

Presentation to Senate and Constitutional Affairs Committee in relation to Personal Property Securities Bill 2008 (Bill)

22 January 2008

Addendum to submission from DLA Phillips Fox

Proposal to exclude security interests granted by companies from the operation of the Bill

Introductory remarks

- 1 There is a significant amount of secured financing undertaken in Australia which does not involve taking security over personal property from individuals and other non-corporate entities. Commercial property and development finance as well as project and infrastructure financing and big ticket leasing are examples where taking a security over personal property from individuals does not occur.
- 2 Companies and registered foreign bodies are already subject to the *Corporations Act*, including the charges provisions of the *Corporations Act* (Chapter 2K). The *Corporations Act* provides for a national system in relation to the insolvency consequences of companies and registration, priorities and enforcement of registrable charges. These provisions are well understood by companies and have operated in their current form for a significant period of time.
- 3 In relation to security interests granted by companies which are not registrable under the *Corporations Act* and leases granted to companies, we believe that the general law has worked well and that the rules applicable to determining priorities and regulating enforcement are understood and are not a major source of dispute and litigation.
- 4 The charge provisions of the *Corporations Act* already provide for a system whereby registration of a charge in accordance with those provisions will be deemed to satisfy the registration requirements of a number of major pieces of State legislation (which are intended to be replaced by the Bill).
- 5 The Bill does not seek to disturb the ability of security agreements to create both fixed and floating charges. In addition, the Bill recognises that, on enforcement of a charge through the appointment of a receiver, the enforcement provisions of the Bill will not apply.
- 6 The Bill also does not seek to affect the operation of various provisions of the *Corporations Act* in so far as they determine the priority position of the holder of a security interest granted by a company vis a vis various entitlements of employees and others on insolvency.
- 7 Accordingly we invite the Committee to consider excluding from the operation of the Bill all security interests granted by a company (or registered foreign body) whether they are required to be registered under Chapter 2K of the *Corporations Act* or not.

Benefits of the proposal

- 8 As mentioned above, the charge registration regime contained in Chapter 2K of the *Corporations Act* already provides for a national registration system through the charges register maintained by the Australian Securities and Investments Commission (**ASIC**).
- 9 This registration system does not require any State or Territory to pass referring legislation as these jurisdictions have already approved the operation of the *Corporations Act* on a national basis.
- 10 The charge provisions have been operating for a significant period of time and are well understood by the commercial community. In addition, the provisions overcome the need for consideration of multiple State based legislation by deeming registration under Chapter 2K to satisfy the registration requirements under the main pieces of State legislation which the Bill is intended to simplify. On implementation of the Bill, and assuming that the multiple State legislation intended to be simplified are repealed, the deeming provisions in the Corporation Act will no longer be required.
- 11 The integrity and usefulness of the existing charges provisions is recognised in other submissions to the Committee. In particular, we agree with the comment made in the joint submission prepared by Allens Arthur Robinson, Blake Dawson, Freehills and Maleson Stephen Jacques where the authors state in paragraph 2.1:

'The company charge in particular is an example of this flexibility and clarity. It has been a very flexible technique; the priority rules are relatively few in number and have been worked out over the years; and there is a one stop registration system.'
- 12 By excluding charges and other security interests granted by companies (and registered foreign bodies) from the operation of the Bill, priority and enforcement disputes as well as the consequences of insolvency will continue to be resolved as under the current law. Those involved in secured financing which does not involve taking security over a personal property from individuals and other non-corporate entities will save significant amounts in compliance costs as they will not need to amend their documents, processes and re-educate their staff in order to continue to provide the financial accommodation secured by assets of companies and registered foreign bodies. In addition, some of the complexity contained in the Bill may be removed.
- 13 By maintaining the operation of Chapter 2K of the *Corporations Act*, parties dealing with companies and registered foreign bodies will not need to undertake 2 searches on 2 different registers. At the moment, an ASIC search against a company or registered foreign body will not only reveal ownership and directorship details but also the existence and nature of charges registered against the entity. If the Bill was to extend to securities granted by companies and registered foreign bodies, parties dealing with such entities would need to search both the ASIC register and the PPS Register.
- 14 By separating the registration, priority and enforcement regime applicable to security interests granted by companies (and registered foreign bodies) from those applicable

to individuals and other non-corporate entities, the reform will essentially preserve the current system applicable to companies (and registered foreign bodies) which is a national system which has worked well (and has not been materially adversely impacted on by the multiple laws the PPS System is intended to simplify) while providing a stand-alone new national system for security interests granted by individuals and other non-corporate entities where the existence of multiple state laws has caused uncertainty and increased transaction costs.

- 15 In addition, by excluding companies (and registered foreign bodies) from the PPS system, the complexity of the Bill will be reduced thereby reducing compliance costs to those parties who will be subject to it and facilitating their understanding of the reform.

Possible disadvantage

- 16 We have considered whether any circumstances may arise where the continuation of the operation of Chapter 2K of the *Corporations Act* side by side with the Bill will lead to uncertainty or confusion. Given that this proposal contemplates that all security interests granted by a company or registered foreign would be excluded from the Bill, we cannot think of any circumstances where there would be uncertainty as the regimes would cover separate and mutually exclusive situations.

There would be no overlap except if the one secured party had the benefit of securities from both companies and individuals (or other entities covered by the Bill) in relation to the same transaction. Even in those circumstances, there will generally be no uncertainty or confusion as the secured party would enforce its different securities and consider its priority position in respect of the company and non-company securities by reference to the different regimes.

As mentioned above, in many types of finance, security over personal property of individuals are not taken and accordingly the above scenario is not likely to arise. Even if it did, the cost savings to the secured party in not having to comply with the Bill in relation to the securities granted by companies and registered foreign bodies (which would make up the vast majority of the securities held by the secured party) would outweigh the costs of considering the operation of the Bill in relation to rare and unusual circumstances where it also receives securities over personal properties from non-corporate entities.

- 17 Although the proposal will result in there being two different systems applicable to the granting of securities (being the Bill in respect of security interests granted by individuals and non-corporate entities) and the *Corporations Act* and common law (in relation to companies and registered foreign bodies), we believe that the benefits suggested above significantly outweigh this potential disadvantage.

- 18 To the extent that there are provisions in the Bill which are relevant to financing arrangements entered into by companies and registered foreign bodies and which are improvements to the current provisions of Chapter 2K (for example possibly sections 92 and 114 dealing with security interests over assets registered with a serial number) those provisions could be incorporated in Chapter 2K. However we suspect that such new provisions would be limited in number. In relation to assets which have

serial numbers, we note that the current charge provisions of the Corporations Act provide flexibility in the Form 309 which is lodged with ASIC to individually specify the assets the subject of the charge thereby allowing serial numbers to be noted on the register.

Other relevant matters

- 19 In our view, the requirement to consider multiple State-based legislation is more of an issue for financiers dealing with individuals and non-corporate entities than it is for participants in secured financing transactions involving companies. Indeed, it is our experience that when dealing with corporate entities, those taking assets as security from a company or registered foreign body or seeking to acquire any major assets of the same will generally undertake a search of ASIC to determine whether or not a charge is registered over the company. If that charge is a fixed and floating charge over all assets, an appropriate release of the property to be taken as security or acquired will be obtained. As a result, the current charge provisions of the *Corporations Act* are readily understood and complied with and do not lead to significant amounts of litigation in relation to priority disputes. In addition, the deeming provisions in relation to various State base legislation overcomes the need for the holder of the security interest to consider multiple registration requirements (although we accept that in relation to certain types of secured assets eg motor vehicles, financiers may seek to take advantage of State-based security interests in goods-type legislation).
- 20 Given the need to ensure that the reform is practical, takes account of the different sectors of the secured financing market and does not impose unnecessary compliance costs on parties who will obtain no or little benefit from the reform, we believe it is a matter which requires serious consideration.

Although the above suggestion is the main addition to our submission, for completeness, we also mention below some further concerns we have in relation to the Bill.

Impact on Leasing Industry

We note that there is an inconsistency between the inclusion of PPS leases within the meaning of purchase money security interests and the operation of sections 28 and 30.

In addition we have a concern as to how section 233(2) impacts on lessors if they fail to perfect the security interest created by a lease prior to insolvency on the lessee. As currently drafted, it would appear that notwithstanding title and ownership to the leased asset rests with the lessor, section 233(2) will result in transfer of title and ownership (for no consideration) to the lessee.

Extinguishment of security interests/priority rules

The priority rules set out in Part 2.4 of the Bill contain some anomalies. For example, section 100(3) provides that a security interest in collateral that is currently perfected by control has priority over a security interest in the same collateral that is currently perfected by another means. Unlike the sections dealing with priorities between security interests perfected in a similar manner, there is no reference to the timing of perfection and accordingly it is possible that even though a security holder has perfected its security interest by registration, a subsequent security holder which has perfected its security over the same asset by control will take priority (notwithstanding that it may be aware of the existence of the prior security interest due to having the requisite knowledge (as referred to in section 56) of the pre-existing security interest. This should not be the case. See our comments above in relation to constructive knowledge.

Enforcement procedures and duties

We note that in other submissions, comment has been made in relation to section 235 of the Bill. We agree with the Australian Bankers Association that such provision should be deleted as its scope is unclear and it is likely to be a section which will facilitate litigation intended to cause delay and frustration to financiers enforcing their securities. The existing duties applicable to financiers on enforcement contained in general law, under the *Corporations Act* and section 169 are sufficient to protect the interests of the grantors of securities.

As mentioned in our original submission, we have taken an approach in providing our comments on the Bill that secured creditors should not be worse off as a result of the operation of the new regime. In addition to the matters mentioned in our submission we wish to also refer to section 181 of the Bill. This section entitles the grantor of a security interest to prevent the holder of the security interest from enforcing its security at any time prior to disposal or retention of the collateral if the grantor pays the amount in arrears (disregarding the amounts in arrears as a result of an acceleration clause in the security agreements) enforcement expenses and otherwise by remedying the default which triggered the enforcement action.

The current law provides that if a grantor goes into default, the financier is entitled to make demand for the full amount owing and accelerate the obligation to pay that amount (together with all outstanding interest and expenses). The grantor of the security has a right to redeem the property the subject of the security interest prior to the financier disposing of the same provided that all amounts due (including the principal amount which had been accelerated) are paid. The words in brackets appearing in section 181(1)(a)(i) have the effect of not requiring the principal amount which has been accelerated to be repaid and enables the grantor to prevent completion of enforcement action commenced by the security holder. Although it appears that the costs involved in such enforcement action are also to be paid in order to prevent completion of enforcement, this right is impractical from the security holder's perspective particularly as the default may very well be of a nature which is to recur resulting in a repletion of the whole enforcement process and potential restriction on completion.

In our view, this section should be deleted and the grantor's rights to exercise its equity of redemption (by paying all amounts due and payable to the financier, including outstanding principal) is all that is needed to protect the interests of the grantor.

DLA PHILLIPS FOX

22 January 2009

Enforcement procedures and duties

We note that in other submissions, comment has been made in relation to section 22B of the Bill. We agree with the Australian Bankers' Association that such provision should be deleted as its scope is unclear and it is likely to be a section which will be likely to be intended to cause delay and frustration to financiers enforcing their securities. The existing duties applicable to financiers on enforcement contained in general law, under the Corporations Act and section 22B are sufficient to protect the interests of the grantor of securities.

As mentioned in our original submission, we have taken an approach in providing our comments on the Bill that section 22B should not be worse off as a result of the operation of the new regime. In addition to the matters mentioned in our submission we wish to also refer to section 187 of the Bill. This section enables the grantor of a security interest to prevent the holder of the security interest from enforcing its security at any time prior to disposal or retention of the collateral if the grantor pays the amount in arrears (disregarding the amounts in arrears as a result of an acceleration clause in the security agreement) enforcement expenses and otherwise by remedying the default which triggered the enforcement action.

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