-month' rules in subsections 85(c) and 86(c).
15. The QLS notes that given the:
- unitary model of secured transactions is used in all states of the USA;¹
 - number and size of Agri financiers operating in the USA;
 - number of Agri enterprises conducted by SMEs;
 - PPSA is intended to be an economic tool for the provision of finance to SMEs;
 - common time period (for sowing to harvesting) for crops is six months, the raising of livestock takes a much greater period;
 - effects which natural disasters (such as drought) can have upon crop and livestock production, and increased cost and requirements for Agri Inputs (such as increased cost of water (for both) and feed); and
 - greater clarity and priority which can be provided to financiers of Agri Inputs the more likely it may be that financiers will wish to participate in the Australian Agri industry,

it is useful to consider and compare their treatment of Agri Inputs when making submissions on the operation of sections 86 and 87 of the PPSA.

16. Generally, in a crop and livestock lifecycle, finance occurs by the provision of:
- (a) True PMSI finance (eg seed finance or herd finance) by which the new capital is able to be raised by the farming enterprise, the PPS PMSI financiers providing this and taking a PMSI security interest over the new capital.
 - (b) Occupation and use of real property, the financiers of the farming enterprise's land (not falling under the PPSA) (who may be lessors or financiers of the land, but for ease of reference are collectively called 'mortgagees' below) are (from such land) providing to the farming enterprise:
 - (i) nutrients to crops; and
 - (ii) grass feed to grazing livestock.
17. In effect, the PPS PMSI financier is directly, immediately and continuously taking the benefit of the mortgagee's nutrients and grass feed by the production of the crop and the fattening of the livestock.
18. Whilst not necessarily to the detriment of the mortgagee, the QLS notes that it is generally at no additional cost to, and of substantial commercial benefit (ie continually increasing the value of the collateral) to the PPS PMSI financier, whilst also automatically obtaining PMSI priority ahead of the mortgagees.

¹ Where unitary model of secured transactions laws principally finds its historical foundation in Article 9 Uniform Commercial Code.

The PMSI priority exception in section 86 (as to PMSI's priority in livestock) ought to be removed

19. In later stages, especially during drought, other Agri Inputs (and not being the PPS PMSI financiers) are often required to crops and livestock, either or both to:
 - (a) preserve the value of the collateral, such as provision of:
 - (i) water; or
 - (ii) feed or transport to other locations during droughts, or veterinary services due to ill health;
 - (b) greatly accelerate and improve the production value of the collateral, such as by:
 - (i) crop spraying or harvesting services for crops; or
 - (ii) improved paddock grasses/feed or by 'finishing off' livestock in feedlots with high quality feed.
20. When considering this further 'new capital' of Agri Inputs which is directly benefitting the PPS PMSI financiers in each case (by preserving or improving the capital value of the crops or livestock), it is difficult to discern why the provider of Agri Inputs for:
 - crops ranks ahead of a PPS PMSI financier; but
 - livestock ranks behind a PPS PMSI financier.
21. The effect of this change would also enable a substantial opportunity for 'drought finance' for livestock by third parties, who would obtain priority ahead of PPS PMSIs in the livestock, which they cannot currently.
22. The QLS submits that, to be consistent with the priority given to Agri Inputs for crops:
 - the PMSI priority exception in section 86 (as to PMSIs in livestock) ought to be removed to enhance the market of providers for Agri Inputs for livestock; and
 - as is currently the case for crops, the uncapped dollar value of such priority of the Agri Inputs for livestock should remain.

The whole of the provisions contained in subsections 85(c) and 86(c) PPS should be removed.

23. The six-month period referred to in subsection 85(c) is the common sowing to harvest period in Australia for crops. This seems to hark back to the times when 'crop liens' agreements had to be renewed and re-registered on state registers each year.
24. For some reason (or perhaps to reflect a common 'finishing off period' for cattle feedlots), this six-month period has been adopted for livestock also in subsection 86(c).
25. Generally, no such time period exists in any equitable liens able to be cited, as to Agri Inputs in the USA.

26. Given what has been said above as to the improvement and maintenance of the capital value of crops and livestock by Agri Inputs, the QLS submits that the 6 month rule is not suitable, and the whole of the provisions contained in subsections 85(c) and 86 (c) should be removed.

Law Council Contact

27. Please contact John Farrell, Senior Policy Lawyer, on (02) 6246 3714 or at john.farrell@lawcouncil.asn.au in the first instance, if you require further information or clarification from the Law Council.

Yours sincerely



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