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Our reference: 665

Dear Sirs

**Comments on Personal Property Securities (Corporations and other Amendments) Bill 2010**

Thank you for this opportunity to make submissions to the Senate Standing Committee on Legal and Constitutional Affairs on the Personal Property Securities (Corporations and other Amendments) Bill 2010 (**Bill**). Our submission is enclosed with this letter.

The focus of this submission is on Schedules 1 and 2 of the Bill. We generally support the Bill, though we do not believe the amendments that are to be made to the Corporations Act and the Personal Property Securities Act by the Bill are sufficient to address the inconsistencies and ambiguities identified by stakeholders. We have outlined our concerns in detail in the enclosed submission.

Please note that the views expressed in the submission are the views of the author and are not the views of any client of Clayton Utz.

[ Yours Sincerely, Angela Flannery, Partner ]

## Comments on Personal Property Securities (Corporations and Other Amendments) Bill 2010 (Bill)

### Schedule 1 - Amendments to the Corporations Act 2001 (Cth) (Corporations Act)

#### 1. Section 588FL

1.1 The Bill provides for a new section 588FL and associated provisions to be inserted in the Corporations Act. These provisions replicate, with modifications, the existing section 266 of the Corporations Act. These provisions also replicate, with important changes that are discussed below, section 267 and associated provisions of the Personal Property Securities Act 2009 (Cth) (PPS Act).

1.2 A key difference between the proposed new section 588FL of the Corporations Act and section 267 of the PPS Act is that:

- (a) section 267 and associated provisions of the PPS Act 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, as relevant; and
- (b) section 588FL and associated new provisions of the Corporations Act, insofar as those provisions apply to security interests granted by companies enforceable against third parties under Australian law, will provide that most security interests granted by a company which are regulated by the PPS Act and which are perfected only by registration will generally vest in the grantor if registered after the later of:
  - (i) 20 business days after the relevant security agreement giving rise to the security interest came into force; and
  - (ii) 6 months before the date that the winding up of that company commences or the "section 513C day" (as defined in the Corporations Act) in respect of that company.

In other words, 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.

1.3 There appear to be no compelling policy reasons for an equivalent of the existing section 266 of the Corporations Act to apply where the regime in section 267 and associated provisions of the PPS Act would apply. 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, as will occur in the event that the new section 588FL is inserted in the Corporations Act.

1.4 Finally, the purpose of section 588FL(3) is unclear. 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. There is no equivalent in the existing Corporations Act and this subsection should be deleted.

## 2. PPSA retention of title property

- 2.1 The Bill will insert a new section 51F in the Corporations Act to define "PPSA retention of title property". To qualify as PPSA retention of title property, all 5 requirements in section 51F(1) must be satisfied. We suggest that section 51F(1)(b) is deleted. There will be many circumstances in which personal property should be considered to be PPSA retention of title personal property where only the other 4 requirements of section 51F(1) are satisfied. For example, assets subject to a retention of title arrangement may be leased by the grantor of that security interest to a third party. In those circumstances, although the requirements of section 51F(1)(b) would not be satisfied, the relevant assets should still be considered to be PPSA retention of title property.
- 2.2 In addition to this change to the definition, further consideration should be given to the use of this term in the Bill. For example, by the operation of the proposed section 435B, for the purposes of section 441A(1)(a), in determining whether a secured party has security over all or substantially all of the assets of a company, PPSA retention of title property of the company will be considered to be property of the company. It should be excluded for the purposes of making that determination. For example, where a financier has a general security interest over all of the assets of a company (equivalent under the existing law to a fixed and floating charge over all of the assets of a company) and that company has entered into a significant number of finance leases of equipment, that equipment would be considered to be property of the company for the purposes of section 441A(1)(a). The general security interest would not extend to that equipment (as the company does not, at general law, have title to it so cannot have granted security over it). The general security interest would only extend to the contractual rights of the company under the finance leases. This could mean that the secured party would not obtain the benefit of section 441A under the new law on the basis that it does not have security over all of the assets of the company. This will be the case even though that secured party would have obtained the benefit of the existing section.
- 2.3 We assume that the concern which has prompted the inclusion of PPSA retention of title property as property for the purposes of Part 5.3A of the Corporations Act could be to ensure that where a person has security interests over all or substantially all of the PPSA retention of title property of a company and that company does not own other significant assets, the secured party should have similar rights to a secured party that does hold security over all or substantially all of the assets of a company. However, if this is the intention of the amendment, this should be achieved by a different approach that does not have the adverse impact indicated above.
- 2.4 Another example of where the use of the new concept of PPSA retention of title property creates issues is the proposed amendments to section 419A. As it currently stands, the rule in section 419A of the Corporations Act is that if, under an agreement entered into before the appointment of the relevant controller, the relevant company continues to occupy or be in possession of property owned or leased by a third party and the controller is controller of that third party property, the controller is liable for rent and other monetary obligations owing to the owner or lessor after an initial 7 day grace period.
- 2.5 The Bill will amend section 419A(1) by adding a third requirement that must be satisfied before the rule applies (this is included in the new section 419A(1)(c)). Under the amended section, the controller will only be liable for the payment of rent and other monetary obligations if, in addition to satisfying the 2 requirement set out in the previous paragraph, the third party property is not PPSA retention of title property.

- 2.6 The proposed section 419A(1)(c) has the effect of altering existing rights under the Corporations Act as it excludes a significant number of arrangements from the operation of that section where those arrangements would be subject to the existing section. This proposed amendment to section 419A should be reconsidered. Although Part 5.2 of the Corporations Act will not apply to the enforcement of security interests held over PPSA retention of title property, where a controller under *another type of security interest* has been appointed and is, pursuant to that appointment, continuing to use PPSA retention of title property, that other controller should be liable to pay the rent and other amounts under the security interest relating to the PPSA retention of title property.
- 2.7 The amendment to section 419A should also be contrasted with the proposed amendment to section 419 of the Corporations Act. The proposed amendment to section 419 makes it clear that if a controller itself entered into a lease of goods that gives rise to a PPSA security interest in the goods that controller will be liable for the rent and other payments. The position should be no different in relation to existing leases (or other security interests that give rise to PPSA retention of title property) under section 419A.
- 2.8 The final point in relation to PPSA retention of title property relates to the exclusion of the application of Part 5.2 of the Corporations Act to the enforcement of security interests in PPSA retention of title property. This exclusion should be broadened. As mentioned in paragraph 4.4 below, transfers of accounts are security interests for the purposes of the PPS Act, irrespective of whether the transfer is for the purpose of securing payment or performance of obligations. Such transfers may transfer beneficial, but not legal, title to the accounts. In such a case, there is a strong argument that the transferred accounts are not PPSA retention of title property because those accounts would not satisfy the requirements of the proposed section 51F(1)(c) (which requires that, for property to be PPSA retention of title property, the relevant grantor must not have *title* to the property). Where there is such a transfer, and the transfer is not for the purpose of securing payment or performance of obligations, Part 5.2 of the Corporations Act should also not apply. An alternative would be to amend section 51F(1)(c) to provide that the relevant grantor must not have title to the property other than bare legal title.

### 3. Application of transitional provisions of the Corporations Act

- 3.1 The transitional provisions in part 10 of Schedule 1 of the PPS Bill apply in relation to "registrable charges". A registrable charge is defined as a charge registrable under the Corporations Act created before the registration commencement time under the PPS Act. Therefore, for example, a charge will be a registrable charge if it is a charge of the type referred to in the existing section 262 of the Corporations Act signed before the registration commencement time, even if it is not actually registered (whether provisionally or otherwise) under the Corporations Act as at the registration commencement time.
- 3.2 If a "registrable charge" is not registered under the Corporations Act at the registration commencement time, it will not be possible to subsequently register it. There are many reasons for a delay in registration, this is the reason why section 263 of the Corporations Act currently allows 45 days for registration to occur. Notwithstanding that there may be legitimate reasons for a delay in registering a registrable charge entered into not later than 45 days before the registration commencement time, which results in such a charge not being able to be registered, the new section 1502 will provide that Chapter 2K of the Corporations Act (subject to limited exceptions) will continue to apply to that charge. This will have negative consequences for the holder of the charge, for example, it will be unable to take advantage of the priority provisions in Chapter 2K which in certain circumstances give later registered charges priority over prior registered charges (see, as one instance of this, section 279(3) of the Corporations Act). However, the holder of the charge will be unable to take steps to remedy the non-registration except potentially through expensive court proceedings.

- 3.3 If sections 1502 to 1506 are to be retained either:
- (a) the ASIC charges register will need to remain open for not more than 45 days after the registration commencement time to ensure that all charges which are registrable charges are able to be registered (those charges would then need to be transitioned to the PPS register); or
  - (b) the definition of registrable charge will need to be amended. This could be done in one of 2 ways. First, it could be defined to include only those charges which were actually registered under the Corporations Act or it could be defined to include those charges that were actually registered under the Corporations Act or, in the case of charges entered into within the 45 day period prior to the registration commencement time, registered on the PPS register within 45 days of the date of creation. If this option was adopted, we suggest the latter definition. This ensures that there would be a register on which the security interest is actually able to be registered at all times.

We suggest adopting option (a). If this approach was adopted, then this would assist in resolving the issue that we have raised regarding the proposed regulation to be made under section 322(3) of the PPS Act, which we have commented on below.

#### 4. Expanded concept of security interest

- 4.1 The Bill will insert a new section 51A in the Corporations Act, defining security interest. Security interest means a "PPSA security interest", as defined in the Bill (that is, an interest that is a security interest under the PPS Act), together with a charge (the definition of which includes a mortgage), lien or pledge.
- 4.2 The approach is then taken that existing references to charges, liens and pledges in the Corporations Act will generally be replaced with the broader "security interest". 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 and pledges.
- 4.3 Take, for example, the proposed new section 440B of the Corporations Act. At the current time, section 440B of the Corporations Act states that a chargee or mortgagee of property of a company in administration cannot enforce its charge or mortgage except with the consent of the administrator or the leave of the court (subject to exceptions set out in other sections of the Corporations Act).
- 4.4 Under the proposed new version of section 440B, in most circumstances, a secured party will not be able to exercise its rights under any security interest during the administration of the company that granted that security interest. Security interest will include transfers of accounts, which are security interests under the PPS Act, irrespective of whether any such transfer is given as security for the payment or performance of obligations. Consider where a company in administration had transferred equitable title to certain accounts to a third party in circumstances where the transfer was not intended as security for the payment or performance of obligations. It may be the case that those accounts would still be considered property of the transferor company for the purposes of the new section 440B because the company would still hold *legal title* to the accounts. It would not be appropriate for the proposed new section 440B of the Corporations Act to apply in relation to such a transfer where the transfer was intended to be absolute and was not made for the purposes of securing payment or performance of obligations.
- 4.5 We suggest that further consideration is given to whether, in each particular case, it is appropriate for all categories of PPSA security interests to be treated in the same way as charges, liens and pledges under the Corporations Act.

5. **Possessory security interests and related issues**

- 5.1 The Bill includes a new section 51D of the Corporations Act, which defines possessory security interest. Possessory security interests are PPSA security interests perfected by possession or control as well as other general law liens and pledges.
- 5.2 Under the PPS Act, to have "control" of personal property for perfection purposes does not generally require physical possession of that property (in fact, in limited cases under the PPS Act it is not necessary to have physical possession of personal property to have possession of that property - see section 24(5) of the PPS Act). However, where possessory security interest is used in the Bill there is typically an additional requirement that the secured party has actual possession of the relevant property. An example of this is the proposed new section 441EA.
- 5.3 The new section 441EA requires that the relevant interest is a possessory security interest and that the secured party has possession of the property before the secured party is able to rely on the section. Therefore, for example, where a security interest is held over ASX listed shares and that security interest is perfected by control, the secured party will not be able to take advantage of the provisions of the new section 441EA. Part 7 below contains further comments on the differences between the proposed new section 441EA and the existing section 441JA of the Corporations Act.
- 5.4 Another example of where an additional requirement of physical possession creates issues in relation to possessory security interests is the new section 440B(3). The Bill will repeal sections 440B and 440C of the Corporations Act and replace those sections with a new section 440B. Under the new section 440B(3), a secured party may continue to possess property during the administration of the company that granted a possessory security interest in that property if the property is subject to that possessory security interest and the property is in the lawful possession of the secured party. If it is intended that all possessory security interests are to be treated equally under the amended Corporations Act, which we assume is the case, the section should be amended to provide that where a person has a possessory security interest that is perfected by control, that person should be able to continue to exercise that control during the administration. Part 4 of this submission contains other comments on section 440B.
- 5.5 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.

6. **Section 440JA of the Corporations Act**

- 6.1 Section 440JA of the Corporations Act is to be amended by the Bill to provide that Division 6 of Part 5.3A of the Corporations Act does not apply to (amongst other security interests) possessory security interests held by an ADI over cash in the form of notes or coins. The effect of section 440JA is that, when a grantor company is in administration, the enforcement of the security interests referred to in that section will not be restricted under Division 6 of Part 5.3A in the same way that enforcement rights in relation to other security interests will be restricted under that Division. Therefore section 440JA provides a significant benefit to relevant secured parties. Importantly, Division 6 does not (and will not when the amendments to be made by the Bill take effect) restrict the exercise by any person of any set-off rights. Set-off rights are not considered to be encumbrances under the existing law and will not fall within the definition of security interest under the PPS Act.
- 6.2 It is highly unlikely that a possessory security interest would be created by an ADI over notes and coins. This is the case because an ADI would not typically simply hold notes or coins of a customer. Instead, that currency would be credited to an account with the ADI and, under the existing law, set-off rights created in relation to that account.

- 6.3 The PPS Act permits an ADI to take a security interest over an account with that ADI. However, unlike a possessory security interest of the type referred to above, such a security interest would not have the benefit of the amended section 440JA of the Corporations Act. Therefore, there would be a significant disadvantage to an ADI in taking a security interest over an account held with the relevant ADI as compared to relying on set-off rights in relation to such an account. As noted above the exercise of such set-off rights is not constrained under Division 6 of Part 5.3A of the Corporations Act in the event that an administrator is appointed to a company.
- 6.4 There appears to be no policy reason why set-off rights relating to an ADI account and a possessory security interest over currency held by an ADI should, on the one hand, be treated any differently to a security interest held by an ADI over an account with that ADI, on the other. Each of those interests provide very similar rights to the ADI.
- 6.5 In order to ensure consistent treatment of set-off rights held in respect of an ADI account, possessory security interests in currency held by an ADI and security interests over ADI accounts held by the relevant ADI, the proposed exemption in section 440JA should be extended to apply to any security interest held by an ADI over its own accounts.

## 7. **Maintain existing rights**

- 7.1 In a number of cases where existing Corporations Act sections apply only to pledges and liens, the Bill will extend the operation of those sections to all security interests. For example, under the existing section 442CB(1), an administrator must act reasonably in exercising a power of sale in relation to property subject to a pledge or a lien. Under the amendments to that section proposed by the Bill, an administrator will have an obligation to act reasonably when exercising a power of sale in relation to any secured property. Sections 442CB (and a number of related sections) were inserted into the Corporations Act by the Corporations Amendment (Insolvency) Act 2007. These sections were inserted for the purposes of clarifying the existing law, insofar as it related to pledges and liens. There is no need for this section (and other related sections of the Corporations Act that were inserted under the same amending legislation) to be extended to all security interests. The amendments to section 442CB and other related sections inserted by the Corporations Amendment (Insolvency) Act 2007 should therefore be reconsidered.
- 7.2 Another example of where it appears that a deliberate decision has been made to change the rights of parties under the existing law relates to the proposed new section 441EA. The proposed new section 441EA will replace the existing section 441JA (which is to be repealed). The existing section 441JA only applies if there is no higher ranking security interest. This requirement is not included in the new section 441EA. 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.
- 7.3 Further, under the new section 441EA, the holder of the relevant security interest is entitled to retain the sale proceeds up to the amount of the debt secured. If there was a higher ranked secured party, there is no provision for that higher ranked party to claim any part of the disposal proceeds. This is inconsistent with the PPS Act.

## 8. **Transitional security interests**

- 8.1 The Bill inserts a new section 51 into the Corporations Act to define PPSA security interest. PPSA security interest permanently excludes transitional security interests.
- 8.2 We do not understand why transitional security interests are permanently excluded from the definition. For example a 10 year lease, entered into in 2010 and evidenced by a written

agreement, that would be a PPS lease if it was entered into after the registration commencement time will always be excluded from the definition of PPS security interest (and will be considered to be a "lease" under the Corporations Act) for the entire term of that lease notwithstanding that the transitional provisions of the PPS Act will, not later than 24 months after the registration commencement time (as defined in the PPS Act), cease to apply to that lease. At the time a transitional security interest ceases to have the protections of the transitional provisions of Part 9 of the PPS Act it should cease to be considered as a transitional security interest for the purposes of the Corporations Act.

9. **The reference to "the appointment of receivers and other controllers under Part 5.2"**

9.1 Part 5.2 of the Corporations Act regulates the enforcement of security interests over the assets of a company. The power to appoint a controller under a security interest typically flows from the security interest itself. It does not arise under Part 5.2 of the Corporations Act.

9.2 The Bill contains references to:

- (a) "... a receiver or controller appointed for the purposes of Part 5.2 ..." in the following items:
  - (i) item 36 (the new sections 441A(2)(d)(iii) and 441A(3)(b)), and
  - (ii) item 37 (the new section 441C(2)(b)), and
- (b) "... a receiver or controller appointed under Part 5.2 ..." in item 42 (the new sections 442D(1)(a) and (b) and 442D(2)(a) and (b)).

9.3 These references should be amended so that they correctly refer to "... a receiver or controller appointed under a security interest to which Part 5.2 applies ...". This change is required as a controller (including a receiver) is neither appointed under, or for the purposes of, Part 5.2 of the Corporations Act.

10. **Other minor points**

10.1 *Section 441AA of the Corporations Act* - Section 441AA needs to be reconsidered in light of the requirements for perfection under the PPS Act. For a security interest to be perfected, the PPS Act requires, amongst other things, that the security interest must attach to the relevant property. A requirement for attachment is that the grantor has rights in the relevant assets. If a grantor acquires assets that are subject to a security interest after the secured party has commenced enforcement of the security interest (for example, a general security interest over all of the assets of a company) then, provided the security interest was perfected in relation to any other assets at the time the enforcement of the security interest commenced, Division 7 of Part 5.3A of the Corporations Act should also apply to the newly acquired property.

10.2 *Section 443E of the Corporations Act* - The new section 443E(1)(b) is unnecessary and should be deleted because the debts described are unsecured debts of the relevant company and the new section 443E(1)(a) already captures all the company's unsecured debts.

10.3 *Section 553E of the Corporations Act* - By operation of section 553E, the Corporations Act currently applies provisions under the Bankruptcy Act 1966 (Cth) for proving debts in the winding up of an insolvent company. As it currently stands, section 553E is subject to section 279 of the Corporations Act (which relates to priorities of charges). Section 279 forms part of Chapter 2K of the Corporations Act which will be repealed by the Bill. The Bill amends section 553E by simply omitting the reference to section 279. The operation of section 553E should remain subject to priorities of security interests. Accordingly, the reference to "and to section 279" should be replaced with "and to the priority regime for security interests under the



Personal Property Securities Act 2009 and the operation of Part 10.13 of the Corporations Act".

- 10.4 *Section 1504 of the Corporations Act* - The proposed section 1504(2) of the Corporations Act requires clarification. That section states that if a registrable charge is "void" under section 266 of the Corporations Act immediately before the commencement time, then section 266 of the Corporations Act will continue to apply to that registrable charge. However, there is no provision of section 266 that currently renders a charge, in its entirety, "void". We note:
- (a) under section 266(1) a registrable charge is "void as a security on that property as against the liquidator, the administrator of the company, or the deed's administrator" in certain circumstances;
  - (b) under section 266(3) a registrable charge is void to the extent that it secures the amount of certain liabilities where those liabilities have not been notified to ASIC; and
  - (c) under section 266(5) a registrable charge is void to the extent that, in certain circumstances, it relates to the same property as another particular charge.

It is assumed that the reference to "void" in section 1504(2) is intended to refer to void in each of the circumstances referred to above. This needs to be clarified in the drafting.

## Schedule 2 - amendments to the Personal Property Securities Act

### 11. Perfection of ADI account by control

11.1 Pursuant to the amendment to be made to section 21(2)(c)(i) of the PPS Act by the Bill, the only person that may perfect a security interest over any ADI account by control is the ADI with whom the account is held. No other person with a security interest over an ADI account may perfect that security interest by control. Therefore, for example, Bank A could not perfect by control a security interest it held over an account a grantor had with Bank B.

11.2 As a consequence of this change, amendments are required to the following sections of the PPS Act:

(a) *Section 25*

At the moment, section 25(1) contemplates that control, for perfection purposes, may be obtained over an ADI account by a number of different methods. The only method that will be relevant on the amendment of section 21(2)(c)(i) occurring is that set out in section 25(1)(a)(i). Sections 25(1)(a)(ii), 25(1)(a)(iii) and 25(1)(b) will not be relevant as these provisions contemplate that a third party (not being the ADI with which the relevant ADI account is held) could perfect a security interest over an ADI account by control.

Sections 340 and 341 consider the meaning of "control" in the context of determining whether an asset is a circulating asset. Those sections provide that "control" has its ordinary general law meaning. We understand from our discussions with the Attorney-General's Department (AGD) that sections 25(1)(a)(ii), 25(1)(a)(iii) and 25(1)(b) are intended to extend the meaning of "control" for the purposes of those sections, rather than for the purposes of determining whether a security interest has been perfected. If this is the case, the appropriate location for those sections is in sections 340 and 341. This is in line with the approach taken for inventory and accounts in section 341. Including sections 25(1)(a)(ii), 25(1)(a)(iii) and 25(1)(b) in Part 2.3 of the PPS Act, which

deals with possession and "control" of personal property for perfection purposes, is confusing.

(b) *Section 75*

Section 75 currently cross refers to section 25(1)(a)(ii) of the PPS Act. As noted above, section 25(1)(a)(ii) contemplates that a third party could perfect its security interest by control and therefore is no longer relevant. In our view, section 75 should be amended to simply provide as follows:

"A perfected security interest, held by an ADI, in an ADI account with the ADI has priority over any other perfected security interest in the ADI account."

12. **Section 267A - vesting in grantor of security interest that attaches after winding up**

12.1 Section 267(2) provides that an security interest which is unperfected at the time specified in section 267(1)(b) vests in the grantor immediately before an event mentioned in section 267(1)(a) (such as a resolution being passed for the winding up of a company). The section does not contemplate the situation where a security interest is perfected *after* such an event solely as a result of attachment occurring after that event in particular, solely as a result of the grantor actually acquiring an interest in the property after that event. This leads to a potential issue with regards to security over future-acquired property. This uncertainty is clearly not appropriate where the only reason perfection had not occurred at the relevant time was because the grantor had not acquired the property. It would also, in the context of companies, be inconsistent with the existing operation of section 266(1) of the Corporations Act, which looks only at the time of registration of the security interest under the Corporations Act, not acquisition of the underlying secured property.

12.2 The proposed new section 267A does not address this issue. It, in essence, provides that an unregistered security interest that attaches to the collateral after the event referred to in section 267(1)(b), in accordance with a security agreement made before that event, will vest in the grantor in the same way that security interests that attach before the relevant time. Notwithstanding what is stated in the Explanatory Memorandum, section 267 already provides that such a security interest would vest in the grantor - as it would have been unperfected by virtue of the lack of registration (and lack of attachment) at the time referred to in section 267(1)(b). We suggest that the current wording for section 267A(1) is expressed "in the reverse" to remedy the lack of clarity identified in the previous paragraph. In other words, section 267A should provide that a security interest does *not* vest in the grantor if the conditions in the proposed sections 267A(1)(a), (b) and (c)(i) apply and, in addition, there *was*, at the critical time, a registration on the PPS register that would perfect the security interest when it attached and that attachment occurred after the critical time.

13. **Proceeds should exclude enforcement proceeds**

13.1 The commentary released by the AGD in December 2009 regarding Schedule 2 of the earlier version of the Bill has raised a concern in relation to the meaning of the term "proceeds" as used in the PPS Act. The commentary on the proposed amendment to section 57 included the following sentence in relation to the application of section 33(2) of the PPS Act:

"The effect is that the secured party would lose the benefit of the super-priority when it takes enforcement action to dispose of collateral perfected by control."

The reference to enforcement action implies that, in the view of the AGD, proceeds from enforcement of a security interest are considered to be within the definition of "proceeds" under the PPS Act. It had been our understanding that "proceeds" as defined for the purposes of the PPS Act, including where this term is used in section 33(2) of the PPS Act, would not include any amounts that were received by a secured party on enforcement of a security

interest or amounts received by a person appointed by a secured party to enforce a security interest (for example, a receiver and manager appointed under a security interest over all of the assets of a company). In this regard, our view is supported by the following:

- (a) Section 31(3)(b), which provides, in effect, that proceeds will not include amounts which a grantor is entitled to as a result of the operation of section 140(2)(f). In other words, proceeds will not include residual amounts to which the grantor is entitled following enforcement of the security interest under Chapter 4 and distribution of relevant amounts to holders of security interests over the relevant property; and
- (b) Section 140 itself, which refers to "proceeds" as having its ordinary meaning in the context of the enforcement of security interests.

However, there are security interests to which section 140 of the PPS Act does not apply, including where a security interest over collateral of a company is enforced via the appointment of a receiver/receiver and manager. Where a receiver/receiver and manager is appointed, typically that receiver/receiver and manager would be the agent of the company, not the secured party. Therefore arguably, in those circumstances, where a receiver/receiver and manager was appointed and disposed of the collateral the payment it received on that disposal would be "proceeds" within the meaning of section 31 of the PPS Act, that is, money derived directly from a dealing with the collateral in which the grantor of the security interest has an interest.

- 13.2 Although the definition of proceeds in the PPS Act is different to the definition used in the New Zealand legislation, we have explored this issue in the context of the New Zealand legislation. From a brief review of New Zealand legal commentary, it would seem that "proceeds" under the New Zealand legislation is generally considered to only arise from a dealing by the grantor of the security interest outside of an enforcement situation.
- 13.3 We do not believe the extract from the commentary referred to above represents the intended interpretation of "proceeds". We also note that the Explanatory Memorandum for the Bill does not contain this reference when explaining the amendment to section 57. However, given the lack of clarity on this issue we suggest that section 31(3)(b) of the PPS Act is amended to make it clear that any proceeds received on enforcement of a security interest, whether enforcement occurs under Chapter 4 of the PPS Act or otherwise, are not "proceeds" within the meaning of section 31 of the PPS Act.

#### 14. **Transitional provisions**

- 14.1 The simplification of the transitional provisions in the PPS Act is supported, however there are still a number of issues with the transitional provisions in Chapter 9 that should be remedied.
- 14.2 The first issue relates to section 314. It currently provides that Chapter 4 of the PPS Act applies *only* in relation to security agreements made at or after the registration commencement time. This is clearly not correct. The intention of the section is to provide that, where a security interest arises *after* the registration commencement time under a security agreement made *before* the registration commencement time, Chapter 4 will not apply in relation to that security interest. An example of where such a security interest would arise would be where a general fixed and floating charge was granted by a company over all of its assets before the registration commencement time and the company acquired assets after the registration commencement time. In such a case, the security interest would only arise in relation to the after acquired assets at the time of acquisition. It is clear Chapter 4 should not apply in those circumstances. However the drafting of section 314 goes beyond providing for this rule. It provides that Chapter 4 will not apply in relation to a security interest not evidenced by a security agreement. An example of a security interest not evidenced by a security agreement is

a pledge created by the delivery of the pledged assets. This will be the case irrespective of whether such a security interest was created before or after the registration commencement time. Section 314 should be drafted in the negative, that is, so that it states Chapter 4 does not apply in relation to security interests arising under security agreements made before the registration commencement time. If drafted in that manner, other security interests created after the registration commencement time will not be inadvertently excluded from the operation of Chapter 4.

14.3 The table in the proposed section 320 is not correct. That table assumes that all priority disputes are determined under section 55 of the PPS Act. Section 55 sets out the default priority rules only. These are not the only priority rules in Part 2.6 of the PPS Act (or elsewhere in the PPS Act). One example of the inaccuracies of the table is that it states that a perfected transitional security interest (not perfected by control) will have priority over a later created security interest over the same collateral that is perfected by control. This should not be the case as, applying section 57, the security interest perfected by control should have priority. The table can be removed and replaced with a statement that, subject to sections 323 and 324, the priority of transitional security interests should simply be determined in accordance with the other provisions of the Act following the application of sections 321 and 322.

14.4 Although not directly relevant to the Senate Standing Committee review, the PPS Bill needs to be considered in the context of the consultation paper on the PPS Regulations that has recently been released by the AGD. The regulation to be made under section 322(3) of the PPS Act provides in part that, if there is a period in which a transitional security interest must be registered on a transitional register and that period has not yet expired at the registration commencement time, then that transitional security interest is *not* prescribed. This means that, for example, security interests created by companies over their assets in the 45 day period before the commencement of the PPS Act may not have been registered under the Corporations Act, but would still be perfected for up to 24 months by the operation of section 322. Such a security interest would have this protection even though a third party dealing with the company grantor would have no way of determining if the security interest existed (as it would not be registered either under the Corporations Act or on the PPS register). There would be no incentive for the secured party to register on the new register if this protection is granted. This rule should be changed. If a transitional security interest is not registered on the relevant transitional register before the registration commencement time it should not have the benefit of the temporary perfection provisions. The secured party, to protect its interests, should in those circumstances ensure that it has perfected under the PPS Act regime. See also the comments in part 3 above in relation to the transitional provisions of the Corporations Act.

## 15. **Circulating assets**

15.1 The Bill will amend section 341 of the PPS Act to provide that, in determining whether an asset is a circulating asset, the PPS Act definition of inventory does not apply. Instead, the general law meaning of inventory will apply.

15.2 It is not clear why this amendment has been made. No information is provided on this issue in the Explanatory Memorandum. Inventory is comprehensively defined in section 10 of the PPS Act and that definition would appear to include all property that would be inventory for the purposes of the general law and no other property. There is no indication in either the PPS Act or the Explanatory Memorandum for the PPS Act that the section 10 definition of inventory is intended to be either broader or narrower than the general law meaning of that term. If the section 10 definition is intended to be different to the general law meaning of inventory, then the differences should be expressly stated in the PPS Act.

**16. Bofinger and rights of subrogation**

- 16.1 In October 2009, the High Court handed down its unanimous decision in *Bofinger v Kingsway Group Limited* [2009] HCA 44 (**Bofinger**). This case considered circumstances involving 3 security interests over the same property. The holders of those security interests had agreed that those security interests would rank in a particular order. The High Court held that the guarantors of the debt secured by the first ranking security were entitled to be subrogated to the rights of the first ranking secured creditor in respect of the first ranking security and therefore could claim in respect of the secured property in priority to the second and third ranking secured creditors. The position would have been different if those guarantors had agreed to waive their rights of subrogation.
- 16.2 It is not always practically possible for secured parties that agree a particular priority order for their securities to obtain the consent of all guarantors to that order of priorities or to obtain a waiver of rights of subrogation from those guarantors, as would be required to protect the priority arrangements following *Bofinger*.
- 16.3 The PPS Act provides, in section 61, that a secured party may agree to subordinate its security interest in collateral to any other interest in the collateral. This section should be extended to provide that any guarantor that is entitled to be subrogated to the rights of that secured party will be bound by any priority arrangement agreed by that secured party.

**17. Section 332(c) - effective registration**

- 17.1 ASIC's DOCIMAGE system stores digital copies of all documents lodged with ASIC including charges, company forms, applications and notices. We have previously suggested to the AGD that any charge documents lodged with ASIC that are assigned a DOCIMAGE number should be considered to be effectively registered for the purposes of section 332(c) of the PPS Act. Imaging is not an administrative step preliminary to the registration of a charge. According to material published by ASIC, paper forms for example, are processed in five stages: bar coded, fees assessed, compliance checked, registered in accordance with Chapter 2K of the Corporations Act, and finally scanned and stored on the DOCIMAGE system. In the case where a DOCIMAGE number has been assigned but an ASIC search is yet to reflect the registration or provisional registration of the charge, that charge should be considered to be effectively registered for the purposes of section 332(c) of the PPS Act. We suggest section 332(c) makes this clear.

**16 April 2010**