Statutory review of the Personal Property Securities Act 2009

The Australian Reconstruction Insolvency & Turnaround Association is the professional body representing company liquidators and trustees in bankruptcy, as well as lawyers, financiers, academics and others practising in or otherwise interested in insolvency and reconstruction law and practice. ARITA and its members have considerable expertise and experience in relation to the assessment of PPS interests in the context of the granter’s insolvency. We have also been active both before and after the introduction of the PPSA in instructing our members and others on the operation of the regime, at our forums and conferences, and in our journal and other communications. ARITA is represented on both the PPS Stakeholder Forum and the PPS Operations Forum.

We are pleased to be able to respond to your request for comment on your review. Our submission is based on matters of principle rather than detail.

1. Summary

In section 2 of this submission, we explain how insolvency law accords priority status to secured creditors. This requires such claimants to be able to prove their status and their claim. Our experience to date shows that secured PPS claimants are inattentive in responding to the expeditious processes that insolvency law imposes. This is both due to the state of the Register, and to what may be less than satisfactory PPS business practice. Whatever the reason, we consider that delay and cost problems being impacted upon the insolvency process would be alleviated by allowing the liquidator¹ to issue notice to claimants on the PPSR to substantiate their claims within a set period, or risk rejection of their claims as PPS security interests – section 3. An existing example of such an approach is the "vesting" provisions in the PPSA. We also recommend statutory protection be given to the priority of a liquidator for remuneration for work done in determining PPS claims and priorities: section 4. We also mention that PPS compliance by a business should be a factor in any pre-conditions to the protection of directors and others from insolvent trading and other related liabilities in the twilight stage of a company’s distress – section 5 of this submission.

¹ For convenience, we refer only to a liquidator as being one example of an insolvency appointee; our comments apply generally, to both corporate and personal insolvency, unless otherwise stated.
2. The nature of insolvency

It is accepted as fundamental in insolvency that secured creditors have priority and can stand outside the insolvency process. This is provided for under the Bankruptcy Act and the Corporations Act.2

It is also fundamental that all creditors be able to prove their status as a secured creditor and if necessary the quantum of their debt.

An aim of PPS laws is to regularise and make clear the status of priority creditors with interests in personal property of the company, to the same level as those with security interests in the company’s real property.

Consistent with ARITA’s general approach to priorities of claims in insolvency as a matter of legal policy, we do not offer a view on how those priorities are set.

Rather, we expect the law to require that the right to any priority or claim be made sufficiently clear to the extent possible according to its nature. This expectation applies to claims to a PPS security interest status in personal property. This is necessary as a matter of commerce and business, and assumes greater significance in the content of the grantor’s insolvency when all claims and priorities are to be verified and determined.

The winding up of a company generally operates according to a legal process of expedition, to the extent for example that most litigation claims against the company become matters for assessment by the liquidator, acting in a quasi-judicial capacity. That expedition is required in order to facilitate a prompt resolution of the winding up for as little cost as can be managed consistent with creditors’ and other parties’ rights. Insolvency law therefore places the onus on those with claims in the liquidation to prove their priorities and claims, and often within strict time limits.

One purpose of the PPS regime, as we understand, is that on winding up of the insolvent grantor, the position of secured claims against the personal property of the grantor should be able to be ascertained and determined reasonably expeditiously. This has to allow for the need to deal with the inherent complexities of commercial claims, for example, in PPS, in the commingling of products.

What has often been the case is that while the PPS law and its intention may be reasonably clear, in practice the conduct of parties and the PPS Register itself does not afford liquidators the benefit of clarity in relation to PPS claims. Insolvency practitioners have had to spend considerable time and cost in determining such claims from the PPSR, in trying to obtain information from PPS claimants about their interests, and in dealing with those who claim to have interest, but whose interest cannot be readily shown to have been perfected.

In practice, this seems to occur through the inadequate state of the PPS Register, through creditor’s own inadequate use of it, and the fact that the register allows ‘stale’ interests to remain.3 We contrast that with land title registers, acknowledging the more stable nature of land as collateral.

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2 As we said in our 20 August 2008 submission, security is relevant to a number of issues in insolvency including how and for what amount a secured creditor’s debt can be proved, the release of the insolvent from liabilities, the validity of the security, whether and how secured creditors can petition for a winding up order, the rights of the liquidator to deal with the security, and including a secured creditor’s right to vote.

3 This appears to arise from inattention to the obligation on a secured party to remove the PPS registration if there are no (or no longer) reasonable grounds for the secured party to believe that it has a security interest: s 151, Personal Property Securities Act 2009. We also note the amendment demand regime that allows a person...
We refer to two cases illustrative of the issues, both reported in ARITA’s Australian Insolvency Journal.⁴

Case examples

In the Hastie Group, there were 995 registrations noted against the companies in the PPSR. The Group’s records inadequately described the nature and location of all the plant and equipment, some of which had been moved between companies and different building sites without records being kept. The voluntary administrators wrote to all creditors who had an interest recorded in the PPSR but 80% failed to respond and many of the responses received were of little assistance to the administrators. The administrators also wrote to a number of financiers who appeared to have a secured claim in respect of the plant and equipment, and they placed advertisements in newspapers across Australia. The administrators were able to identify approximately $2 million worth of assets but in the end result 77% of the total number of items of plant and equipment remained unclaimed. This necessitated court intervention and directions to allow the administrators to sell the assets despite the PPS interests. See Carson, in the matter of Hastie Group Limited (No 3) [2012] FCA 719.⁵

In Renovation Boys, the administrators needed court leave under s 442C(2)(c) of the Corporations Act to dispose of property of the company that was subject to a security interest under the PPSA. The directions were given that a sale could proceed after 14 days on condition that the proceeds of sale were held subject to the provisions of Pt 5.3A Div 8. As the Court said, “there is justification for giving such a direction given the limited funds available to the administrators and the costs of the Company continuing to occupy leased premises and employ staff so as to deal with the relevant property beyond the expiry of that two week period”. As to the costs incurred, the Court gave a direction that the administrators were justified in imposing a levy of 31% on stock items as a condition of the customers taking delivery of their stock, the Judge saying that “(i)t seems to me that that approach is a reasonable one and it is difficult to imagine any other approach that could sensibly be adopted in the circumstances”. See In the matter of Renovation Boys Pty Ltd (admins apptd) [2014] NSWSC 340.

We refer to these cases as examples of the intersection of the PPSA and insolvency, and illustrative of the many other cases that might be resolved without court intervention, often because, we surmise, because of limited funds in the insolvent company.

3. Reform recommended – liquidator’s notice to PPS claimants

Once a company enters external administration, insolvency laws take over, with their different focus and policy approach, in particular to ensure the efficient and prompt winding up of the company’s affairs, for as little cost as can be achieved. Existing security interests and priorities are recognised, but on terms and under processes applied by insolvency law.

We suggest that, as matter of general approach, insolvency law allow a practitioner to give notice to claimants on the PPS Register to verify their claims within a set period, say 21 days, failing which their claims will be treated as unsecured or not at all. As an insolvency example, Corporations Regulation 5.6.65 provides that a liquidator must give notice of an intention to declare payment of a dividend from the company’s funds, and, relevantly, a creditor that does not respond with a proof of its claim within the set time is excluded from participating in the dividend.

with interest in the collateral to demand the registration be removed if there is no longer a security interest: s 187.

⁵ The correctness of that decision and the utility of such directions was questioned as “unsound” in PPS Register – Unclaimed good and the decision in Hastie Group (2013) 25 (1) A Insol J 20, David Walter.
There is an existing related policy approach in relation to the "vesting" of certain unperfected security interests under Part 8.2 of the PPSA.6

There would need to be consideration of how such an approach would be implemented within each type of insolvency administration. There also may be other such mechanisms available to assist the expeditions process needed in insolvency in dealing with PPS claims.

As is apparent form the Hastie Group administration, and other cases reported, dealing with PPS claims can involve considerable time spent, and therefore remuneration accrued by the administrator, to the general diminution of funds available for creditors generally. In part, as we say, this is because of the general insolvency process upon creditors to prove the validity of their claim, practically, it will often be the liquidator with the skills and access to available company records who is called upon to either prove or disprove such claims. As has been said,

"(w)hile some of this additional work may initially be worn by Practitioners as they come to terms with the PPSA, it will only be with the benefit of hindsight that we will be able to determine whether there will be a continued upward pressure on costs, which are likely to be eventually borne by the creditors they represent. Such differing views will need to be resolved by litigation adding to the costs associated with the process.7

That position will improve over time and we are pleased to see the enhancements to the PPSR and other developments recorded at the meetings of the regular PPS Forums. Nevertheless, the approach we adopt is recommended to be available in circumstances where it would assist the insolvency process.

4. Reform recommended – remuneration priority

A liquidator has an equitable lien over assets of the company in respect of which claims need to be determined, apart from the statutory priority under s 556 of the Corporations Act. The law in relation to the priority of a liquidator’s remuneration over secured claims is stated in Universal Distributing,8 in relation to work in locating secured and realising company assets. We have some concerns that in dealing with PPS claims, where security interests may or may not be confirmed, there may be uncertainty in some instances that the liquidator’s remuneration prevails. The work of a liquidator in dealing with PPS claims is not necessarily involved in realising assets, rather in determining those PPS claims and priorities, many of which may be shown to be security interests.

We do note that in matter of Renovation Boys Pty Ltd (admins apptd) (No 2) [2014] NSWSC 354, in clarifying orders made in the earlier judgment, cited above, the Court noted that a prior security holder would not be able to rely on its priority against the equitable lien available to a voluntary administrator “because to do so would be unconscientious”. This applied also to retention of title claimants, the Court saying that it would be “unconscientious for those persons to now take property in the stock, without recognising the efforts that the administrators have made to identify and retain it, so that it can be made available to them”.

While the Universal Distributing principle may apply in most cases, we suggest that this be legislatively stated, such that the law provide for a statutory priority for the benefit of the liquidator in respect of the determination of all security interests, and if, necessary any costs of sale: see generally Part 5.3A Division 8, Corporations Act. This would serve to avoid any “unconscientious” outcomes and to avoid court intervention and directions.

8 Recently discussed in Stewart v Atco Controls Pty Ltd (in Liquidation) [2014] HCA 15
5. PPS as good business governance

ARITA considers that general tax, PPS and other legal and regulatory compliance is an important aspect of good business conduct. From our insolvency perspective, corporate, tax and securities compliance is a pre-condition to the company’s ability to monitor its financial and operational position. This then allows the company to better safeguard against financial distress and its potential insolvency. This also provides a safeguard for company officers.

ARITA sees the need for the law to permit restructuring of a distressed company’s financial affairs in the twilight zone that may be leading to its formal insolvency. In the on-going debate about the liability of company’s officers for debts of the company in that period, in particular for insolvent trading, or personal tax liability, ARITA’s general policy position is that there should be a ‘business judgment’ or ‘safe harbour’ protection for those companies and their officers that have generally been compliant with tax and other regulatory obligations, and who have proper systems and controls in their company.9 Property attention to the company’s credit, securities and financial arrangements, and to its own borrowing obligations, is necessary.

In the PPS context, it would be expected of a business that it regularly review and maintain its security interests and ensure their perfection, including that any interests are registered accurately. PPS due diligence should be required when giving credit to customers. As a borrower, a company should ensure that the PPS Register is accurate in relation to its own position, including by way of arranging removal of security interests that have been discharged.

In the insolvency focused experience of our members, records of insolvent companies often fall short of what is be required, and may in fact have led to the company’s financial demise. ASIC’s Insolvency Statistics Report 372 disclosed that a significant proportion of external administrators’ reports for the financial year 2013 attributed ‘poor financial control (including lack of records)’ as a cause of company failure.

There is a recent parallel with the introduction of the GST in 1999 and the need for businesses to put systems in place in order to ensure tax compliance. Just as governance and risk management obligations were required to be implemented by taxpayers, so too is PPS compliance required and expected, assisted by, as with the ATO’s GST guidance, PPS guidance issued by the Registrar, for example in managing credit risk. ARITA has itself sought to promote the knowledge and use of the PPS regime though its publications and training.

We consider these approaches are consistent with engendering good business practice. Our PPS comments are generally made from this perspective.

PPSR statistics

ARITA generally supports the better collection and analysis of business statistics in particular in relation to the operation of the insolvency system. We support the gathering and publication of statistics by the Registrar and see its potential for a closer examination of what some see as the increased priority given to secured creditors in insolvency. Again we are pleased to see the developments recorded in the discussions of the PPS Forums. This will better assist the on-going assessment of the PPS regime.

9 Joint submission to government of the IPA (now ARITA), the Law Council of Australia and the Turnaround Management Association Australia, March 2010.
**Contact**

Please contact our Legal Director Mr Michael Murray on 02 9080 5826 or mmurray@arita.com.au if we can assist further. In particular, if you require any other articles on PPS from the considerable body of such articles in ARITA's *Australian Insolvency Journal*, please let us know.

Yours sincerely

![Signature]

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