

## **EXPLANATORY STATEMENT**

### **Select Legislative Instrument No. 37, 2014**

**Issued by the authority of the Attorney-General**

*Personal Property Securities Act 2009*

*Personal Property Securities Amendment (Motor Vehicles) Regulation 2014*

Section 303 of the Personal Property Securities Act 2009 (the Act) provides that the Governor General may make regulations prescribing matters required or permitted to be prescribed by the Act, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Section 10 of the Act permits regulations to the Act to provide for a definition of motor vehicle.

Regulation 1.7 of Division 3 of Part 1 to the Personal Property Securities Regulations 2010 (the regulations) provides for the definition of motor vehicle. In particular, regulation 1.7 (2)(b) provides that a motor vehicle is:

- a) personal property built to be propelled, wholly on land, by a motor that forms part of the property, and
- b) either:
  - i) is capable of a speed of at least 10km/h, or
  - ii) has one or more motors that have a total power greater than 200 W.

The Regulation narrows the definition of motor vehicle from self-propelled devices having either of these characteristics to those having both.

The narrowing of the definition reduces the number of goods that are motor vehicles for the purposes of the Act. As motor vehicles are a subset of the category 'serial numbered goods' within the Act, the narrowing of the definition of motor vehicles therefore reduces the number of goods that are serial numbered goods and which may require individual registration to be made when a security interest is taken over them. This reduces compliance costs for businesses by allowing them to rely on a single, general registration made against the name of the party granting the security interest, without the need, in most cases, for individual registrations against each serial numbered item.

Details of the Regulation are set out in Attachment A.

The peak bodies representing affected industries as well as peak bodies representing stakeholders connected to those industries (including lenders, financiers, insolvency practitioners, accountants and legal practitioners) were consulted during the preparation of the Regulation.

A Statement of Compatibility with Human Rights is set out in Attachment B prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Office of Best Practice Regulation was consulted on this Regulation and a Regulation Impact Statement has been prepared. The Statement is extracted at Attachment C.

The Regulation will commence on 1 July 2014.

Authority: Section 303 of the *Personal Property Securities Act 2009*

**Personal Property Securities Amendment (Motor Vehicles) Regulation 2014**

**Regulation 1 – Name of Regulations**

This regulation provides that the title of the Regulation is the *Personal Property Securities Amendment (Motor Vehicles) Regulation 2014*.

**Regulation 2 – Commencement**

This regulation provides for the Regulation to commence on 1 July 2014.

**Regulation 3 – Authority**

This regulation specifies that the Regulation is made under the *Personal Property Securities Act 2009*.

**Regulation 4 – Amendment of *Personal Property Securities Regulations 2010***

This regulation provides that the *Personal Property Securities Regulations 2010* are amended as set out in the Schedule.

**Schedule – Amendments**

**Item [1]**

This item repeals paragraph 1.7(2)(b) and substitutes the definition which requires the item of personal property to be capable of a speed of at least 10 km/h and to have one or more motors that have a total power greater than 200 W.

**Statement of Compatibility with Human Rights**

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

**Personal Property Securities Amendment (Motor Vehicles) Regulation 2014**

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Overview of the Regulation**

The *Personal Property Securities Amendment (Motor Vehicles) Regulation 2014* (the Regulation) will narrow the definition of motor vehicle for the purposes of the *Personal Property Securities Act 2009*. The current definition in Regulation 1.7 of Division 3 of Part 1 to the *Personal Property Securities Regulations 2010* (the regulations) provides that a motor vehicle is personal property built to be propelled wholly on land, by a motor that forms part of the property, and that either is capable of a speed of at least 10km/h, or has one or more motors that have a total power greater than 200 W. The Regulation will amend the regulations to provide that personal property must have both of these characteristics in order to be a motor vehicle.

The narrowing of the definition reduces the number of goods that will be motor vehicles, which in turn will reduce the number of security interests which may require the making of separate registrations against the serial number of the goods involved rather than only a registration against the party granting the security interest.

**Human rights implications**

This Bill does not engage the rights protected by the international conventions listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Regulation Impact Statement:**

**Application of the *Personal Property Securities Act 2009* to leases**

**Introduction**

Secured lending against personal property is an important element of the Australian credit market and, accordingly, the broader economy. The *Personal Property Securities Act 2009* (the PPS Act) was an important microeconomic reform, replacing a complex and fragmented system, including over 70 Commonwealth, State and Territory Acts, with a single national regime for the creation, registration, priority and enforcement of security interests in personal property.

The PPS Act also created the Personal Property Securities Register (the Register) which consolidated and replaced over 40 Commonwealth, State and Territory registers used to provide notification to third parties of interests in personal property. Apart from giving secured parties a simple means of publicising and protecting their interests, the Register also provides an authoritative public record of interests in personal property for the benefit of third parties (such as financiers, lenders, insolvency practitioners and buyers of personal property).

By providing greater certainty about the creation, priority and enforcement of security interests in personal property, the PPS Act and Register were intended to reduce the costs of borrowing and increase the range of property available to secure finance, especially for small businesses.

Section 12 of the PPS Act defines a security interest to be an interest in personal property provided for by a transaction that, in substance, secures the payment or performance of an obligation. A simple example would be where a bank provides a customer with a loan to purchase a car. The customer grants the bank an interest in the car (the personal property or ‘collateral’) which secures the repayment of the loan.

Unlike the laws it superseded, the PPS Act is not concerned with the form of the transaction (e.g. whether it is a mortgage, pledge, lease etc) or the identity of the person who has title to the property involved when determining whether a security interest exists. This was an important simplification of previous arrangements.

The PPS Act requires security interests to be perfected in order to guarantee their priority as against other security interests over the same item of property. One of the key ways in which perfection of a security interest is achieved under the PPS Act is through registration of the interest on the Register.

## Application of the PPS Act to leases<sup>1</sup>

It can be difficult to determine if a lease is a security interest according to the definition in the PPS Act. Some leases, such as those used as another means of financing the acquisition of personal property, will be security interests. For example, Business A requires a particular item of equipment and enters into a transaction with Business B who buys the equipment and leases it to Business A for an extended period. For Business A, the making of lease payments represents an alternative to the making of loan payments had it obtained finance and purchased the equipment. Business B's interest in its equipment would be treated as a security interest granted by Business A.

Whether other lease arrangements meet the definition of a security interest can be more difficult to determine. Generally, short term leases of personal property will be unlikely to meet the definition, but as lease terms becomes longer, especially as they begin to approximate the useful life of the leased property, they become increasingly likely to be a security interest.

### *Deeming leases to be security interests*

To resolve this uncertainty, the PPS Act follows the approach taken by other common law countries with a PPS system (such as New Zealand and Canada) and deems leases to be 'PPS leases' and therefore security interests in certain circumstances. This means that these leases are treated as if they were security interests, even though they do not secure payment or the performance of an obligation (i.e. they do not meet the definition of a security interest in section 12 of the PPS Act).

The PPS Act's deeming provisions are set out in section 13 of the PPS Act and have several parts. First, a lease of a term of more than 12 months is deemed to be a PPS lease. To ensure that the effect of this rule is not undermined by parties entering into leases and omitting to specify a term, the PPS Act provides that leases of an indefinite term are also PPS leases. The PPS Act also makes provision for situations where a lease is specified to be for a term of less than 12 months but, because of options to renew the lease (either automatically or at the election of one of the parties) or because the lessee (e.g. the customer) remains in possession of the goods with the consent of the lessor (e.g. the hire company) after the expiry of the initial term, the total term or terms of the lease exceed 12 months. These leases are also deemed to be PPS leases.

Finally, the PPS Act deems leases of more mobile items of personal property (such as motor vehicles, boats and aircraft – known in the PPS Act as 'serial numbered goods') to be PPS leases where the leases involved are for 90 days or more.

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<sup>1</sup> The PPS Act and the deeming provisions discussed here are equally applicable to businesses involved in the bailment of goods for value. A bailment is the delivery of personal property by the owner of the property (the bailor) into the possession of another person (the bailee) upon an express or implied promise that the property will be redelivered to the bailor or dealt with in a stipulated way. Unlike a lease, the bailee is not generally entitled to use the property in his or her possession.

**Table 1 – PPS leases – the deeming provisions**

Section 13(1)(a)-(d) of the PPS Act provides that a lease will be a PPS lease where it is:

(a) for a term of more than 12 months

(b) for an indefinite term

(c) for a term of up to 12 months but is automatically renewable or includes options to renew and the total terms of the lease might exceed 12 months, or

(d) for a term of up to 12 months but the lessee remains in possession of the goods for more than 12 months with the consent of the lessor.

Section 13(1)(e) of the PPS Act further provides that a lease of serial numbered goods will be a PPS lease if the lease is for 90 days or more.

The effect of the deeming provisions is that these leases will be treated as security interests even if they do not meet the definition of security interest in section 12 of the PPS Act.

Deeming certain leases to be security interests not only provides certainty about the application of the PPS Act, it also addresses the problem of apparent ownership or wealth created by such arrangements which is a key focus of the PPS Act. The possession of goods by someone who is not the owner of the goods can create uncertainty and risk for:

- financiers or lenders who might be determining whether to provide finance to a person in possession of such goods and whether they can safely take an interest in the goods to secure repayment of that finance
- insolvency practitioners who might need to determine what goods on the premises of an insolvent business are available for sale and distribution to creditors, or
- buyers of those goods.

By creating rules that encourage the registration of lease arrangements on the Register, the PPS Act enhances the value of the Register as a record of interests in personal property for third parties.

*Registration of security interests*

While registration of a security interest is not mandatory, it does provide the secured party (e.g. the lessor or hire business) with certain protections which may be important depending on the risk involved in the lease. A key protection is that registration of a lease that is a PPS lease will protect a lessor (i.e. the hire business) against loss of the leased property in the event of the lessee's (i.e. the customer's) insolvency. Registration also gives 'super-priority' to PPS leases. This means that the interest of the hire business in the leased goods will have priority over any other security interest in the leased goods regardless of whether those other interests were registered before the interest of the hire business. This means the interest of the hire business in the property will come first as against other creditors.

Where goods are leased to a commercial customer, a registration against the customer's name will cover multiple PPS leases involving that customer in relation to property of the kind described in the registration. A registration costs \$8.00 and will last for seven years (registrations of up to 25 years or an indefinite term are also available for a higher fee). This registration will protect the hire business against potential loss of the leased goods in the event of the customer's insolvency.

In the event that a hire business has not made a registration and loses their property in an insolvency, the PPS Act provides that they are entitled to seek compensation of an amount determined in accordance with the lease or the sum of the market value of the leased goods and the amount of any other damage or loss resulting from the termination of the lease (whichever is greater). The claim for compensation of the hire business has the same status as that of an unsecured creditor.

Where the goods leased are serial numbered goods, a further registration against the serial number of the goods will protect a hire business against the risk of their interest in the property being extinguished if the customer transfers (e.g. sells) the property to someone else. In the event that the hire business does not make the additional serial number registration, the PPS Act provides that the hire business's general registration against the customer will give the hire business an interest in the proceeds of any sale.

A significant proportion of the goods leased by small and medium equipment hire businesses are serial numbered goods, and most would fall within the definition of a 'motor vehicle' (a subset of serial numbered goods). The definition of motor vehicle is set out in the *Personal Property Securities Regulations 2010* (the PPS Regulations) and covers a wide variety of items beyond a car. Peak bodies representing the equipment hire industry estimate that less than 5% of all stock available for lease is non-serial numbered goods. For other hire businesses involved in the lease of cars, boats or aircraft, serial numbered goods will similarly represent a high proportion of all stock available for lease.

If the customer hiring the serial numbered goods is a consumer, a one-time registration against the serial number will suffice to provide all of the protections outlined above.

A defect in a registration by serial number (for example, because the serial number is incorrectly recorded in the registration) will mean that the registration is ineffective, however the Register is connected to a national vehicle information database to help hire businesses and other users verify the data they have entered.

The importance of these protections may differ depending on the risks posed by a particular lease or lease arrangement. A lease of low value goods to a walk in customer where that lease is expected to be of a short duration may not warrant registration. The risk of the customer going bankrupt in the course of a short term lease, and the cost to the business in losing the property in a bankruptcy may be no more than if the customer lost the property or destroyed it (although the ability of the business to recoup its loss may be different).



The lease of high value goods or multiple goods, especially where the goods represent a significant proportion of the property of the business, may warrant registration to protect the business against possible loss of those goods if the customer gets into financial distress.

#### *Leases that are not security interests*

Leases that are not security interests for the purposes of section 12 of the PPS Act, and are not otherwise deemed to be PPS leases (i.e. because they are for a term of less than 12 months, or less than 90 days in the case of serial numbered goods) fall outside the scope of the PPS Act. In these cases, the hire business would rely on proof of their ownership of the property which is the subject of such a lease (for example, the lease agreement) to avoid loss of the property in the event of the customer's insolvency.

#### **The problem**

The problem centres on the complexity in determining whether a lease should be registered. Given that an average hire business can enter into 400 leases a week, any confusion can have significantly adverse outcomes for a business.

The cost of not registering can be high, as it can result in the loss of a hire business's interest in a leased good. At the same time, the complexities can result in a hire business taking a cautious approach, and undertaking a high level of registrations, imposing an onerous compliance burden on the business.

#### *Why register on the Personal Property Securities Register?*

Businesses have an incentive to register their interest in goods they lease to others on the Register. Registration guarantees that the business's interest in the goods has priority over other interests in the same goods. This is important if the business that leases the goods becomes insolvent; if a business does not register their interest in the goods, their interest is similar to an unsecured creditor and secured creditors' interests will take priority. If the interest is properly registered, it will have priorities over any other interests even if those other interests were registered earlier. The lease will 'come first' against other creditors.

Registration therefore provides a level of certainty to businesses; their interest in the goods is secure even if the business leasing the goods becomes insolvent.

#### *When and what do businesses need to register on the Personal Property Securities Register?*

Determining whether a lease is a security interest, and what kind of registrations should be made, can be complex.

Businesses can be subject to penalties if they register arrangements that should not be registered. Businesses therefore need to consider both the length of the lease and the nature of the goods in coming to a decision on the question of registration.

If the lease is for a term of more than 12 months or an indefinite term, it is clear to a lessor that the lease can be registered to gain the protections afforded by the PPS Act.

If the lease is for a term of less than 12 months, there are additional complexities, depending on the nature of the goods leased. For serial numbered goods, such as motor vehicles, the lease of these goods can be registered even if the lease is less than 12 months as long as the lease is for 90 days or more. Consultation has shown that businesses are finding the complexity of having two rules covering different goods and different lease terms confusing and costly to deal with.

In addition, if a business leases multiple goods to a customer, one or more of which are serial numbered goods, the business can make a general registration against the customer but this general registration would not protect the business against loss of the serial numbered goods if the customer transfers (e.g. sells) the goods. This means that the business would need to make not only a general registration, but a specific registration against each serial numbered good in order to completely protect the business's interests in the serial numbered goods.

This can result in confusion on what is the appropriate option, potentially resulting in hiring businesses carrying unknown risk, or undertaking considerable compliance effort to ensure that any such risk is averted.

Table 2 contains an example of the way in which the PPS Act's deeming provisions apply. This example will be used throughout the RIS to demonstrate the impact of the different options for reducing the compliance costs for small and medium equipment hire businesses.

**Table 2 - Example:**

Business A leases two serial numbered goods to Business B, one item for an indefinite term and one item for a defined term of between 90 days and 12 months. The leases are 'true' leases – they are not an alternative means of Business B financing the acquisition of the goods.

Business B is a commercial customer of Business A.

Under the current deeming provisions, both leases are PPS leases.

A registration against Business B's name would protect against loss of either item in the event of Business B's insolvency and give Business A an interest in the proceeds of a sale in the event that Business B tries to sell the serial numbered goods.

Two further registrations – one registration against the serial number of each leased item – would protect against extinguishment of Business A's interests in the goods in the event that Business B tries to sell them.

Whether the registrations need to be made would involve some consideration of the risk involved in the lease.

**Objective**

The objective is to reduce the costs of complying with the PPS Act for small and medium equipment hire businesses whilst still maintaining the utility of the Register as a record of interests in personal property for third parties.

## **Options**

### **Option 1: Do nothing**

This option would see no change to the operation of the PPS Act and PPS Regulations. Small and medium hire businesses would need to consider whether a general registration and a serial number registration should be made in respect of most of their leases. Small and medium hire businesses could reduce the need to make a registration by including a default term in the lease to ensure that leases were generally made for a term of less than 12 months, or less than 90 days in the case of serial numbered goods.

### **Option 2: Modify the definition of motor vehicle**

This option would see the PPS Regulations amended to narrow the definition of motor vehicle thereby excluding certain items from its scope. As the excluded items would no longer be serial numbered goods, small and medium hire businesses would no longer need to consider whether a serial number registration should be made in respect of the lease of such goods and the application of the 90 day deeming provision would be reduced.

### **Option 3: Repeal one or both rules deeming leases to be PPS leases**

This option would propose an amendment to the PPS Act to either repeal the provision that deems leases of serial numbered goods of 90 days or more to be PPS leases, or repeal the deeming provisions altogether so that no lease would be deemed to be a PPS lease.

The first approach would simplify the PPS Act because there would be only one deeming provision (capturing leases of a term of more than 12 months or an indefinite term) and it would apply whether or not the goods involved were serial numbered goods. The change would minimise the need for small and medium hire businesses to consider making registrations in respect of leases of less than 12 months.

The second approach would propose an amendment to the PPS Act to abolish the deeming provisions in their entirety. This would mean that leases would only be covered by the PPS Act if they met the definition of a security interest in section 12. To the extent that businesses were confident that their leases did not meet the definition, the need to make registrations in respect of such leases would be reduced.

## **Impact analysis – costs, benefits and risks**

### **Option 1: Do nothing**

This option leaves the operation of the PPS Act, PPS Regulations and the Register undisturbed and would have no impact on, and generate no new costs or risks for, other stakeholders including third parties seeking to determine the nature of an interest in personal property.

As a continuation of the status quo, the costs and risks involved in managing the application of the PPS Act for hire businesses and their financiers would remain unchanged. These costs are likely to be more significant for smaller hire businesses who may not have the same access to

tools, advice and resources as larger hire businesses and accordingly have limited capacity to automate their registration processes in cases where registration was considered warranted. While the costs of transitioning to the PPS Act have already accrued, there would be some ongoing costs in maintaining knowledge of the PPS Act and Register and training new staff in addition to the costs of working with the PPS Act.

It is acknowledged that some hire businesses will be taking a cautious approach and making registrations in respect of most customers and most leases of serial numbered goods and incurring potentially unnecessary costs as a result. These costs would include responding to inquiries from parties wanting to determine the nature of the security interest held by the hire business, for example inquiries from a financier considering whether to extend credit to one of the hire business's customers.

Some hire businesses have amended their standard lease terms and conditions to provide that leases will be for a term of less than 12 months, or less than 90 days in the case of serial numbered goods. These leases will not trigger the PPS Act's deeming provisions. This practice could be adopted generally by other hire businesses. It is not expected that this step would add significantly to the costs of leasing (e.g. a term could be determined and entered into a lease with other information, such as a description of the goods being leased). It may, however, give rise to a need to revisit the term of leases of serial numbered goods that are likely to be for 90 days or more but less than 12 months.

To the extent that small and medium hire businesses have standard contracts or terms and conditions that require amendment to include a default lease term, it is expected that there would be modest one-off costs.

#### **Application 1:**

Using the facts in the Example, both leases would continue to be PPS leases. To obtain all the protections under the PPS Act against loss of the items in the event of Business B's insolvency or if Business B sells the goods, three registrations would be required (one against Business B, and two serial number registrations).

#### **Option 2: Modify the definition of motor vehicle**

If the range of goods that fell within the definition of a motor vehicle was reduced, the excluded items would no longer be serial numbered goods and there would be no need to consider whether a registration by serial number was required. The application of the 90 day deeming provision would also be reduced. The lease of an item that no longer fell within the scope of the definition of motor vehicle would only be a PPS lease if the lease was for more than 12 months or an indefinite term, rather than the shorter timeframe of 90 days or more.

The current definition of motor vehicle in the PPS Regulations includes personal property that is built to be propelled, wholly on land, by a motor that forms part of the property and is capable of either a speed of at least 10km/h or has 1 or more motors that have a total power greater than 200W. This definition covers a large number of the goods leased by small and medium

equipment hire businesses. By combining the two parts of the definition (speed and power output), fewer items would come within its scope and the application of the 90 day deeming provision would be reduced.

It is possible that some items would continue to be serial numbered goods despite the change. This could introduce some complexity into the operation of the PPS Act when applied to hire businesses. Some hire businesses would move from a situation where most of their goods are serial numbered goods to a situation where some of these goods are no longer serial numbered goods. There would be some one-off and ongoing costs to businesses in determining which goods were no longer considered to be motor vehicles. The change may also create some risk for the hire business. A failure to make a serial number registration in relation to higher risk leases because of confusion about whether or not the goods were serial numbered goods may expose the hire business to the risk of extinguishment of their interest in the property in the event that the customer transfers (e.g. sells) the goods to someone else.

If this change was progressed in combination with the repeal of the 90 day deeming provision (Option 3), this complexity would be reduced. Whether a good was a serial numbered good and whether a separate serial number registration was required would only be important where the lease was for a term of more than 12 months or an indefinite term. The hire industry has advised that less than 1% of its leases are for a period of more than 12 months.

The option would have little impact on stakeholders other than small and medium equipment hire businesses and their financiers. As this option is focussed on the definition of motor vehicle, it would not have an impact on hire businesses in other sectors (such as those involved in the lease of boats or aircraft). It is also not expected that this particular change to the definition would have an impact on businesses involved in the lease of motor vehicles in the ordinary sense of that term.

#### **Application 2:**

Using the facts in the Example, a change to the definition of motor vehicle could have one of four possible outcomes.

The first is that the change means that neither item is a serial numbered good. If this were the case, only the lease of an indefinite term would be a PPS lease. One registration against Business B's name would give Business A the relevant protections under the PPS Act against loss of the goods in the event of Business B's insolvency and an interest in the proceeds of any sale of the goods by Business B.

The second is that the change means that the goods leased for an indefinite period are no longer serial numbered goods, but the goods leased for a defined term remain serial numbered goods. If this happened, both leases would still be PPS leases. A registration against Business B would protect Business A against loss of the goods in the event of Business B's insolvency and would create an interest in the proceeds of any sale of the goods by Business B. A further registration against the serial number of the goods leased for a defined term could be made to protect against extinguishment of Business A's interest in the goods if they are sold by Business B.

The third is that the change means that the goods leased for a defined term are no longer serial numbered goods, but the goods leased for an indefinite term remain serial numbered goods. If this happened, only the indefinite lease would still be a PPS lease. A registration against the customer's name would protect Business A against loss of the goods in the event of Business B's insolvency and would create an interest in the proceeds of any sale. A further registration against the serial number of the goods could be made to protect against extinguishment of Business A's interest in the goods if they are sold by Business B.

A final possibility is that both goods continue to be serial numbered goods and there is no change to the number of registrations needed to give Business A all of the relevant protections under the PPS Act.

**Option 3: Repeal one or both rules deeming leases to be PPS leases** Repeal of the rule deeming leases of serial numbered goods of 90 days or more to be PPS leases would simplify the operation of the PPS Act. Rather than there being two deeming provisions, there would be only one and it would deem leases of a term of more than 12 months or an indefinite term to be PPS leases regardless of the type of goods leased.

Repeal of the 90 day rule would minimise the need for small and medium hire businesses, as well as other businesses regularly engaged in the lease of serial numbered goods, to consider whether registration is warranted in respect of leases of a term of less than 12 months. Leases of serial numbered goods of a defined term of more than 90 days but less than 12 months would no longer be PPS leases. The need to make a registration against a customer and against the serial number of the leased goods would only need to be considered where the lease was for more than 12 months or an indefinite term.

The impact of this option on a hire business will depend on its mix of serial numbered and non-serial numbered stock, noting that both equipment hire businesses and businesses involved in the lease of boats and aircraft will be dealing predominately with serial numbered stock. The benefits of a reduction in the need to consider registration will likely be greater for smaller hire businesses than larger hire businesses given that larger businesses may have automated their registration processes to an extent (through the use of software for example) allowing them to devote fewer resources proportionally to the task of registration compared with a smaller business.

For some businesses, repeal of the 90 day rule would mean that they could no longer register as many leases on the Register. While fewer registrations would result in reduced costs for the business, the business would also no longer gain the benefits that flow from registration of a lease on the Register, including the certainty that the business's interests in the leased goods are protected against other interests.

In practice, repeal of the 90 day rule would mean that, in respect of leases of a term of less than 12 months, a hire business would rely on proof of their ownership of the goods (e.g. the lease agreement) rather than registration to avoid loss of the goods in the event of the customer's insolvency or in cases where the customer sought to sell the goods to a third party. This is currently the position that applies to leases of a term of less than 90 days. This option would

bring the PPS Act into alignment with PPS regimes in other common law countries (such as New Zealand and Canada) where there is a single deeming provision that deems leases to be subject to PPS laws where the lease is for a term of more than 12 months or an indefinite term. To the extent that their activities cross over into these jurisdictions, this alignment may have benefits for Australian financiers, businesses and legal practitioners.

The change is unlikely to materially affect the status of the Register as a record of interests in personal property and adversely affect the interests of third parties seeking to determine the nature of an interest in personal property. While it is not possible to determine how many registrations on the Register relate to the short term hire of serial numbered goods, it is expected that the numbers would be low. While the PPS Act does currently create incentives for the registration of interests in leases of serial numbered goods for 90 days or more, registration is not mandatory and is likely to occur only where the risk posed by a particular lease warrants registration. The key reason why a registration would be made would be to protect the hire business against the possible transfer (e.g. by sale) of the leased goods by the customer to someone else. Peak bodies representing small and medium sized equipment hire businesses have advised that while the sale of leased goods does occur, it is a rare but accepted business risk.

As an alternative, the PPS Act could be amended to repeal the deeming provisions altogether. The potential benefit of this option is that it could take all leases of small and medium hire businesses out of the scope of the PPS Act where the businesses were confident that the leases would not otherwise meet the definition of a security interest in section 12 of the PPS Act.

There are likely to be substantial risks and costs to small and medium hire businesses, and other stakeholders, arising from this option. To the extent that businesses were unsure of whether a particular lease was a security interest in substance because it was expressed to be for an indefinite term, they would no longer be able to make a protective registration.

This is because the PPS Act requires registrations to be made only where a party (e.g. a hire business) has a reasonable belief that they will become a secured party pursuant to a lease. Registrations made without such reasonable belief would be exposed to the possibility of civil penalties and damages. The uncertainty created by the change could also increase the cost of finance to these businesses and their customers. A business that supplies credit to a hire company by taking an interest over the hire company's property will likely want to know that the property is appropriately protected in the event that a lease of the property is a security interest and if unregistered may result in loss of the property to the hire company's customer in the event of the customer's insolvency. In these circumstances, the creditor may insist on the hire business making an early registration. If the ability to do this was unclear because of the repeal of the deeming provisions, then there would be additional costs for the creditor in monitoring the operations of the hire business and knowing the business's customers to assess the risk involved in extending finance to the business. Similarly, a creditor considering extending finance to a business in possession of goods owned by another could not rely on the PPS Register as a source of information about whether they can safely take security over that property and would need to undertake further due diligence with possible consequences for the cost of credit.

The other benefit of deeming certain long term leases to be PPS leases is that it avoids arguments about the point in time at which a lease stops being an ordinary lease and starts being a security interest. Based on the experiences overseas, it is likely that the abolition of the deeming provisions would encourage litigation about whether particular leases are in substance security interests following the definition in section 12.

**Application 3a – repeal of 90 day rule:**

Using the facts in the Example, the lease defined to be of a term of between 90 days and 12 months is no longer a PPS lease and no need for registration arises.

The lease of the other item for an indefinite term would be a PPS lease. A single registration against Business B would protect Business A from loss of the item in the event of Business B's insolvency and give Business A an interest in the proceeds of any sale of the item by Business B. Depending on the risks involved, a separate registration by serial number could be made to protect against extinguishment of Business A's interest in the goods due to its sale by Business B.

**Application 3b – repeal of both deeming provisions:**

Using the facts in the Example, the leases would be subject to the operation of the PPS Act only if they met the definition of a security interest in section 12. If Business A were confident that the leases did not meet the definition, no need for registration may arise. There may nonetheless be a risk of dispute about the nature of the leases.

If Business A was unsure of the nature of the leases because they were for an indefinite term, a protective registration would not be possible unless Business A had a reasonable belief that the lease would create a security interest.

**Consultation**

The key objective of consultation was to assess how well the proposed options met the concerns raised by small and medium sized equipment hire businesses and to assess the impact of the proposed options on other parties whose activities may be linked to the hire industry (particularly financiers of the industry). Consultation also sought to assess the impact of Option 3 on other businesses regularly engaged in the lease of serial numbered goods (particularly boats and aircraft). Consultation commensurate with the magnitude of the problem and the size of the proposal's potential impact has been undertaken. A single stage RIS has been prepared and as no decision has been previously announced, an options stage RIS is not required.

The concerns of small and medium hire businesses are generally known to key stakeholders having been raised at various times in the last 12 months at meetings of a peak stakeholders forum for PPS issues managed by the Australian Financial Security Authority (AFSA). AFSA is responsible for the operation of the Register. The forum is a continuation of the consultation mechanisms established by the Attorney-General's Department during the development and implementation of the PPS Act and Register commencing in 2006.



Consultation was targeted to those stakeholders involved or closely connected to the lease of goods and was undertaken over a two week period from 14 February 2014 to 28 February 2014. The stakeholders consulted were the Hire and Rental Industry Association (HRIA) and the Elevating Work Platform Association of Australia (EWPA), the Australian Finance Conference, the Australian Bankers' Association, the Australian Motor Industry Federation, the Boating Industries Alliance Australia, the Marina Industries Association, Australian International Marine Export Group, the Australian Shipbuilding & Repair Group, the Australian Business Aviation Association, the Regional Aviation Association and the Australian Airports Association. Responses were not received from the latter two bodies.

Following feedback from peak bodies representing the hire industry in the first week, consultation was expanded to include other stakeholders with an interest in the operation of the PPS regime more generally. These stakeholders included the Australian Chamber of Commerce and Industry, the Institute of Chartered Accountants, Australian Restructuring, Insolvency and Turnaround Association (formerly the Insolvency Practitioners Association), and the Law Council of Australia.

Stakeholders were contacted by phone and provided with an email outlining the problem to be addressed, options for responding to the problem, the anticipated impact of each option, and the timeframe for response. Stakeholders were also asked to provide qualitative and, where possible, quantitative information to help assess the impact of the proposed options. Only the HRIA and EWPA provided quantitative information to facilitate the preparation of costings.

Most stakeholders discussed the proposed options informally with the Department throughout the two week period and all were offered the opportunity of a further formal meeting with the Department by phone or in person. A few stakeholders took up this option. Some short extensions to the consultation deadline were also provided on request to help stakeholders consult their membership.

### **Option 1: Do nothing**

Stakeholders were not explicitly consulted on this option. When approached as part of the consultation process, many stakeholders were sympathetic to the concerns of small and medium equipment hire businesses and supported consideration of ways in which the impact of the PPS Act on those businesses could be reduced but queried the need for legislative amendment.

Others stakeholders, including those representing the motor industry, considered that the PPS Act was operating as intended, that its application to businesses involved in the lease of goods created minimal imposts and provided them with a superior level of protection to that enjoyed under the pre-PPS law, and that their preference was for no change to the PPS Act or Regulations.

The submission of the HRIA and EWPA indicated that an option which relied on small and medium hire businesses being responsible for moderating the impact of the PPS Act on their business was not supported.

The HRIA and EWPA argued that the practice of agreeing on a default lease term would impose timeframes on hire businesses and their clients that were artificial and unwanted and would lead to the need to revise default timeframes of less than 90 days in the case of serial numbered goods or less than 12 months for other goods. With the exception of a default timeframe of less than 90 days, this concern is not borne out by information provided that the vast majority of hires are in fact for periods far less than the 12 month threshold. The HIRA and EWPA advised that, as a general guide, less than 1% of the leases of small and medium hire businesses would be for more than 12 months.

The HRIA and EWPA were unpersuaded that the inclusion of a default lease term would resolve doubt and avoid arguments about whether the lease was actually a lease of an indefinite term and therefore a PPS lease because such nominal terms might not reflect the actual intention of the parties as to the term of the lease. This concern also appears unfounded as it is clear that the PPS Act's deeming provisions are concerned with the specified term of a lease. The view that the inclusion of a default term would safely avoid the application of the PPS Act's deeming provisions was shared by a number of other stakeholders who saw it as a practical response to the deeming provisions.

### **Option 2: Modify the definition of motor vehicle**

A number of stakeholders did not comment on this option, deferring instead to the views of small and medium hire businesses on whether a change to the definition of motor vehicle would provide relief. The HRIA and EWPA considered that it may not provide significant relief as some items of property would still fall within the definition of a motor vehicle (and hence be serial numbered goods). Other stakeholders made similar observations and suggested that while the proposal was a good starting point, a more substantial review of the scope of the definition was needed. The Australian Motor Industry Federation did not support any change to the definition of motor vehicle although it is noted that the change proposed would not affect the treatment of motor vehicles in the ordinary sense of that term.

On its own, this option may not provide meaningful relief to small and medium hire businesses and could introduce some additional complexity to the operation of the PPS Act. However, if progressed in combination with Option 3, this complexity would be reduced as the question about whether goods were serial numbered goods and whether a separate serial number registration was needed would primarily arise where the lease was for a term of more than 12 months or an indefinite term. The hire industry has advised that less than 1% of its leases are for a period of more than 12 months. For leases of a term of more than 12 months or an indefinite term, Option 2 would result in fewer items requiring a serial numbered registration as well as a general registration against a commercial customer.

### **Option 3: Repeal one or both rules deeming leases to be PPS leases**

Repeal of the 90 day deeming provision attracted the most support and the least opposition from stakeholders. The HRIA and EWPA agreed that repeal of the 90 day rule would assist small and medium hire businesses. Most peak bodies representing businesses in the marine and aviation industries involved in the lease of goods also considered that this amendment would reduce

confusion and risk to hire businesses and reduce costs by minimising the need to make registrations in respect of leases of serial numbered goods (which includes boats and aircraft) where those leases were for a term of less than 12 months. Some stakeholders acknowledged that this would bring Australian law into line with the PPS regimes in New Zealand and Canada which did not draw a distinction between serial numbered goods and other goods for the purposes of deeming certain leases to be security interests.

In light of comments by the hire industry that the risk of sale of leased items is low, it also appears that additional serial number registrations bring limited additional benefits to hire business beyond the protections that a general registration affords. For leases that are likely to be for 90 days or more but less than 12 months, businesses could decide to rely on a general registration against the customer rather than make additional registrations against the serial number of the goods.

Further, repealing the 90 day rule would also mean that, to the extent businesses chose to include a default timeframe in a lease to avoid the application of the deeming provisions, they would only need to consider the inclusion of one default timeframe (e.g. a term of less than 12 months for all goods rather than also needing to consider inclusion of a term of less than 90 days for serial numbered goods). The inclusion of such a timeframe would safely avoid the application of the deeming provisions. Based on advice from the hire industry that most leases will be for less than 12 months, there would be limited need to revisit this default timeframe.

For leases of a term of less than 12 months, hire businesses would protect their interests by relying on proof of their ownership of the leased goods (e.g. the lease agreement).

Most stakeholders considered that this option would reduce the need for registrations of short term leases of serial numbered goods without significantly affecting the value of the Register as a source of information about interests in personal property.

Lower compliance costs would potentially reduce the costs of leasing goods for customers, although the consultation did not gather evidence to say that this would be a likely outcome. The Australian Motor Industry Federation raised concerns that the change may have unintended consequences for the cost of bailments of goods. However, this risk is considered to be remote given that bailments of less than 90 days are not currently covered by the PPS Act and the amendment would mean that bailments of 90 days or more but less than 12 months would be similarly excluded. Concerns about the cost of bailments of less than 90 days were not identified during consultation. Concerns about a possible increase to the cost of bailment were also not borne out in the comments of other stakeholders.

Stakeholders in and related to the hire industry (e.g. financiers) did not consider that repeal of the 90 day rule would result in a material change in practice such that there would be any significant cost in transitioning to a situation where the 90 day rule no longer existed.

The alternative approach of repealing both deeming provisions was, with the exception of the HRIA and EWPA, strongly opposed by stakeholders. Stakeholders were of the view that the abolition of section 13 would generate uncertainty about whether a given lease was a security

interest according to the definition in section 12. This uncertainty was considered likely to increase costs for the industry because it would open the way for disputes about whether a given lease was a security interest, create risk for other parts of the economy because it would limit the extent to which third parties could rely on the Register to determine whether personal property may be subject to competing interests, and create new obstacles in the way of small and medium enterprises seeking to acquire equipment on favourable terms. A number of stakeholders noted that equivalents of the deeming provisions were inserted into Canadian personal property securities legislation as a red tape reduction measure to address extensive litigation that arose in relation to the proper treatment of particular leases. Some stakeholders raised concerns that the option risked a return to pre-PPS Act interpretative distinctions between ‘finance leases’ and ‘operating leases’ which the PPS Act was intended to avoid.

Repeal of the 90 day rule provides an optimal balance between maximising opportunities to reduce the costs of compliance for small and medium hire businesses without significantly impacting on the utility of the Register as a source of information about interests in personal property or creating new costs or risks for other stakeholders. It is agreed that the potential benefits of repealing the deeming provisions altogether would be far outweighed by the costs of uncertainty to the hire industry and other stakeholders and would create further costs because of its impact on the Register as a source of information about interests in personal property.

### **Conclusion and recommended option**

The preferred option is the amendment of the PPS Act to repeal the rule that leases of serial numbered goods of a term of 90 days or more are deemed to be PPS leases as outlined in Option 3. This option could also be progressed in combination with the amendment to the definition of motor vehicle in Option 2.

Stakeholders agreed that repeal of the 90 day rule would go some way to alleviating the need for small and medium hire businesses to make registrations in respect of leases of serial numbered goods of less than 12 months without compromising the value of the Register as a substantially complete record of interests in personal property or creating significant new costs or risks for other stakeholders.

Option 3 is expected to result in savings to hire businesses because fewer short term leases of serial numbered goods would be deemed to be PPS leases removing the need for registrations to be made. The change may also mean that businesses decide not to make further serial numbered registrations in relation to goods that are likely to be leased for 90 days or more but less than 12 months and can more easily take action to avoid the application of the remaining deeming provision by including a single default time limit in their leases (of less than 12 months) which broadly reflects actual practice (i.e. that most leases are for less than 12 months duration). There would also be savings in that there would be no interest to de-register (remove from the Register) once the lease had come to an end.

If progressed in combination with Option 2, there would be further savings to hire businesses in relation to leases of a term of more than 12 months or an indefinite term. There would no longer

be a need to consider the making of a separate registration by serial number in respect of items that were no longer caught by the definition of motor vehicle.

AFSA reports that a practiced operator with knowledge of the Register should be able to effect a registration in 2-5 minutes and remove a registration in 2 minutes. This is lower than estimates provided by the HRIA and EWPA and is therefore considered a conservative estimate. An hourly labour cost of \$40 has been used which is the reported cost of administrative work based on information from the HRIA and EWPA. The number of registrations that would no longer be required is difficult to determine as there is no data on the number of registrations between 90 days and 12 months and whether the leases involved across all affected businesses are of a defined term (accepting that indefinite leases are likely to be more common). HRIA and EWPA advise that for businesses that have a greater proportion of serial numbered stock, between 10 and 15% of leases may be leased for longer terms, but that as a general guide less than 1% of hires will be for more than 12 months. From this, an assumption has been made that 12% of leases could be caught by the 90 day deeming rule, but not the 12 month deeming rule, and that the need for registrations for these leases would be reduced as a result. These savings are set out in **Appendix A**.

### **Implementation and review**

Option 3 would require the making of legislative amendments to the PPS Act. To allow affected stakeholders time to make any small adjustments necessary to take advantage of the change to the PPS Act, it is proposed that the commencement of this amendment, if passed, would be delayed for a short period determined in consultation with stakeholders. Delayed commencement would also allow changes to the operation of the PPS Register to be made and for Government to develop educational materials to help communicate the changes to stakeholders. Option 2 would require the making of an amendment to the PPS Regulations and a similar delay in the commencement of the amendment would also be proposed.

The amendments would also be expressed to apply to goods leased on or after commencement of the changes. This would preserve the operation of the law in relation to any pre-existing interests created in respect of leases before the commencement of the changes.

A statutory review of the PPS Act is due to be completed by 31 January 2015. This review may provide an opportunity to obtain preliminary feedback from stakeholders about the implementation of Option 3.

**Appendix A - Regulatory Burden and Cost Offset (RBCO) Estimate Table**

<b>Average Annual Compliance Costs (from Business as usual)</b>				
<b>Costs (\$m)</b>	<b>Business</b>	<b>Community Organisations</b>	<b>Individuals</b>	<b>Total Cost</b>
<b>Total by Sector</b>	<b>(\$ 11.2)</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>(\$ 11.2)</b>
<b>Cost offset (\$m)</b>	<b>Business</b>	<b>Community Organisations</b>	<b>Individuals</b>	<b>Total by Source</b>
<b>Agency</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Within portfolio</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Outside portfolio</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Total by Sector</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Proposal is cost neutral? <input checked="" type="checkbox"/>yes <input type="checkbox"/>no</b>				
<b>Proposal is deregulatory <input checked="" type="checkbox"/>yes <input type="checkbox"/>no</b>				
<b>Balance of cost offsets <b>(\$ 11.2)</b></b>				