

THE PERSONAL PROPERTY SECURITIES ACT

If your business involves extending credit to your customers so as to enable you sales to be made then you could very well be affected by the Australian government's new Personal Property Securities Act which comes into force in May 2011. There is no doubt that banks and other lenders who take mortgages and other security over things other than land will be affected. But so too will businesses that lease or rent goods to their customers. Also businesses which keep retain ownership of their products until their customers make the final payment will be affected. Most probably all of these transactions will have to be registered on the new government registry set up for this purpose. If you don't register, you could lose your goods to someone else. The following article explains why.

A. INTRODUCTION

The Personal Property Securities PPS Act (No.130 of 2009) (the "PPS Act") was passed by the Australian Parliament on 26th November 2009, assented to on 14th December 2009 and will commence operation on 1 May 2011.

The PPS Act is a law about security interests in personal property. It replaces over 70 different state laws which regulate the taking of security over property other than land. The PPS Act unifies the principles pertaining to security over personal property and also sets up an internet based mechanism for the registration and search of the applicable security interests. The PPS Act has been modelled on similar legislation in place in New Zealand since 1999. It also borrows concepts from longstanding North American statutes.

The policy underpinning all of these laws is to overcome the problem of "the evil of apparent wealth", whereby a person in possession of a chattel has the outward appearance of being free to encumber or sell it even though that person may not in fact be the owner, or the chattel may have already been secured to another person. The PPS Act aims to address this policy need in a systematic, all-embracing way, in place of the existing piecemeal and ad hoc state-based laws.

B KEY CONCEPTS

Collateral

Under the PPS Act, *personal property* consists of virtually all forms of property other than land and some statutory licences. It includes goods and equipment of all kinds (motor vehicles, boats, equipment), inventory, intellectual property (such as trademarks and patents), currency, contractual rights, investment instruments (being shares, units and debt securities), livestock, crops and artwork. This list is not exhaustive. When personal property becomes the subject of a security interest it is known as *collateral*.

Security Interest

A *security interest* is defined as an interest in personal property created under a transaction which secures a payment or the performance and obligation. Examples of security interests include the familiar fixed and/or floating charge, a chattel mortgage, a hire purchase agreement, the goods lease, a conditional sales contract (ie a retention of title arrangement(“ROT”)) a pledge, and transfers of accounts or book debts.

Note that under the PPS Act there is some uncertainty about whether a licence can be a security interest. Generally speaking, a licence which is a right to provide services that relate to personal property will **not** fall under the PPS Act (e.g. a taxi licence). However, a licence to **use** tangible property can comprise a security interest.

Note too that the certain transactions are deemed to be security interests even though they do not secure anything. These are (i) the commercial consignment (which includes an ROT arrangement), (ii) the assignment of an account or book debt, or the transfer of chattel paper (leases, security interests in goods and intellectual property), and (iii) goods leases. The PPS Act does not, though, apply to liens, fixtures, set-offs, security over water licences, or transfers of debts where the transfers are for collection or as part of the sale of a business.

The person granting the security interest is known as the *grantor* (formerly, for example, the mortgagor or chargor). The grantor grants a security interest in the collateral to the *secured party* (formerly the chargee or mortgagee).

Security Agreement

A security interest must be in writing to be recognised under the PPS Act. Therefore there must be a *security agreement*. This will be similar to the deeds, mortgages or contracts that are already familiar. The PPS Act provides that the security agreement may, unlike the existing law, secure past, present and future money advanced under it. The security agreement can apply to all of the existing property of a debtor, to property of a particular class and even to after-acquired property.

Attachment

A security interest is valid against the grantor when it attaches to the applicable personal property – the collateral. *Attachment* is said to occur when the grantor has rights in personal property (i.e. collateral), it transfers those rights, and either the secured party gives value (e.g. advances money), or the grantor does an act creating the security interests (e.g. declaring a trust). Also note that a security interest in future property can be created in the present, attaching to the relevant property at the time in the future it is acquired.

The security interest is enforceable against third parties when it attaches to collateral and either the secured party has *possession* or *control* of it or a security agreement covers the collateral. Note though that there is some uncertainty regarding whether the collateral is the asset (piece of property) itself, rather than the rights in or to the asset.

Perfection

If a security provider does not have control or possession of personal property then even if there is a security agreement in place attachment alone will not be sufficient as against third parties. The competing claims of security providers or others (such as a liquidator) over the property will be resolved in favour of the provider whose security interest in that property (collateral) is “perfected”.

Perfection means that a security interest is enforceable against all others, not just the grantor. For perfection to have occurred such that a secured party’s rights are unchallengeable, it will be necessary for that party to possess or control the collateral, or to have registered its security interest.

The usual way to achieve perfection will be registration of the security interest on the PPS register. This will be achieved by means of the filing of a “financing statement”. If a security interest is unperfected (or the collateral is not otherwise in the possession or control of the security holder) , it will lose (i) priority to perfected security interests (ii) title to most purchasers of the collateral and (iii) the whole of the security provider’s interests on liquidation, bankruptcy or voluntary administration of the grantor.

Purchase Money Security Interests

As between perfected security interests, perfection by control has the highest priority. Controllable property includes an investment instrument (such as a listed share), or an ADI (bank) account. The next level of priority is given to a sub-category of personal property created by the PPS Act called a *Purchase Money Security Interest, or “PMSI”*.

A PMSI comprises (i) a bailment or lease, (ii) a security interest to secure a purchase price and (iii) a commercial consignment or ROT arrangement. The PPS Act gives PMSIs priority over all other forms of security interests. Arguably this reflects the existing law – for example, a goods lease of identified chattels in the possession of a lessee will always confer the superior property rights on the named lessor, even in the presence of a floating charge over the lessee, or upon the insolvency of the lessee.

Under the PPS regime it will be essential for the lessor/security holder to perfect its position by registering its PMSI in order to be certain of defeating third parties such as a liquidator. A perfected PMSI will always take priority over a prior registered security interest affecting all the assets (including after-acquired assets) of the grantor.

C PRIORITIES

In summary the principal priority rules under the PPS Act are as follows:

- A perfected security interest defeats an unperfected security interest.
- Perfected security interest ranks in order or priority in time – the earlier of registration time the better
- A perfected PMSI generally defeats a perfected but non-PMSI security interest.
- A security interest perfected by control defeats a security interest perfected in some other way.

In consequence, the effect of the well-know legal maxim *nemo dat qui non habit* (you can't give what you don't have) and certain other principles of law has been diminished by the PPS Act, though the nature of security interests under existing law essentially remains intact. For example the categories of security such as the mortgage or charge may still be used. The concept of the floating charge is replaced by a security interest over "circulating assets", but a circulating asset is wider in concept than a floating charge – for example, it can include an ROT arrangement.

Perfected security interests will survive transfer by the grantor to another party (ie will be enforceable against third parties). The PPS Act will permit them to be traced into other assets and proceeds. Contractual restrictions on assignments or accounts (debts) are overridden by the new laws which also set up a parallel register for trade marks and patents.

There are priority rules for particular situations, such as between competing PMSIs in particular collateral, and in the cases of co-mingling of assets, or where assets become attached to other property ("accession").

D. THE PPS REGISTER

The PPS register will enable secured parties to given notice of actual or prospective security interests. The data that are recorded includes information about the secured parties, the grantors and the collateral. It will be possible to register in advance of the provision of finance (something which cannot be done under the present secured property regimes), and also where the assets are entirely offshore.

The register will be national in scope and internet based – online and accessible to anyone who wishes to search it 24 hours a day 7 days a week. Its operation will be in real time, so that registration of a security interest may be confirmed in minutes. Security providers will file a "financing statement" which will enable the Registrar to produce a "verification certificate" to substantiate successful registration of the security interest.

Registration remains valid for 7 years in the case of "consumer property" (held by an individual), and 25 years in the case of all other property. If a registration is defective (for example, due to a misdescription of the collateral), the secured party has 5 business days to cure the defect, otherwise the registration is ineffective. As regards corporate grantors it is

expected that a security interest will have to be registered within 20 business days of its creation, otherwise it will be rendered invalid if a liquidator is appointed within the succeeding 6 months.

Most existing registered security interests (eg company charges, REVS motor vehicles) will be migrated onto the PPS register over a two year transition period; security interests not currently registered (such as goods leases or ROT arrangements) will also need to be registered on the PPS register within the two year transition period to preserve their rights.

Taking property free of Security Interests

There is no concept of extinguishment as such in the PPS Act, but a transferee of collateral will take property in that collateral free of any security interests in certain circumstances, e.g. the goods were meant to be described by serial number but were not; a motor vehicle was not registered by serial number during the previous day or was not acquired from a dealer; the property is all consumer property; in the case of currencies; in the case of investment instruments and also in the case of temporarily perfected security interests in proceeds and goods.

Enforcement of Security Interests

All rights, duties and obligations under the PPS Act's enforcement provisions must be exercised honestly and in a commercially reasonable manner, obtaining market value or the best price available (as for the Corporations Act). Remedies under the PPS Act supplement the security agreement and rights at general law, and co-exist with the consumer credit code. There are rules regarding notice periods, and seizure of particular types of collateral.

E. PREPARING FOR THE PPS ACT

Commencement of the PPS Act will mean that a grantor of security or prospective security holder can no longer rely solely on its title to goods – both parties need to consider whether in substance or in reality a deemed security interest has come into existence, and/or whether it has been perfected.

Further, it will be necessary for a prospective security holder to identify any existing PMSIs, and, if there are any, notify the holder(s) of those PMSIs of a prospective further security interest. A potential security holder will need to pay more attention to the nature of the

assets, i.e. identifying assets able to be registered by serial number, or identifying assets for which control may be taken. Also, it will have to pay attention to the use to which assets may be put, i.e. the priority/extinguishment rules apply differently depending on whether assets are inventory or consumer goods.

So, with the introduction of the PPS Act the onus is clearly on exiting or new security holders of personal property to ensure that their security interests are registered for maximum protection of their rights to recover the money owing on that property.

Allan C. McDougall
Special Counsel
Pigott Stinson Lawyers
Level 3
10 Barrack Street
Sydney 2000
Australia
Tel: 612 8251-7777
a.mcdougall@pigott.com.au

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