

# Personal Property Securities Reform - An Overview

*With over 195 existing Acts and Regulations and over 70 registers throughout Australia currently dealing with the grant and registration of security over personal property, the introduction of the PPS Act is intended to harmonise the laws throughout Australia and provide one online database to register and search for security interests in personal property.*

The complexity, confusion and uncertainty associated with the grant of security over personal property in Australia and ascertaining the existence of any security interest over personal property is intended to be resolved by the commencement of the *Personal Property Securities Act 2009 (Cth)* (**PPS Act**).

The PPS Act will make fundamental changes to secured finance in Australia, particularly relating to those transactions not ordinarily thought of as security arrangements including retention of title, commercial consignments, transfer of accounts, bailment and finance lease agreements. These arrangements will now be required to be registered to protect and preserve the security in, and priority regarding, such security interests granted over personal property.

The PPS Act will create a single national law and a single national online register (being the **PPS Register**) for the registration of all security interests in personal property - replacing over 70 registers throughout Australia including the ASIC company charge register, REVS for vehicles, Bills of Sale, Ships Mortgages and Crop Liens/Mortgages.

Whilst further legislation (including the regulations) is still to be drafted and passed, at this stage, the commencement of the PPS Act is slated for May 2011.

This publication provides an overview of the key concepts associated with the PPS reform.

## What is the PPS Act about?

The PPS Act and associated legislation establishes largely uniform rules for:

- creating valid and enforceable security interests;
- governing priority between competing interests;
- determining when a security interest will be enforceable on the Grantor's (previously referred to as the chargor) insolvency;
- establishing the circumstances in which personal property is acquired free of a security interest; and
- enforcement of security interests.

## What is personal property?

Personal property includes many different kinds of tangible and intangible property, but excludes real property (i.e. land), fixtures and certain specifically exempted property such as water rights. Personal property may include motor vehicles, machinery, office furniture, stock-in-trade, crops and livestock, commingled goods, contracts rights, licences (provided they are transferable), intellectual property and company shares.

Under the PPS Act, personal property is referred to as collateral and can include both consumer property and commercial property.

Real property (i.e. land) is expressly excluded from the operation of the PPS Act.

1 Source: Australian Government Attorney-General's Department. Presentation Paper, Seminar Tuesday, 25 May 2010.

## What is a security interest?

A security interest is an interest in personal property that secures payment or the performance of an obligation by a party.<sup>2</sup> A security interest can include what, traditionally, has been referred to as fixed and floating charges, as well as chattel mortgages, hire purchase and lease arrangements, conditional sale agreements, consignments, retention of title arrangements, transfer of an account and account receivables. It also includes a PPS Lease which is a new concept identified in the PPS Act being a lease or bailment of goods for a term of more than one year (or for an indefinite period or that is automatically renewable).

## Attachment

The PPS Act introduces a concept of attachment which states that a security interest is not enforceable, whether against the Grantor or third parties, unless it is 'attached' to the collateral.<sup>3</sup> That is, attachment refers to the time at which collateral becomes the subject of a security interest.

Attachment occurs when:

- a Grantor has a transferable interest in the collateral or the power to transfer an interest in the collateral; and
- value is given by the Secured Party (or chargee) or, the Grantor does an act to create the security interest.

Some examples of attachment include:

- signing a security agreement over existing collateral (e.g. the signing of a charge instrument, chattel mortgage etc); and
- depositing share certificates with the Secured Party with the intention to create a security.

## Perfection

After attachment, the security interest needs to be perfected. Perfection involves notifying the existence of the security interest to third parties and taking every available step to ensure that your security interest has priority over any interest another party may have in the same collateral.

The PPS Act provides for perfection to occur by way of either:

- the Secured Party having possession or control of the collateral;
- registration of the security interest in the collateral on the PPS Register; or
- temporary perfection as provided for under the PPS Act (being a transfer of all existing registered secured interests in personal property from the range of jurisdictional registers to the PPS Register) – such perfection will only be available for 24 months after the commencement of the PPS Act.

Importantly, the act of perfection provides additional protection to Secured Parties whereby their security interest will survive in the event of the insolvency of a Grantor. An unperfected security interest is void in an event of insolvency of the Grantor.

Accordingly, if a Secured Party does not perfect a security interest, another security interest may take priority or another person may acquire an interest in property free of a security interest.

## Enforcement

The PPS Act does not derogate in any way from the various rights and remedies the parties may agree to in the terms and conditions of their various security agreements<sup>4</sup>. The general tenure of the enforcement provisions detailed in chapter 4 of the PPS Act are evidence of a consumer protection rationale with a number of the enforcement sections able to be contracted out of in respect of security interests over collateral that is not used predominately for personal, domestic or household purposes. Market practice may result in priority arrangements becoming more and more common with greater emphasis on the various enforcement rights of the Secured Parties having competing interests in the same collateral.

## Extinguishment

The concept of extinguishment deals with the circumstances in which a person purchasing or leasing collateral can take it free of a security interest. Part 2.5 of the PPS Act deals with the rules of extinguishment which, in essence, replaces:

- the common law concept of a bona fide purchaser for value without notice; and
- a Grantor's right to deal with floating asset charges.

Extinguishment or 'taking free' as it is commonly referred to, can occur:

- when a Secured Party has expressly or impliedly consented to a dealing;
- where there is an unperfected security interest and the transferee acquires an interest for value;

<sup>2</sup> Section 12 Personal Properties Security Act 2009 (Cth).

<sup>3</sup> See section 19 of the Personal Properties Securities Act 2009 (Cth).

<sup>4</sup> Section 110 of the Personal Properties Securities Act 2009 (Cth);

- in any dealings in the ordinary course of the Grantor's business;
- where a transferee acquires serial numbered property and the serial number is incorrect or missing and a search of the PPS Register does not disclose any security interest; and
- a number of other circumstances as provided for in Part 2.5 of the PPS Act.

The concept of extinguishment requires the absence of actual, or in some cases, constructive knowledge that the dealing is a breach of a security agreement.

### Priority Rules

In the absence of a priority agreement between a number of Secured Parties and the Grantor, the PPS Act provides a series of 'default rules' in respect of priority between competing security interests in the same collateral.

The following security interest...	Has priority over...
Perfected security interest	Unperfected security interest
Perfected by control	Perfected by other means
Perfected (first in time)	Perfected (later in time)
Unperfected (attached first)	Unperfected (attached later)

### PMSI

One of the key reforms included in the PPS Act is the introduction of the concept of Purchase Money Security Interests or PMSI which expands the scope of security interests under the PPS Act. A PMSI can be obtained by a Secured Party when they enable the Grantor to acquire particular collateral. This may occur<sup>5</sup> :

- where a Secured Party provides for the collateral;
- where a person provides funds to acquire collateral;
- the interest of a lessor or bailor under a PPS Lease; or
- the interest of a consignor under a commercial consignment.

PMSI would include retention of title arrangements, hire purchase and lease finance arrangements, bailment agreements and transfers of accounts receivables (such as factoring arrangements). A fundamental characteristic of a PMSI is the degree of connection between the money borrowed and its use.

It is important to note that the process for registration of a PMSI is quite specific with very short periods of time available to register a PMSI to gain the 'super priority' granted to a PMSI over other perfected security interests.

The 'super priority' means that a PMSI has priority over a security interest (i.e. not a PMSI) acquired after or registered beforehand.

### Impact of PPS Act on Fixed and Floating Charges

The commencement of the PPS Act sees the abandonment of the distinction between fixed and floating charges and the concept of crystallisation of a floating charge over property. Instead, a security interest will attach to the collateral in accordance with the terms of the security agreement and the Grantor will be able to deal with the collateral as provided for in that agreement and under the PPS Act.

We envisage that security agreements will take a similar form to that of fixed and floating charges, whereby the Grantor's dealing with the collateral the subject of a security interest will be restricted upon the occurrence of a default event under the security arrangements. This arrangement is usually the case in fixed and floating charges common in the marketplace.

All charges currently registered on the ASIC register will be migrated to the PPS Register under the temporary perfection arrangements provided for in the PPS Act.

### Key matters to be aware of regarding PPS Reform

Whilst some of the legislation and all of the regulations are yet to be finalised, we highlight the following key considerations:

- the PPS Act provides a fundamental change for title based security PMSI such as ROT arrangements, consignment, bailment, lease finance and assignment of accounts receivables which now need to be registered to protect and preserve priority;
- a Secured Party has the ability to register its security interest early (on the basis of having reasonable grounds) and before attachment of the security interest to collateral;
- priority agreements will become more and more common between Secured Parties to clarify the extent of contracting out of the PPS Act enforcement provisions;

<sup>5</sup> Section 14 of the Personal Properties Securities Act 2009 (Cth).

- failure of a Secured Party to perfect its security interest can detrimentally affect enforceability (particularly in an event of Grantor insolvency);
- the act of registration of security interests on the PPS Register requires very specific information and defective data entry can affect the enforceability of the security interests (specifically PMSI); and
- the information required to adequately complete the relevant documentation to register a security interest will have detailed identification requirements.

If you would like further information on how your business activities may be affected by the PPS Reform or advice on amendments which may be required to your documentation to adequately address the reforms, please do not hesitate to contact any of our PPS team.

For further information, please contact:

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