



Law Council
OF AUSTRALIA

Business Law Section

Ms Carmen Miragaya
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Commercial and Administrative Law Branch
Attorney-General's Department
3-5 National Circuit
Barton ACT 2600

28 February 2014

Dear Miragaya,

Possible amendments to the *Personal Property Securities Act 2009 (Cth)*

Introduction

1. This submission concerning the possible amendments to the *Personal Property Securities Act 2009 (Cth)* ("**Act**") is made on behalf of Business Law Section ("**BLS**") of the Law Council of Australia ("**LCA**").
2. This submission has been prepared by two of the specialist committees of the BLS - the Financial Services Committee and the Insolvency and Restructuring Committee ("**Committees**"). The Committees are made up of senior legal practitioners working in their respective areas who have detailed and relevant experience in dealing with issues arising out of the Act across Australia.
3. In your email to Greg Rodgers of the BLS on 24 February 2014, you suggested five possible responses to the concerns raised by small and medium sized hire businesses about the impact of the Act and the increased regulatory compliance it has caused, particularly for businesses that lease goods on an indefinite basis, where online registration of security interest on the PPS Register¹ may be required.
4. Each of your suggested responses will be addressed in this submission and general comments from the Committees are also provided that relate to the general nature of the responses.

Submission

Response 1 – clarify meaning of a lease of an indefinite term

5. The first proposal is to clarify the meaning of a lease of an 'indefinite term' in section 13(1)(b) of the Act to clarify that the provision does not apply to a lease of a defined duration of less than one year only because the lease is terminable by either party prior to the end of the fixed term.

¹ The register established by section 147 of the *Personal Property Securities Act 2009 (Cth)*

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6. It is submitted that any further amendment to the Act to clarify that a lease which is of a duration which is less than one year will not be considered a PPS Lease² is unnecessary as it does not appear to be the intention of the Act that such leases would fall within the definition of a PPS Lease.
7. However, it is considered that there is no foreseeable downside in making an amendment to the Act to clarify this issue, provided the amendment to the Act does not alter the legal effect of section 13(1)(b) of the Act.
8. The benefit of amending the Act to clarify this issue would be a potential decrease in compliance costs for parties who are currently taking steps to perfect³ what they consider to be a security interest granted pursuant to a PPS Lease, when in practice there is no security interest that requires perfection.

Response 2 – abolish the PPS Lease deeming provisions

9. The second proposal is to abolish the PPS Lease deeming provisions which provide that any PPS Lease is considered a security interest for the purpose of the Act⁴ (“**Deeming Provisions**”).
10. With respect, the Committees are not able to support this proposal. In the view of the Committees, removing or materially amending the Deeming Provisions would cause serious and adverse consequences for many sectors within Australia, including the broader leasing industry. It is considered that the likely adverse effects once an amendment was fully implemented would outweigh the benefit flowing from a potential decrease in compliance costs for businesses in the hire industry whose arrangements are clearly operating leases or short term hire. In addition to these adverse effects, all businesses (including the short-term hire beneficiaries of the proposed reform) would of course incur additional expense to change procedures and documents to cater for an amendment to the Deeming Provisions.
11. The Committees are of the view that the proposed reform to the Deeming Provisions would cause a net increase in regulatory compliance costs and "red tape", which would primarily fall on lessors and financiers. It is foreseeable that the abolition of the Deeming Provisions could place new obstacles in the way of small and medium enterprises seeking to acquire equipment on favourable commercial terms and increase the costs faced by small and medium enterprises in the hire industry and the wider economy.
12. In our submission, these results would flow from an increased importance to the question of whether a lease arrangement ‘in substance’ secures payment or performance of an obligation, so as to fall within the definition of a security interest⁵ that would be registrable. While some cases will very clearly be (or not be) a security interest, in practice there are a wide variety of situations where the true categorisation will be unclear, and cannot finally be determined without resorting to court proceedings. Those proceedings would then have to be determined by the operation of common law principles rather than the priority and perfection rules in the Act. It is submitted that the abolition of the Deeming Provisions has the potential to increase overall risk in the hire industry and the wider economy as third parties cannot rely on the PPS Register to determine whether a person has clear title to personal property, has title subject to a security interest or is merely hiring the personal property. Although the PPS Register does not resolve the issue completely, it serves as a notice board to the general public that personal property may be subject to competing interests.

²Ibid s13

³Ibid s21

⁴Ibid ss12(3)(c), 13

⁵Ibid s12(1)

13. The Committees note with concern that equivalents to the Deeming Provisions were inserted (in effect as a “red tape” reduction measure) in the Canadian personal property securities legislation after the legislation commenced. They became necessary when experience showed there to be, in many cases, real confusion whether a particular form of operating lease amounted to a security interest. This resulted in extensive litigation as to whether particular lease or hire agreements secured payment or performance of an obligation. The Deeming Provisions, while potentially causing inconvenience for some businesses (in that processing registrations becomes an economic necessity) in fact are designed to remove an occasion for material wastage of costs across the economy. They reduce uncertainty that would otherwise affect a wide range of economically important contracts.
14. If the Deeming Provisions were abolished it is submitted that this would cause many businesses in the hire industry to register leases on the PPS Register in cases where they are genuinely in doubt as to the correct characterisation of a lease and whether it constitutes a security interest. If the business was incorrect and in fact a lease was not an in substance security interest the business could inadvertently breach section 151 of the Act, which requires a party to have a reasonable belief that they are, or will become, a secured party in relation to the collateral.
15. In the broader context, the Committees note that the PPS laws were intended as a significant piece of microeconomic reform, implemented with bipartisan support. The existence of a security interests register that may be relied on as substantially complete is significant economic infrastructure. If a section of the economy and range of transactions were effectively exempted from the need to register by removal of the Deeming Provisions, the benefits of the PPS Register would be diluted, which would be disappointing having regard to the significant expense to the Commonwealth and to the finance industry of implementing a personal property securities register.
16. It is submitted that removing the Deeming Provisions would be an inappropriate measure, and in any event should not be considered without a thorough review of the wider impact it would have on the operation of the Act and the economy.

Response 3 – abolish section 13(1)(e) of the Act

17. The third proposal is to abolish section 13(1)(e) of the Act which has the effect that a lease or bailment of goods that may or must be described by serial number will be considered a PPS Lease if the duration of the lease or bailment is 90 days or more.
18. The Canadian and New Zealand versions of the Act do not draw a distinction between serial numbered goods, such as motor vehicles, and other goods for the purpose of the Deeming Provisions. Their deeming provisions apply consistently for leases for a term of more than one year.
19. It is submitted that section 13(1)(e) of the Act be abolished. It is submitted that this would decrease compliance costs for businesses that lease serial numbered goods for periods of between 90 days and one year without greatly increasing the risk to third party purchasers of such serial numbered goods. Consequential amendments would need to be made to other provisions in the Act that refer to section 13(1)(e) (see, for example, section 268) and also the Corporations Act (see, for example, section 588FN).
20. If section 13(1)(e) of the Act were abolished on the condition that it only related to security interests that arose after the abolition of the section then it is submitted that this could adversely affect secured parties in some circumstances. An example of a secured party that could be affected would be one that has advanced funds to a grantor on the understanding that it was given a security interest in a motor vehicle, which was not subject to a registered security interest at the time of the advance, when in fact the motor vehicle was hired on an operating lease of a duration of between 90 days and one year (which would cause the lease

to be a PPS Lease). If section 13(1)(e) of the Act were abolished in such circumstances, the secured party would no longer have a security interest in the motor vehicle as the grantor would cease to have the right to grant a security interest in the motor vehicle.

Response 4 – modify the definition of motor vehicle

21. The fourth proposal is to amend the definition of a motor vehicle⁶ to require both elements of regulation 1.7(2)(b) to be fulfilled in order to qualify as a motor vehicle for the purpose of the Act.
22. This response would still have an impact on the hire industry if section 13(1)(e) of the Act were abolished, due to the operation of the taking free provision in relation to serial numbered goods.⁷
23. It is submitted that this response would be more appropriately directed at the hire business industry so they can comment on whether this would reduce compliance costs.

Response 5 – provide for leases of an indefinite term to only become a PPS Lease once the lessee has been in possession for more than one year

24. With respect, the Committees are strongly opposed to the fifth proposal.
25. The Committees consider that the proposal would be likely to materially increase uncertainty for those in the hire industry and financiers. This could increase costs for secured parties attempting to enforce security interests and dissuade financiers from offering loans secured by lease agreements, which would in turn result in increased cost and difficulty for small and medium size enterprises in obtaining finance.
26. It is arguable that if the proposal were to be implemented, it would require a significant number of consequential amendments to have the desired effect, and each of those amendments raises the potential for unintended consequences. The concern relates to the following provisions:
 - a. Section 62 of the Act, which provides for when a purchase money security interest (“**PMSI**”) has priority over a regular security interest in the same collateral (“**PPSA Amendment**”); and
 - b. section 588FL of the *Corporations Act 2001* (Cth), which provides for certain security interests granted by a company to vest in the insolvent company if they are not registered within specific timeframes (“**Corporations Act Amendment**”)

PPSA Amendment

27. In relation to the PPSA Amendment, the current position is that in order to obtain the super priority status of a PMSI, the secured party is required to register their security interest within strict timeframes (depending on certain technical distinctions such as whether the goods are inventory and whether the personal property is goods or other property) from when the grantor obtains possession of the goods.
28. It is arguable that if the fifth proposal were adopted further amendments would be required to section 62 of the Act to govern when a lease of an indefinite term that has reached the one year mark is required to be registered in order to obtain the super priority of a PMSI.

⁶Personal Property Securities Regulation 2010 (Cth) reg1.7(2)(b)

⁷Personal Property Securities Act 2009 (Cth) s44

29. It is submitted that section 62 of the Act would not need to be amended if the fifth proposal were adopted because up until the point where the person leasing the goods retains uninterrupted possession of the goods for one year, they would not fall within the definition of a 'grantor'⁸ as they are not a person to whom any of the following would apply⁹:
- a. a person who has the interest in personal property to which a security interest has attached – as the security interest only arises after the person retains possession for one year; or
 - b. a lessee under a PPS Lease – as the indefinite lease will only become a PPS Lease once the person retains possession for one year.
30. The comments in paragraph 29 of this submission appears to be consistent with a number of Canadian authorities¹⁰ that deal with the issue of leases for a term of less than one year where the grantor (debtor in the relevant legislation) retains uninterrupted possession of the collateral for more than one year.

Corporations Act Amendment

31. The fifth proposal would be problematic in the context of section 588FL of the *Corporations Act 2001* (Cth) where the 20 business day period commences when the security agreement that gives rise to the security interest comes into force. In the absence of amendment or clarification of when a security agreement 'comes into force' it is arguable that the 20 business day period would commence when the hire agreement is entered into, even if it is only deemed to give rise to a security interest after one year.
32. It is submitted that the concern raised in the preceding paragraph may not require amendment to the *Corporations Act 2001* (Cth), but this is still unclear. It is relevant to consider the definition of a 'security agreement', which means¹¹:
- a. an agreement or act by which a security interest is created, arises or is provided for; or
 - b. writing evidencing such an agreement or act.
33. One view is that an indefinite hire agreement is not an agreement by which a security interest is created and it is the act of retaining possession of the goods pursuant to the hire agreement for a period of one year that results in the creation of the security interest. It would follow that the security agreement would only 'come into force' within the meaning of section 588FL of the *Corporations Act 2001* (Cth) once the one year period had been reached and it is from that point when the 20 business day time period provided for by section 588FL would begin to run.

General comments on fifth proposal

34. It is noted that the above concerns for financiers and those involved in the hire industry may already exist in relation to PPS Leases arising under section 13(1)(d) of the Act. The above issues as to timing of registration could exist where a lease is for a period of less than one year, and is later extended over the one year period. However, it is submitted if the fifth proposal were adopted, these concerns are likely to increase as those in the hire industry

⁸ Ibid s10

⁹ Taken from the definition of grantor, Ibid s10

¹⁰ *Guaranty Trust Co. of Canada v. Canadian Imperial Bank of Commerce*, 1989 2 P.P.S.A.C. (2d) 88 (Ont. H.C.), affirmed 1993 6 P.P.S.A.C. (2d) 51 (Ont. C.A.); *Royal Bank of Canada v. Toronto-Dominion Leasing Ltd.*, 1987 8 P.P.S.A.C. 103 (Sask. Q.B.)

¹¹ *Personal Property Securities Act 2009* (Cth) s10

amend their business practices to lease goods on an indefinite basis to avoid the application of the Act. There has been no legal guidance as to which interpretation of the legislation is to be accepted in Australia.

35. Despite whether the above amendments are necessary or not, it is submitted that a passage-of-time based test could cause significant confusion in the hire industry and specifically in insolvency scenarios as to when a security interest arising under a lease for an indefinite term is to be registered in order to obtain the super priority status of a PMSI.
36. Again, financiers are very sensitive to the existence of a PMSI on a grantor's PPS Register record, and any uncertainty as to the possibility of a PMSI appearing after a financier has advanced funds could result in changes to procedures and perhaps credit approval policies, which could potentially reduce the availability of finance.
37. The Committees note that a regime based on expiration of time will naturally invite mistakes which may lead to windfall gains or losses based on essentially random factors (whether an insolvency should occur shortly before or after the one year period). It is submitted that lessors will face new operational costs in tracking each hire agreement and taking steps to register within (we assume) 20 days for each hire that achieves its anniversary. Whether these costs are outweighed by the decrease in volume of registrations that are made would have to be further considered.
38. Quite aside from these technical matters, it is submitted that the proposed amendment would be readily open to "gaming" by the parties in an insolvency scenario, as it would be difficult or impossible for an insolvency practitioner to determine whether a grantor had retained uninterrupted possession of goods for a lease of an indefinite term that commenced over a year prior to their appointment. Equipment providers could "surprise" insolvency practitioners by producing evidence of a short duration loss of possession at some time in the 12 months immediately before the insolvency and would have a material incentive to produce fraudulent evidence purporting to show such a short duration loss of possession.
39. Finally as a matter of policy, the Committees refer to the comments at 15 above. The key benefit of the PPS Register, which has been implemented at such a significant cost, is transparency of security arrangements across the economy. The Act should encourage parties to register their security interest on the PPS Register to provide for a better informed economy and more certainty to lenders as to what personal property can be used as collateral. Proposal 5, if implemented, would provide ample opportunities for parties to disguise the true ownership of goods and the true nature of their economic arrangements and would undermine the orderly operation of the register.
40. It is submitted that the proposed amendment should not be adopted at this time, and in any event should not be considered without a thorough review of the potential impact the proposed amendment would have on the remainder of the Act and on the finance sector as a whole. Although the reform might afford the equipment hire industry an opportunity for limited cost savings it has the potential to cause additional expense for other equally important sectors of the economy.

Conclusion and further contact

41. The Committees understand that there is a statutory review process under the Act, which is about to start, designed to cover issues like the ones raised in these submissions. The Committees are of the view that any significant changes to the Act should be left until the wider review has been completed in order to minimise the risk of unintended consequences resulting from considering sections of the Act in isolation.

42. In conclusion, it is submitted that:
- a. Response one – clarification of indefinite term – the Committees are neither for nor against the proposed amendment, it is recognised that it could decrease compliance costs;
 - b. Response two – abolishing Deeming Provisions – this response should not be adopted without a thorough review of the impact on all stakeholders involved, not just the equipment hire industry;
 - c. Response three – removing 90 day rule – this should be adopted as it is a sensible method of reducing compliance costs;
 - d. Response four – definition of motor vehicle – the Committees are neither for nor against the proposed amendments, and it should be referred to the hire industry for comment; and
 - e. Response five – indefinite term lease only security interest after 12 months – this should not be adopted, at least not without a thorough review of the impact on all stakeholders involved, not just the equipment hire industry.
43. The representatives of the Committees would be pleased to discuss any aspect of this submission.
44. Please contact Greg Rodgers of the BLS' Insolvency & Reconstruction Law Committee (who is the LCA's representative on the PPSA Stakeholder Forum) on 07 3009 9303 if you would like to do so.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'John Keeves', with a long horizontal flourish extending to the right.

John Keeves
Chairman, Business Law Section