Personal Property Securities Act – new developments in Australia

Comments

Bruce Whittaker[1]

I was very aware, when I took on the role of conducting the review, that not everybody would agree with everything I would recommend. That turned out to be the case. While there was a high degree of consensus through the Consultation Papers on most issues, there were indeed a number of issues on which views diverged, and often diverged widely.

There were a number of reasons for this. Some commentators were not as concerned as I was to reduce the complexity of the Act, and were of the view that recommendations for change should have been limited to a small number of key issues.[2] A number of my recommended changes are designed to clarify the meaning of provisions where I felt that the meaning was not sufficiently clear, and some commentators did not share my concern about the uncertainty, taking the view that the provision's meaning was clear enough without change. The bulk of the differences in view were however driven by two particular types of consideration, and it is these types of differences of view that I'd like to make a few comments on.

1. Competing policy interests

A number of industry organisations and individual businesses argued the case for changes that would operate for the benefit of a particular industry sector. The clearest example of this that emerged through the review process was the push by the short-term hiring industry to have their activities exempted from the operation of the Act. The short-term hiring industry argued both energetically and persistently that it was inappropriate for their hiring activities to be subject to the Act, and that they should be exempted – either by way of sweeping amendments to the definition of PPS lease in s 13, or by means of a more general exemption from the Act altogether.

It was not difficult to have some sympathy for their position. Before the Act came along, their business model was not subject to specific statutory regulation, and hiring companies could rely on a combination of contract law and the *nemo dat* rule to ensure for the most part that they could defend their assets against claims by third parties without great difficulty. With the advent of the PPSA, however, they now needed to register financing statements against their customers, often for each hiring transaction (if they were hiring out serial-numbered goods), or risk losing their assets. The hiring industry saw itself as a form of collateral damage – hiring companies argued that their industry was not the source of the mischief that the PPSA was intended to prevent, and that they had been inadvertently sucked into the maelstrom by overly-broad drafting.

Other commentators saw that differently. They argued that the extension of the Act to some hiring transactions was not inadvertent, and that exempting the hiring industry would adversely affect other stakeholders in a way that was inconsistent with the objectives that the Act was intended to achieve.

That, also, was the view that I took in the report. I did agree that aspects of the definition of PPS lease in s 13 were broader than was necessary to achieve the objectives of the Act, and that the definition should be tightened, but did not agree that the hiring industry should be exempted *holus bolus* from the Act in its entirety.[3]

---

[1] Senior Consultant, Ashurst. Needless to say, my comments are personal, and do not necessarily reflect the views of my firm.

[2] Others no doubt feel that I did not go far enough – in particular, those indefatigable souls who proposed that the entire Act be repealed and that we revert to a version of the law that was in force before the PPSA came into effect.

[3] See *Review of the Personal Property Securities Act 2009 – Final Report* (**Final Report**), Section 4.3.5.

To be able to decide where to draw the line between which hiring activities should be captured by the Act, and which should not, though, you first need to answer the question: just what **are** the "objectives of the Act"? At a very high level, Government described the objectives of the Act as being to:

- increase the consistency and certainty of secured finance in Australia;
- reduce the complexity and cost of secured finance in Australia; and
- enhance the ability of businesses and consumers to use their assets as security, and improve their ability to access cost-effective finance in Australia.

Those high-level objectives, however, do not provide much useful guidance on how you should decide exactly what it is that the Act should say. The Act itself also provides no guidance on what the architectural principles are on which it is based. So the approach I took for the purposes of the report was to look to the overseas legislation on which the Act is modelled,[4] to see what were the more specific objectives that those overseas examples were designed to give effect to. Those overseas models are also similarly silent on the objectives that they are intended to implement, but there are at least background materials that shed some light on the question.

In the case of Article 9 of the UCC, for example, much can be gleaned from the state of the background law that Article 9 replaced. The seminal text on the introduction of Article 9 into US law is Professor Grant Gilmour's two-volume treatise *Security Interests in Personal Property*.[5] Gilmore emphasised in the Preface to his work that Article 9 could not be read as a stand-alone text, and that it could only be properly understood by reference to the background of the American law that preceded it. For that reason, he devoted a large part of the first volume of his work to an exploration of the United States' pre-Article 9 law. It is clear from that discussion that Article 9 was revolutionary in the way in which it assimilated all transactions that in substance performed a security function into a single concept of a "security interest" that was then subject to one consistent set of rules. It was much more evolutionary, though, when it came to the content of those rules. As an example, both courts and legislatures in the US had for some time been applying a far more "substance over form" approach to security arrangements than was the case here in Australia before the arrival of the PPSA, and courts in the US would routinely re-characterise a hire-purchase agreement or a finance lease (for example) as a secured loan transaction, and enforce it accordingly. Legislatures had also been wrestling for some time with the "secret liens" problem – the fact that the existence of a secured party's interest in collateral may not be apparent to outsiders – and had enacted a bewilderingly complex series of partial solutions that Article 9 was designed to replace. This background information will have assisted US courts and legal advisers to understand the context in which Article 9 had been written, and to make sense of its provisions. Article 9 is also supported by extensive "Official Comments" which, while not having legislative force, are routinely relied on to assist with the interpretation of Article 9's many provisions.

Australia's secured transactions laws before the PPSA did not provide this type of insight into the intended effects of the Act. Similarly, the Act was not accompanied by an equivalent to Article 9's Official Comments. It is however impracticable to understand the operation of legislation like the Act without having a context to set it in. For this reason, commentators and legal advisers have turned to the reasons that had been given for the introduction of the corresponding legislation overseas, in order to gain a more granular understanding of

---

4 Principally, Article 9 of the US *Uniform Commercial Code*; the various *Personal Property Security Acts* in Canada; and the *Personal Property Securities Act 1999* (NZ).

5 Little, Brown, 1965.

what it was that the Act was trying to do. As just mentioned, I took the same approach in my report.[6]

Those reasons were fairly consistent across the overseas jurisdictions, at least as they applied to in-substance security interests. They were:

- to apply equivalent treatment to transactions that in substance achieved the same security function, regardless of the location of title or the form of the transaction; and

- to provide a publicity mechanism that facilitated the disclosure of those interests to interested third parties.

Of course, the Act also applies to deemed security interests,[7] and the rationales for doing that are not nearly as clear-cut. Broadly, four different reasons have been given for applying the Act to certain types of transactions, whether or not they have a security function. It would not be correct to say that all the reasons are relevant to each deemed security interest, but collectively they are seen to explain why they have all been included. The reasons are:

- to publicise hidden interests in property;

- to avoid characterisation difficulties – that is, to remove the need to undertake a difficult analysis of whether a particular transaction does or does not operate in substance as a security interest;

- because a deemed security interest is simply another way in which a person can use their property to raise finance – an extension of the "consistent treatment" concept; and

- because the Act provides a set of rules that are simpler and clearer than the rules that would otherwise apply.

Returning then to the short-term hiring industry, they wanted to be exempted from the Act entirely. They argued that their hiring arrangements did not give rise to in-substance security interests, and that they should also not be captured (accidentally, in their view) by the definition of a PPS lease.

To test the strength of that assertion, we first need to understand why PPS leases are captured by the Act. The view I took in the report was that the Act had been extended to PPS leases for a combination of the first three of the four reasons I've just listed – to publicise hidden interests in property, to avoid characterisation difficulties and (to a lesser extent) for consistency of treatment.[8] The first two of those concerns become more acute, the longer a lessee is in possession of the leased property – if a person leases goods for a short period of time, they are less likely to be able to convince a third party that they own the goods (and the lease is less likely to be a finance lease) than if the person had been in possession of the goods under a long-term lease, ie for an extended period. For that reason, I recommended that the definition of PPS lease be amended so that a lease would only be a PPS lease if it had a set term of more than one year, or if it actually ran for more than one year. That would bring the overwhelming bulk of hiring arrangements out of the Act, and only leave in those (relatively uncommon) hiring arrangements that have a set term of more than 12 months, or that are for an indefinite term that actually runs for more than 12 months.

---

6 Final Report, Sections 4.1 and 4.3.

7 Transfers of accounts or chattel paper, commercial consignments and PPS leases. See s 12(3) of the Act.

8 Final Report, Section 4.3.5.1.

The solution proposed by the hiring industry would have helped the hiring industry, but would have disadvantaged other users of the system – in particular, third parties who might be considering purchasing the goods or taking security over them. The solution I recommended was to tighten the definition of PPS lease in a way that largely responded to the hiring industry's concerns, but did not compromise the reasons why the concept of a PPS lease had been included in the Act in the first place.

2. Different philosophical starting points

Some differences in view had a deeper, almost philosophical division of thinking as their well-spring. As we all know, the PPSA was not an immaculate conception of the Office of Parliamentary Counsel in Canberra. Rather, the concepts that underpin the Act derived from the overseas models that I've already referred to.[9] One of the very practical difficulties that Australian practitioners faced from the outset was not knowing the extent to which our courts were going to take the overseas jurisprudence into account when interpreting our Act - would courts look readily to overseas case law and commentary to interpret the Act (as was the case, for example, in the *Maiden Civil* case[10]), or would courts apply more traditional techniques to unlock the Act's mysteries, and only use the overseas learnings as a comparative tool rather than as a primary source of understanding (as has been the case in some more recent decisions, such as the *Dura Constructions* case[11])?

I mentioned a little earlier that Article 9 was very much a creature of the legal and commercial environments in which they were born. It goes without saying that the legal and commercial environment in North America in the second half of the last century was very different to the environment which prevailed in Australia some six years ago, when the PPSA was parachuted into it. This meant, when the PPSA arrived, that it did not fit particularly comfortably with the balance of the Australian legal system, and in particular with the general law. As an example, a number of provisions in the Act appear to make assumptions about the general law that will have been correct in the USA, but are not correct here. That lack of fit between the Act and the general law produces an uncomfortable conundrum. Should courts endeavour to interpret the Act as a self-contained and internally coherent body of principles, even where they appear to be at odds with the general law, or should courts lean more on the general law, and endeavour to interpret the Act using traditional general law thinking as much as possible?

One very good example of this conundrum is the topic that both Sheelagh and Craig have discussed, the question of when a person in possession of collateral will be regarded as having "rights in the collateral" that enable the person to grant a security interest over the collateral, rather than just over their possessory interest in it. Sheelagh is well known to be a proponent of the argument that the general law should be used to determine the extent to which a person can give the security – that is, that any person in possession of collateral can give security over the whole collateral that is good against all the world other than the true owner. Craig, on the other hand, is a proponent of what I referred to in the report[12] as the "unitary model", under which bare possession only enables the possessor to give security over their possessory interest, but under which a person (such as a lessee) who is in possession of collateral as the grantor of a security interest is able to give security over the entire collateral, because the Act treats them as if they were the owner of the collateral, whether or not that is the case under the general law.

Sheelagh refers to this as "deemed ownership". I tried very hard in the report not to say that the Act "deems" the grantor to be the owner, as I think that sounds like a more absolute

---

9 See note 4.

10 *Albarran* (*as recs and mgrs. Of Maiden Civil (P&E) Pty Ltd*) *v Queensland Excavation Services Pty Ltd* [2013] NSWSC 852.

11 *Dura (Australia) Constructions Pty Ltd v Hue Boutique Living Pty Ltd* [2014] VSCA 326.

12 Final Report, Section 5.1.2.

result than is necessary. The Act just gives the grantor the ability to deal with the collateral as if it were the owner, even if it isn't – an outcome that is not unknown in other areas of our law.

As I just mentioned, I prefer the "unitary" model's explanation. I do acknowledge, though, that reasonable minds of highly experienced practitioners can differ on this question. Indeed, we can see that from the fact that differing positions on the question are taken by our two speakers today.

Wearing my hat as the reviewer, though, I did not want to be too narrow-minded in the way I approached this question. Even though I prefer the "unitary" model, I thought it was important to give proponents of the "possession" model an opportunity to explain just how their approach would work in practice, before Government made a final decision on which model it wanted to apply. I believe that Sheelagh and others have taken up the challenge, and are in the process of preparing such an explanation. At the end of the day, my focus as reviewer was to recommend outcomes that would achieve the Act's objectives in a way that had broad support from the legal and business communities, and if it can be shown that the "possession" model produces better overall outcomes than the "unitary" model, then I think we should be prepared to support it instead.

Finally, I would like to say a few words about how the reform process is likely to unfold from here. Government is still working its way through the recommendations in the report, with a view to producing draft amending legislation for public comment in April or May next year. That sounds like it's a long way away (and it is), but there's a lot to get through, and the timeline is stretched out somewhat by the fact that the Intergovernmental Agreement between the Commonwealth and the States requires the Commonwealth to give the States a period of time to review any proposed legislation in advance.

The good news in all this of course (at least from my perspective), is that Government is not quietly shelving the report, but is focussed on progressing it. It's likely that the amendments will be passed in two phases, in that the issues that require further consultation will be held over to a later, second piece of amending legislation, but my sense is that Government is approaching the recommendations as a package, and is not proposing to cherry-pick.

Returning to the first amending Act, it would be likely to be passed in the second half of next year. I believe that Government has also heeded my plea to not rewrite the register software this time until the legislation has stopped moving. So even when the Act has been passed, time will still be needed to rewrite and test the register software, and to allow business to do the same with its own software, before the amendments go live. Realistically, that means that the changes are unlikely to take effect until some time in 2017. I'm hoping, however, that the wait will be worth it.

Thank you.