A Law That Damages the Hire Industry

Section 12(3)(c) of the *Personal Property Securities Act 2009* (Cth) (**PPSA**) should be repealed.

This is the section that deems a hire of goods by a hire business, if indefinite or longer than a given time threshold, to be a PPSA 'security interest'. Such a transaction is a 'PPS lease' under section 13.

This is the section that brings Australian hire businesses into the same law that regulated banks and financiers taking security.

A PPSA barbeque stopper

The following scenario is brought about by those provisions:

> *In June 2016 Joe's Hire hires 10 generators to Bodgy Constructions Pty Ltd for 13 months. Joe's fails to make a correct PPSA registration.*
>
> *Earlier, in March 2016, Bodgy had borrowed $1million from Big Bank and Big Bank had taken security over all Bodgy's assets.*
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> *In July 2016 Bodgy appoints an administrator and two days later Big Bank appoints a receiver.*
>
> *The receiver appointed by Big Bank tells Joe's that under the law, the bank's security interest has priority over all assets including the generators.*
>
> *The bank will take the generators and sell them to pay the money owed by Bodgy to the bank.*

How could such a law come to pass?

It seems that Parliament's concern was the problem of 'ostensible ownership'. The legislature evidently feared that people dealing with the customer (Bodgy Constructions) will extend it credit – somehow believing it to be a more substantial business because it ostensibly owns the hired generators.

But this rationale rings hollow on closer examination.

Consider that:

- The bank never knew about the hire and didn't bargain on getting security over the generators, so it wasn't misled about anyone's apparent ownership. It gets a windfall in effect.
- There is no equivalence to what one might, pre-PPSA, have called a security interest. Not only is nothing 'secured' by the generators, they have been on the customer's premises for only a short time.
- It wouldn't matter if the goods had '***Property of Joe's Hire***' permanently emblazoned on them. The PPSA would still take them.
- The hire industry exists largely to provide the flexibility needed by the construction and mining industries to pay for plant and equipment only when it is needed. Participants in those sectors well understand that businesses hire the equipment they use, but this knowledge is irrelevant under PPSA. The PPSA would still take them.

- There is a register but even if Joe's Hire knew about PPSA and about the register, it would have needed good legal advice to register its 'security interest' correctly. Experience suggests that without such advice (and regular refreshers when personnel change) hire businesses will usually make fatal errors in their registrations. The list of pitfalls is long.

The hire industry was not consulted about the PPSA before it was enacted but the potential for it to damage or destroy hire businesses should have been obvious. It has already occurred.

In the above example, Joe's Hire may suffer insolvency itself as a result of losing its assets. Joe may have given a mortgage over his house to secure loans that he relies on the equipment to service and repay.

Perhaps the worst feature of the current law is the casual expectation that hire businesses ought to know all about the PPSA and its extraordinary complexities and that hire businesses (most of which are small) can muster compliance resources and expertise equivalent to those commanded by banks and other financiers who really do take security.

A misguided law with poor policy justification

Adopting a quixotic approach, it is as if PPSA sets out on a quest to slay an apparent evil. The windmill it tilts at is the 'ostensible ownership concern'. It does not seem to have been considered whether this evil even existed to any significant degree.

Remember that before PPSA, **Joe's Hire could simply go down to the insolvent business' premises and get the generators back**. Business seemed to cope with that outcome.

In a thoughtful joint submission to the Whittaker Review of the PPSA (the Review's Report is currently being considered by Government), four of Australia's largest law firms rejected the notion that policy should be driven by the ostensible ownership concern. To quote their submission:

> *It may have been the case in the days of Queen Elizabeth I, when Twyne's case was decided, that one could assess the wealth of a blacksmith by counting the anvils and bellows etc. in his shop, and the coins in his purse. That is no longer feasible.*
>
> ……..
>
> *For businesses at least, financial statements are far more useful as a way of getting a rough idea of the assets of the business. Parties to financing transactions know this, and are unlikely to make the assumption that a business owns assets simply because they are in its possession or apparent possession.*

If the Whittaker Report is adopted the banks will still win.

The radical effect of section 12(3)(c) is to take away ownership in the hired asset if ownership is not 'perfected' by registration. In his Report to Government, Mr Whittaker, a banking partner at Ashurst, at least recognised the problems this poses for the hire industry. He recommended that the hired asset not 'vest in' the insolvent customer.

But when urged by the hire industry also to recommend that the asset not be taken by the customer's bank, Mr Whittaker baulked. He does not recommend removing the PPS lease concept from the law or granting any exemption to the hire industry.

Since most insolvent businesses, like Bodgy Constructions in our example, will have an 'all assets' lender (usually a bank) with security that can take the asset away from the hapless hire business under the PPSA priority rules, the Whittaker recommendation offers little to the hire industry. Losing the asset to a receiver is no different to losing it to a liquidator or administrator, from the hire business' perspective.

The law should be changed.

There is much commendable material in the Whittaker Report which is clearly the product of hard work and analysis. Some of the Report's recommendations offer a degree of relief but they don't fix the fundamental mistake that was made when a law about security interests, priorities and finance was extended to catch simple hires.

Even if the ostensible ownership concern is valid to some degree, how does one balance the cost of the red tape and risks it poses against that? How many damaged or ruined hire businesses are 'worth' the supposed policy benefit? The banks and the hire industry have differing views about this, given that the law currently delivers windfall gains to the banks.

The Whittaker recommendation proposes reserving the windfalls to the banks exclusively.

On the question of keeping hires in the PPSA, the Whittaker Report has got it badly wrong.

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