



18 January 2009

Mr P Hallahan
Committee Secretary
Senate Standing Committee on Legal and Constitutional Affairs
Department of the Senate
Parliament House
Canberra ACT 2600

By email

Dear Mr Hallahan

Inquiry into the Personal Property Securities Bill 2008

1. This submission is made by the Insolvency Practitioners Association (IPA) which is the peak professional body representing company liquidators, trustees in bankruptcy and other insolvency professionals.
2. We made a submission to the Attorney-General's Department dated 22 August 2008 on the May 2008 draft of the legislation. Given the significance of secured interests in insolvency, the IPA supports the introduction of PPS legislation. As with our earlier submission, we focus on the impact of the PPS legislation on insolvencies and we do not address legal or policy issues concerning the proposed PPS regime.
3. By way of brief summary, this submission begins with an explanation of the status of a secured interest in an insolvency. We then give comment on the difficulties in allowing a security to be perfected by other than registration, raise some interactions in concepts and terminology between the PPS law and the *Corporations Act*, and address particular issues of knowledge, and commingling and accessions. We address in particular certain insolvency issues in relation to retention of title claims and insolvency administrators' remuneration liens. The submission also raises a number of drafting issues, including in relation to the service of documents.
4. We note that Appendix B of Attorney-Generals' Revised Commentary of December 2008 provides a summary of key changes to the Draft PPS Bill since May 2008. We have nevertheless found it difficult assessing whether, or the extent to which, our earlier submissions have been dealt with in the revised Bill. We assume we may clarify or further explain our submission as required.
5. This submission uses the term 'PPS Bill' to refer to the November 2008 version; and the term 'May 2008 Bill' to refer to the earlier version. We refer to our 22 August 2008 submission to Attorney-General's as the 'IPA August 2008 submission' and to the Attorney-Generals' Revised Commentary of December 2008



as the 'Revised Commentary'. We use the term 'practitioner' in referring to an insolvency administrator who has an appointment as a liquidator, administrator or trustee in bankruptcy.

Insolvency legislation

6. This submission covers issues arising under the *Corporations Act 2001* and the *Bankruptcy Act 1966*. However, we point out that the insolvency of certain corporate entities can be initiated under other legislation. For example, the insolvency of life insurance companies is dealt with under the *Life Insurance Act 1995*, Aboriginal corporations under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* and banks under the *Banking Act 1959*. In many cases, the particular legislation refers to, and makes applicable, provisions of the *Corporations Act 2001* in relation to winding up and insolvency. In the case of those type of entities we assume that the PPS Bill would apply.

General

7. A fundamental approach of insolvency law is that the rights of secured creditors are protected in the insolvency of an individual or a company. This is subject to certain legislative provisions that defer those rights. It is also subject to the ability of insolvency law to set aside 'voidable' transactions in circumstances where those transactions may involve a person unfairly taking security. From an insolvency perspective, that fundamental approach is accepted by the IPA.

8. In administering an insolvency, a practitioner must determine what property is subject to security and must also determine whether that security is valid. That is often an immediate issue and significant issue. We consider it is important that the law be clear in order to allow the insolvency practitioner to know that a valid secured interest exists. Uncertainty or undue complexity in the status of a secured creditor in an insolvency causes costs and time delays, and often litigation, which are all inherently incompatible with the need for a speedy and cost effective administration of the insolvency.

9. The PPS law also has to be consistent with existing provisions in insolvency legislation. It is preferable that concepts and terminology in PPS law be consistent with insolvency law concepts and terminology.

10. This submission is based on what we understand to be the division between the two regimes, that the PPS Bill deals with the validity of securities over personal property and the *Corporations Act* allows challenges in insolvency to be made to otherwise valid securities.

Secured interests in insolvency

11. The PPS Bill deals with secured interests over personal property. We point out that insolvency law makes no distinction between whether the security is over personal property or over real property.

12. A secured creditor in bankruptcy is one that "in relation to a debtor, means a person holding a mortgage, charge or lien on property of the debtor as a security



for a debt due to him or her from the debtor".¹ The term "secured creditor" is not defined in the *Corporations Act*. The *Corporations Act* uses the terms "charge" and "chargee", which are defined in section 9, as well as other terms such as "pledgee".

13. A secured creditor is able to realise and otherwise deal with its security outside the formal insolvency.² Security remains relevant to a number of issues in insolvency, including:

- The right of a secured creditor to appoint a receiver in response to the voluntary administration of a company,³
- how and for what amount a secured creditor's debt may need to be proved,⁴
- the release of an individual bankrupt from liabilities,⁵
- whether and how secured creditors can petition for a bankruptcy or winding up order,⁶
- rights of the trustee or liquidator to deal with the security,⁷ and
- the secured creditor's right to vote.⁸

Perfection via registration

14. Under s 64 of the PPS Bill, a security interest can be perfected through possession, registration or control. Furthermore, a security interest can be temporarily perfected under a range of provisions in the PPSA.

15. The IPA takes the general position that registration should be a mandatory requirement for perfection of all security interests, or at least in so far as the protection of those interests in the event of an insolvency is concerned. As mentioned above, an insolvency practitioner should be able to readily determine what valid security interests exist in an insolvent's property without undue uncertainty or complexity.

16. The most effective way to remove possible complexities is through a requirement that all security interests must be registered to be valid against a liquidator or administrator. In contrast, the PPS Bill provides for a voluntary registration scheme, allowing secured parties to weigh up the costs and benefits of registering their security interests. While failure to register a security interest on the PPS Register *may* result in unenforceability against an insolvency

¹ *Bankruptcy Act* (BA) s 5

² BA s 58(5); *Corporations Act* (CA) s 471C

³ CA s 441A

⁴ CA Pt 5.6 Div 6 Subdivision C

⁵ BA s 153(1)

⁶ BA s 44(2); CA s 459P(1)(b)

⁷ BA s 90 etc; CA Pt 5.6 Div 6 Subdivision C

⁸ BA s 64ZA(5); *Corporations Regulations* 5.6.24



administrator, perfection by possession or control leaves open the need for a difficult assessment by the insolvency practitioner of the status of the status of the security to be made.

17. However the IPA does accept that broader interests prevail in relation to personal property securities reform such that possession and control can provide valid security. We do note that the significant issue of perfection of a Purchase Money Security Interest ("PMSI") over inventory has been resolved in the PPS Bill by specifically requiring registration of PMSIs (s 109). PMSIs encompass goods subject to retention of title⁹ terms of sale and, as we explained in the IPA August 2008 submission, the determination of such goods among the assets of a company in insolvency is presently a significant and often difficult task for an insolvency administrator. We address this issue later in this submission.

Terminology and application issues

18. We caution that there is need to avoid inconsistency of defined terms in the PPS Bill with definitions in the *Corporations Act*. The IPA considers that consequential amendments to the *Corporations Act* should be drafted concurrently with the PPS Bill in order to ensure the consistency of the two pieces of legislation.

Fixed and floating charges

19. For example, the PPS Bill uses section 50 to cross reference the terminology of 'fixed' and 'floating' charges to the terminology of security interests which is used in the Bill. Under s 9 of the *Corporations Act*, the definition of floating charge includes "a charge that conferred a floating security at the time of its creation but has since become a fixed or specific charge". The term floating charge is in fact used throughout Chapter 5 of the *Corporations Act* and other insolvency related provisions – see sections 262, 263, 279, 282, 442B, 433, 443E, 459C, 566, and 588FJ. These insolvency sections are potentially affected by the PPS Bill.

Section 588J

20. For example, s 588FJ – as to the invalidity of charges created before the winding up - applies only to floating charges. We assume that the proposed regime under the PPS Bill does not seek to alter the operation of s 588FJ.

Employees

21. The Revised Commentary says that "provisions dealing with fixed and floating charges have been fine-tuned to maintain the current legal outcomes that apply to employees upon employer insolvency". We clarify that the entitlement of employees to be paid in priority to a secured floating charge holder applies in relation to the liquidation of a company (s 561), and, subject to the decision of employees, to a company under a deed of company arrangement (s 444DA). The same priority applies in controllerships under Part 5.2 but in that respect the PPS Bill does not apply to property subject to an appointment under that Part: s 155.

⁹ Reservation of title clauses are also known as 'ROT clauses', or 'Romalpa' clauses after an early decision dealing with such a clause: *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd* (1976) 1 WLR 676.



Title

22. We also note that under the PPS Bill, existing references to fixed and floating charges (and charges more generally) would only apply to personal property in which the grantor has title to the property: section 50(1)(b). This is said by the revised commentary to mean that personal property that is subject to a retention of title arrangement, lease or consignment would not fall within the pool of property available for distribution to preferential creditors upon insolvency. The IPA agrees with this outcome. In an insolvency, creditors only have access to property of the insolvent company – property that is subject to a retention of title arrangement, lease or consignment is not property of the company. There are existing provisions in the *Corporations Act* that deal with retention of title and lease and other such security arrangements in the event of the company's insolvency.

Section 588FA

23. Another example is that the taking of a security by a creditor can result in the creditor receiving a voidable preference under s 588FA of the *Corporations Act*. We assume that there is no potential legal inconsistency between the right of a liquidator to challenge the taking of a security under s 588FA and the validity of that interest under the PPS Bill.

Owners and lessors

24. A further issue is whether there remains consistency between the provisions applying to 'owners' or 'lessors' in the *Corporations Act* and leases which constitute a deemed security interest under the PPS Bill and title based PMSIs. See for example section 440C; sections 441A - 441K; section 442C; and section 443B of the *Corporations Act*. These generally deal with the rights and obligations of owners and lessors of property of a company under Part 5.3A administration.

25. There are also a number of similar provisions which refer to a 'charge' or 'chargee' (sections 436C, 441A, 588FJ), and to the terms 'lienee' and 'pledgee'.¹⁰ We again assume that this regime remains consistent with that in the PPS Bill.

Bankruptcy

26. To a lesser extent, the same comments apply in relation to the provisions of the *Bankruptcy Act*.

Knowledge

27. The IPA August 2008 submission had made negative comment on the concept of "knowledge" in the May 2008 Bill. Under section 55 of the PPS Bill, for bodies corporate, the knowledge test operates upon the knowledge held by directors, employees or agents whose duties it is to receive information about, and act in relation to, the circumstances. This replaces the test which had operated on the knowledge of directors, employees or agents with actual or apparent authority to act.

¹⁰ CA s 441JA



28. The general knowledge test applying to individuals has also been revised (s 56). It is now based upon the individual having actual knowledge of circumstances, or a benchmark that the person would have acquired such knowledge had they made inquiries ordinarily made by an honest and prudent person, or would have made such inquiries had they had actual knowledge of the circumstances.

29. As the revised commentary points out, this test more closely reflects the current law on constructive notice than earlier proposed risk tests based around concepts of recklessness. The IPA agrees with this.

Commingling and accessions

30. We had also made comment on commingled property in the IPA August 2008 submission. We now note from s 138(2) of the PPS Bill that property that is manufactured, processed, assembled or commingled is lost in a product or mass if it is not commercially practical to restore the property to its original state. The change is said to overcome potential issues raised by the High Court of New Zealand in *New Zealand Associated Refrigerated Food Distributors Limited v Simpson*.¹¹ In our view, this change to the PPS Bill accords with the existing law. An example we gave in the IPA August 2008 submission is the decision in *Borden (UK) Limited v Scottish Timber Products Limited*¹² which concerned the supply of resin used in the manufacture of chipboard. The resin was irreversibly mixed in the manufacturing process and thereby lost its identity. The resin supplier sought to trace a property claim against the resin into the chipboard and further into the proceeds of sale of the chipboard to third parties. The court held that it was not possible to reserve title to goods that are consumed or that lose their separate identity in a manufacturing process.¹³

31. Similarly, the PPS Bill revises and simplifies the provisions dealing with accessions. The definition of 'accession' has been amended such that an accession would only arise where the separate identities of the attached property are lost as a result of the relevant affixation or installation (section 34). Property having a separate identity to the improved property (such as an outboard boat engine) would be subject to general priority rules, whereas property that is merged into the identity of improved property would be affected by special rules which take account of that merging. The IPA agrees with this outcome.

Void transactions

32. We note that the May 2008 PPS Bill had its own provisions that served to avoid security interests made in favour of an officer of a company within a certain period prior to the company's insolvency. The PPS Bill now proposes to rely on the existing provisions in the *Corporations Act*. The IPA agrees with this approach.

¹¹ [2008] NZHC 951

¹² [1981] Ch 25

¹³ The current law was recently explained in *Pangallo Estate Pty Ltd & ors v Killara 10 Pty Ltd* [2007] NSWSC 1528



33. The PPS Bill provides that certain unperfected security interests would be void as against the liquidator (section 233). However, the Bill has been revised so that certain security interests are unaffected by this rule such as security interests created by the transfer of an account, the interest of a senior creditor under a turnover trust and a short-term PPS lease. Consistent with its position that we make no comment on policy issues outside of insolvency law, the IPA has no comment on this change.

Retention of Title

34. As we earlier explained, retention of title is a significant practical and legal issue for insolvency practitioners. In particular, a seller of unpaid for goods under a retention of title arrangement will invariably ask for the immediate return of those goods on a formal insolvency occurring. The practitioner will then have the early task of determining the legal validity of that claim based on the sale terms and varying status of the goods.

35. The term "retention of title clause" is now defined in the *Corporations Act* at s 9 for the purposes of provisions concerning the obligations and powers of administrators under Part 5.3A in relation to property subject to such claims. Thus s 442C allows the disposal of property subject to retention of title claims; section 442CC imposes obligations on the administrator as to the proceeds of sale; and s 442CB sets the standard of care of sale that is required.

36. The IPA is concerned to ensure that the two regimes – the PPS legislation and the *Corporations Act* - are compatible. The PPS Bill deals with the validity of a security interests over inventory and non-inventory, through the priorities given to PMSIs under s 109 and s 110; and the *Corporations Act* deals with the obligations and powers of an insolvency administrator in dealing with goods subject to such interests. There should be no inconsistencies or gaps between the two regimes

37. We are also concerned to see that the PPS Bill assists an insolvency administrator in making a clear and prompt assessment of the validity of security over the company's personal property. In that respect, when reviewing the concerns we raised in the IPA August 2008 submission, the IPA is now pleased to see that the issue of perfection of a Purchase Money Security Interest ("PMSI") over inventory has been resolved in the amended exposure draft by specifically requiring registration of PMSIs (s 109). This also applies to non-inventory (s 110).

38. This accords with the IPA's view expressed earlier that registration is the desirable method of ultimate protection in the face of the company's insolvency.

39. However, we are still concerned, in relation to inventory, that an insolvency practitioner will need to determine the questions of giving and timing of notice to an existing secured party prior to the grantor obtaining possession, in order for the practitioner to determine whether the PMSI over inventory retains its priority status: s 109. We would prefer that this potentially difficult issue not be required to be determined by the practitioner.

40. In any event, we support the requirement for a PMSI to be registered in order for it to be perfected. This will then ensure the availability of s 233 in relation to an unregistered and hence unperfected PMSI at the date of the company's insolvency.



Insolvency administrators' liens

41. We note section 120 of the PPS Bill provides that a security interest would be subordinate to certain kinds of interests in personal property – priority interests – that arise under legislation or by operation of the general law.

42. In that context, we wish to raise the issue of liens. The remuneration of insolvency administrators is given protection under the relevant legislation by statutory liens over the insolvent's property. An administrator also has a statutory lien over company assets to indemnify him or her for the statutory personal liability imposed on the administrator for debts incurred by the administrator during the voluntary administration period (see sections 443A, 443B, 443E and 443F of the *Corporations Act*). Such liens also exist under the *Bankruptcy Act* (s 189AC). Liens create a secured interest in property.

43. In addition, a general law equitable lien may apply where no statutory indemnity is provided. For example:

- a provisional liquidator has an equitable lien over the assets of a company and is entitled to exercise that lien against the assets before accounting for the remaining balance (if any) to the company's liquidator;¹⁴ and
- an administrator under Pt 5.3A of the *Corporations Act* has an equitable lien over the assets of the company for reasonable remuneration and expenses connected with the realisation of any funds passed over to receivers.¹⁵

44. The equitable lien is available to receivers and liquidators as well as to administrators.¹⁶

45. The administrator's statutory lien under s 443F has priority over all unsecured debts and over debts secured by a floating charge over company property subject to the circumstances listed in s 443E(1)(b). An equitable lien will have priority over unsecured debts. In some cases an equitable lien can prevail over secured debts, for example in circumstances where a liquidator has preserved or realised property subject to security out of which the secured creditor can take payment.¹⁷

An equitable lien as a priority interest?

46. In this context, we do not consider that the PPS Bill is clear whether an equitable lien is to be treated as a priority interest (under s 120) such that it would prevail over a security interest (s 28).

¹⁴ *Shirlaw v Taylor* (1991) 9 ACLC 1,235

¹⁵ *Commonwealth Bank of Australia v Butterell* (1994) 12 ACLC 727

¹⁶ *Weston v Carling Constructions Pty Ltd* (in prov liq) [2000] NSWSC 693; see also *ASIC v McKenney Consulting P/L & Ors* (2003) 21 ACLC 314

¹⁷ *In Re Universal Distributing Company Limited (In Liquidation)* (1933) 48 CLR 171



47. Section 6 says that the Act does not apply to certain interests, including liens, except as provided in s 6(2). That subsection then appears to allow certain other sections to apply to liens, in particular s 120 in relation to the priority between security interests and other interests. It appears from this that a lien is regarded as a priority interest.

48. A "security agreement" is required to create a security interest. Section 120 brings in the concept of knowledge of that security agreement in determining the relative standing between a security interest and a priority interest. It is difficult to identify the relevance of "knowledge" of an insolvency administrator. Section 120 is paraphrased as saying that "the insolvency practitioner acquired the lien without actual knowledge that the acquisition constituted a breach of the security agreement that provided for the security interest". It does not seem to us to be a relevant inquiry to ask whether an insolvency practitioner "acquires" the interest created by an equitable lien and without knowledge.

49. We raise this as an important issue for insolvency practitioners to ensure that the legal status of equitable and statutory liens in an insolvency remains. That is, an insolvency administrator's statutory or equitable lien prevails over interests that do not have a valid secured status in an insolvency, and that such liens are not required to be registered. In addition, there should be no qualification on the validity of such liens raised by requiring the insolvency administrator to be without notice. There are strong policy reasons for the retention of means by which an insolvency practitioner's remuneration should remain protected.

50. We consider that insolvency practitioners' liens should expressly be given priority.

Service of documents etc

51. The PPS Bill contains various provisions as to service of documents and notifications to parties, including creditors. We suggested in the IPA August 2008 submission that these provisions be drafted in conformity with existing service and notice provisions in the *Corporations Act*, for the sake of consistency. For example s 255 of the PPS Bill refers to giving notice by email; we refer you to s 600G of the *Corporations Act* which is to the same effect but which is drafted differently. Also, any such provisions should nominate not only the means of service but also a date upon which the relevant document is deemed to be 'given' or served; see for example s 600G(5). In that respect, under the PPS Bill, a date of service is nominated when giving notice by fax (s 254) but no date of service is nominated when a notice is given by email (see s 255). Likewise, no date is nominated for pre-paid post – s 249. We see no reason to have different wording in Commonwealth legislation for the one concept.

Drafting issues

Section 233

52. We point out that "Note 2" to section 233(1) says that "(a) security interest might also be void under sections 263 and 264 of the *Corporations Act 2001*"; the section references should be to sections 266 and 267.



Insolvency and bankruptcy

53. The PPS Bill says that '*insolvency* has the same meaning as in paragraph 51(xvii) of the Constitution' by which the Commonwealth Parliament has power to make laws with respect to 'bankruptcy and insolvency'. As an example, s 287 of the PPS Bill refers to a priority that "comes to be determined because of an insolvency or bankruptcy". We assume that section means "comes to be determined because of a formal corporate insolvency (encompassing liquidation, administration etc) or a formal personal insolvency (encompassing bankruptcy, a personal insolvency agreement etc)". We simply point out that insolvency has quite a different, and defined, meaning under the *Corporations Act* (s 9) and under the *Bankruptcy Act* (s 5(2) and (3)). Also, bankruptcy is defined in the *Bankruptcy Act* as "in relation to jurisdiction or proceedings ... any jurisdiction or proceedings under or by virtue of" the *Bankruptcy Act*.

Present liability

54. Both ss 46 and 52(2) determine when a secured party has control of a non-ADI account - including if the deposit of amounts in a specified ADI account does not result in any person coming under a "present liability" to pay. "Present liability" is defined to mean a liability "(a) that has arisen; and (b) whose extent or amount is fixed or capable of being ascertained; whether or not the liability is immediately due to be met". We simply point out that this is in effect the insolvency definition of a *future* debt; that is, a liability "not immediately payable but which will certainly become due in the future on a date which is presently determined or which will be determined by reference to future events".¹⁸

Deceased bankrupt estates

55. We note that while s 6 provides that the PPS Bill does not apply to certain interests in property created under the *Bankruptcy Act*, including vested property, it makes no reference to deceased estates in bankruptcy under Part XI (which has its own vesting provisions).

Transitional provisions

56. We also note that the transitional provisions would preserve existing rights in cases of bankruptcy or insolvency, or assent by the security holder, for 24 months but that those transitional provisions would also provide incentives to security interest holders to register their interests under the new regime. The incentive arises from the fact that should the grantor become insolvent, security interests that have not been perfected would have a lower priority than security interests that have been perfected. Creditors seeking to preserve their priority on the grantor's insolvency have an incentive to perfect their security interest.

57. The IPA accepts that there needs to be an acceptable transitional regime over a period of time but we point out that the reality of an insolvency practitioner having to deal over that period of time with both the pre-PPS and the new PPS regime will add to the complexity and costs of insolvency administrations.

¹⁸ See *New Cap Reinsurance Corporation Ltd (in liq) v A E Grant & Ors* [2008] NSWSC 1015.



Further assistance

58. The IPA is pleased to assist in the consideration of this important legislation and we would be happy to provide further input, or attend any public hearings, as may be required. For that purpose, please do not hesitate to contact the IPA's Technical Director, Ms Kim Arnold (02 4283 2402 – karnold@bigpond.net.au) or our Legal Director Mr Michael Murray (02 9080 5826 – mmurray@ipaa.com.au).

Yours sincerely

P Cook
President

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