SENATE SUBMISSION

Responses to matters raised by the Committee during questions on 6 August 2009

We appreciate the opportunity to put our views on various matters to the Committee during its hearings in Sydney on 6 August 2009. We would like to address the following matters put to us during questions at the hearing.

1. Priorities and process

We were asked to prioritise the points raised in our submission with a view to identifying three or so items as our key concerns.

We want to emphasise that our concern is to have legislation that works well, and achieves its goal of achieving certainty and clarity within its policy framework. To that end we have spent a very significant amount of time and resources reviewing the Bill and in making our submissions; this follows the great deal of time we spent in cordial and fruitful meetings with the Attorney-General's Department on the earlier exposure draft.

We have looked again at our submission. Our difficulty is that we had already tried to keep it to a minimum. The matters raised in our submission (and submissions of others) are all key concerns. We were very selective in making them, given the time frame.

We do think they need to be addressed. The bill in its current form, while in many ways an improvement on previous drafts, still has too many uncertainties and difficulties to achieve its goals, and would lead to more litigation.

The concerns could on the whole be addressed by drafting changes that might be accommodated in amending legislation passed before the Bill became effective as law (so as to accommodate state referral legislation), but it should to recognised that there would need to be more than a handful of changes, and some may be substantial. This may take time but there is no policy reason to have the legislation passed quickly and in our submission it is worth taking that time to get things right. We cannot over-emphasise the importance of certainty in this area of the law – one of the policy objectives.

We are happy to continue discussing drafting issues with the Attorney-General's Department.

2. Our submission not comprehensive

Senators said that our submission was 'comprehensive'. We wish to emphasise that in our view it is not. We concentrated on a few areas. The submission lists key concerns that we have identified in a relatively short period, bearing in mind the very substantial changes to the Bill from the exposure draft and the fact that the time available to us to review the Bill is constrained by the fact that we are all engaged in full time practices.

We would be very surprised if we have identified all the important issues under the current Bill; there are likely to be many more that we and others have not yet identified.

As we mentioned, there were a large number of points in other submissions with which we agree but which we did not make ourselves. There were many areas like PMSIs which we did not address simply because we did not have the time.

3 Timing

We mentioned that our New Zealand colleagues said there needed to be a long implementation period, much longer than currently suggested. We can see the benefit of having a date, like 2011, that is sufficiently close to concentrate minds, but if the New Zealand experience is anything to go by, it may need extension. Our chief concern is that it is important to take the initial time to get the legislation right, and this may affect the implementation date.

4. Impact on farmers – requirements for signing and description

Senator Fisher questioned us on the potential impact of the Bill on farmers who supply under retention title arrangements. One point we raised in our answers to her questions was that retention of title arrangements may be invalidated not only by a failure to register but by a failure of the purchaser to sign the agreement containing retention of title or to describe the sale goods sufficiently. We added, however, that the requirements for signing may have been rectified in the new Bill.

(We have assumed farmers would normally supply pursuant to a written document, but like other suppliers would often not have that document signed. To the extent a farmer was to supply without its retention of title being included in a written document that would be fatal to its retention of title under the proposed scheme).

On review of clause 20 of the Bill we note that provision has been included for a security agreement to be enforceable without signing when the grantor does something specified in the writing with the intention of accepting it. The requirement that the mode of acceptance be specified in the writing is not a requirement of our current law and may not be specified by farmers. It would be better removed. The second requirement leaves open the question of whether the required intention is subjective (which would be a significant change and lead to uncertainty).

A further consideration is that under the current law it would not be necessary for the supplier to show that an effective contract had arisen in order to preserve its retention of title. A written invoice setting out a retention of title clause would be sufficient to indicate that the supplier did not intend to pass title on delivery. This of itself would be sufficient to protect the supplier's title whether or not the purchaser ever accepted the term.

Accordingly, our view is that the Bill is likely to operate to invalidate retention of title arrangements provided for by farmers (and other suppliers) due to a failure to satisfy the formal requirements of clause 20 in many circumstances notwithstanding the fact that the supplier may have registered their interest on the register.

5 Clause 14(2)(c)

We have had a closer look at this provision and agree it seems anomalous and should be removed. It could aversely affect the availability of credit for consumers.

To keep to the example of the farmer and retention of title: if the farmer's customer was buying feed for a horse, the farmer would lose priority if it was a pet horse but not if it was a stud horse. This would occur where the purchaser had already entered into a security agreement with a financier who had registered its prospective security interest on the register (and therefore obtained an earlier 'priority time'). This is one of a number of examples of provisions where one party's decision as to the use of goods has significant consequences as to other parties' security.

This is an example of a point we missed in our own review.

6 The Attorney-General's Department response

We were asked about the Department's response to our submissions. We have not seen the second part, but as to the first, in general we can say that where they raise different interpretations, that indicates a lack of certainty or clarity which can, and should, be fixed. Very briefly:

Deemed security interests not registrable

The "alternative interpretation" is one that cuts across clear wording. This could be easily fixed by drafting changes.

Investment entitlements left out

This should be addressed without waiting for a treaty, at least to the extent of dealing with investment entitlements, as to control etc, in the same way as investment interests. The conflicts of law issues might be addressed by references to general law, or more specific rules, which could be subject to regulations adopting the treaty when effective.

Flawed assets

The fact that they are given as examples can give rise to confusion and uncertainty, as the courts try to make provisions of the Act apply to something to which they don't naturally apply. The treatment of flawed assets as a security interest would be all the more anomalous given that they are most analogous to (and used as an adjunct to) rights of set-off, which are specifically excluded.

What would make the inclusion more serious than in New Zealand is the insolvency vesting provisions (which are absent from the NZ Act).

Repos etc should be excluded

The earlier consultation draft had wording which would work well. We are not aware of any concerns being raised with that wording.

Commingling

We do not think s101 fully addresses our concerns. It fact, it can make things worse. Say we are dealing with bars of gold which fluctuate in value, a secured creditor whose bars are worth $1000 when added to the mass can suffer unnecessarily if the bars become worth $2000. Section 102 still raises the issue which concerns us.

This could be fixed if the legislation adopted the simple principle that equal ranking holders in a mass of fungibles participated according to the proportionate part of the mass contributed. Australia could in this way have a significant improvement on overseas positions.

ADI Accounts

The Department says that the policy considerations here are difficult in deciding which foreign financial institutions should "benefit" from the provisions. We do not see what these might be.

First, a number of the provisions relating to ADI Accounts (eg, as to control) are for the benefit of the secured party (and the grantor), not the ADI. Only one (clause 75 giving them priority) benefits the ADI. If there were some policy reasons for limiting the institutions which benefit from that clause, they could be addressed in that clause.

Second, one of the policies of the reforms is to promote consistency of outcomes when dealing with similar property. Whether an institution is an ADI or a foreign bank makes little or no difference to commercial parties in the context of taking security over an account with that institution.

The Department did not address our other point, that the definition by reference to "protected accounts" within the meaning of the Banking Act seems unduly restrictive and likely to lead to anomalous results. That term has been designed to accommodate the financial guarantee scheme – we do not see why it is relevant in the policy framework of the PPSA . It would appear to produce some bizarre results – for example, after a certain date, foreign currency accounts with an ADI will cease to be 'ADI Accounts'.

Description

The Department's response concerning the first two examples (ie, 'all equipment' and 'all equipment at the factory at 17 Jersey Road') runs against clause 20(4) which specifies that a description using the term 'equipment' is inadequate unless the property is more particularly described 'by reference to item or class'. The clear inference is that 'equipment' is not a class.

We agree that the interpretation put forward by the Department with respect to the third and fourth of our examples is the better one, but again we are concerned that this open to argument, given the provisions of the Act such as clause 20(4) and uncertainty as to the meaning of the term 'class',.

The difficulty is that in this area, touching validity and priority, a "better" position is not certain enough for secured parties.

All assets and other security weakened

We corrected a few points on our original submission.

Our overall point is that framers of the policy should be aware that the choices made (when compared to NZ and current law) give buyers and subsequent secured parties priority over a perfected registered security interest even when they knew of the original perfected security interest . This will not only undermine the value but add to costs of all assets security as secured parties need to take potentially costly steps to monitor the position and take further steps to protect themselves – for example, to monitor whether the grantor is acquiring serial number goods or investment instruments, and take additional steps if the grantor does do so.

We are concerned that insufficient consideration may have been given to the fundamental importance within the Australian economy of the all assets security as an easy means for

Australian businesses to obtain finance. To weaken this security device in order to strengthen others (particularly in circumstances where the other secured party knew of the earlier, registered transaction) seems likely in our view to have an overall negative economic effect.

The vesting provision in clause 267

We addressed this in our oral submission.

One fundamental problem is that a security over future property cannot be perfected until it attaches, and it doesn't attach until the asset is acquired. All security interests are therefore unperfected to that extent they relate to assets acquired after the appointment of a liquidator and the secured party will lose recourse to the asset despite being registered prior to commencement of the liquidation. Among other things, this would effectively destroy the ability of a receiver to carry on a grantor's business after the commencement of its winding up.

Apart from the above technical issue, we are not satisfied that a secured creditor will as a practical matter always be able to register ahead – consistent with the current regime under the Corporations Act, some period following creation of the charge should be allowed for perfection before an intervening winding up invalidates the security. We do not agree with the Department's response that a security would in such cases probably be void under the voidable transactions provisions – a security for a new advance would not be void in these circumstances'

Another major problem is that where an unperfected secured party has title to an asset, that entire asset vests, leaving only a claim for the secured amount, if any, which may be far less than its value. Clause 269 does not cover all possibilities which would be caught by the general words of clause 12(1) or the specific words of clause 12(2) or 12(3).

The Clayton Utz suggestion, as we understand it, only partly addresses this issue, in the sense that the unperfected lessor or consignor still loses title in their submission if there is a perfected security interest over the asset. As that subsequent security interest in any event gains priority we do not see why that should be a determining factor for the company or other unsecured creditors to get a windfall.