



An introduction to the Personal Property Securities Act 2009 Cth. ('PPSA')

Authors

Oliver Shtein
Executive Lawyer

and

Elena Klishkovska
Lawyer

Bartier Perry Pty Limited
ABN 30 124 690 053

An introduction to the Personal Property Securities Act 2009 Cth. 'PPSA')

1. Personal property security (**PPS**) reform is transforming the law and practice for secured financing involving personal property. PPS reform brings the different Commonwealth, State and Territory laws and registers regarding personal property security interests under one national system. From 30 January 2012 there is one national PPS law and one national PPS Register¹ (**PPSR**).
2. Rationalisation of the patchwork of State and Federal law in this area was long overdue, particularly in the area of registration. However the PPSA delivers a reform of great complexity with a high degree of prescriptive detail.
3. The legislation also brings into the realm of security law many common arrangements that were previously the subject of only general commercial law principles. One of the most radical effects of PPSA is to extend the concept of 'security interest' beyond conventional secured financing to cover certain leases, bailments, consignment and retention of title transactions.
4. In this regard the policy objective of PPSA appears to be to attack the 'evil of apparent wealth' – that under the current system an entity may seem to own assets that in fact are owned or claimed by others. The technique used by PPSA to achieve this is to deem, in effect, that the rights of the owner are a form of security interest. As experience with the introduction of a PPSA-style regime in New Zealand shows, it is this aspect that is most likely to catch the unwary.

*"What to lawyers may be a painful change to familiar conceptual structures may be precisely the practical relief that industry needs"*²
5. The PPSA is a reform of such scope and complexity that no single paper of this kind can hope to do more than sketch it. There are already two Australian textbooks dealing with the PPSA. In this paper we seek only to give an outline of what we see as the most significant aspects of the new law.
6. Canada and New Zealand both have PPSA-style regimes and in this paper we refer to Canadian and New Zealand cases which may assist in interpreting our legislation.

New vocabulary

7. In addition to the extended definition of 'security interest' that will be discussed below, PPSA introduces a new vocabulary³ of other terms. These include:

collateral – personal property subject to a security interest

¹ www.ppsr.gov.au

² From the report of the New Zealand Law Commission cited by William Young J in *Waller v New Zealand Bloodstock* [2006] 3 NZLR 629 para [60]

³ s 10 primarily

grantor - a company, individual or other entity that grants a security interest over personal property to another party. Grantors include those who:

- use their business assets as security for a loan, for example a fixed and floating charge or factoring agreement;
- receive property under a retention of title arrangement or on consignment, or
- lease or receive on bailment personal property from another party for an extended period

secured party - a company, individual or other entity that has a security interest in collateral

Scope - PPSA affects personal property

8. PPSA regulates security interests in 'personal property'. The definition of 'personal property'⁴ catches all property except for 'land' (as defined) and certain statutory rights that are declared under the relevant State or Federal statutes not to be personal property. Notably, water rights have been expressly excluded under PPSA⁵.

9. 'Land' includes freehold and leasehold estates and other interests in land but excludes 'fixtures' as defined in section 10. PPSA does not apply to interests in fixtures⁶. Differences between the PPSA definition of 'fixture' and the general law concept of a fixture may raise issues in determining the scope of PPSA.

10. Personal property may be grouped into four major categories for PPSA purposes:

- (a) goods;
- (b) financial property;
- (c) intermediated security; and
- (d) intangible property.

11. The category of personal property that is subject to a 'security interest' may be significant, as different rules such as mode of perfection and 'taking free' (extinguishment) rules apply depending on the category. In a paper of this kind it is not possible to explore these differences in detail.

What is a 'security interest'?

12. The concept of a 'security interest' is at the heart of PPSA. The Act identifies security interests in two ways.

First, it applies a functional test which will catch transactions which in substance function as a security.

⁴ s 10

⁵ s 8(1)(i)

⁶ s 8(1)(j)

Second, it extends the definition to catch various arrangements that are not typically thought of as security transactions and may not pass the functional test.

13. Under PPSA security interests can therefore be classified as either 'in substance' security interests⁷ or 'deemed' security interests⁸.

14. However, it is important to remember section 8 of PPSA which provides an extensive list of interests to which PPSA does not apply. Some of these include:

- (a) any right of set-off or right of combination of accounts⁹;
- (b) rights under general law or under the relevant State¹⁰ and Federal statutes in relation to the control, use or flow of water¹¹;
- (c) a lien, charge or any other interest in personal property that arises under the relevant State and Federal statutes (other than PPSA), unless the person who owns the property in which the interest is granted agrees to the interest¹²;
- (d) a lien, charge or any other interest in personal property, that is created, arises or is provided by operation of the general law¹³;
- (e) certain interests in property created under the Bankruptcy Act 1966¹⁴;
- (f) an interest in a fixture¹⁵;
- (g) particular statutory rights granted by relevant State or Federal statutes which are declared not to be personal property for the purposes of PPSA¹⁶. For example, commercial fishing licences under the Fisheries Management Act 1994 (NSW) are to be so declared.

The functional test – 'in substance' security interests

15. Section 12 of PPSA defines a security interest as:

*an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property)*¹⁷.

⁷ s 12(1) and exemplified in s 12(2)

⁸ s 12(3)

⁹ s 8(1)(d)

¹⁰ For example Water Management Act 2000 (NSW)

¹¹ s 8(1)(i)

¹² s 8(1)(b)

¹³ s 8(1)(c)

¹⁴ s 8(1)(g)

¹⁵ s 8(1)(j)

¹⁶ s 8(1)(k)

¹⁷ s 12(1) as expected to be amended at the date of writing. As originally enacted the definition refers to interests 'in relation to' personal property.

16. To determine that there is a security interest, the following elements will need to be established, keeping in mind possible exclusions from PPSA under section 8:

- (a) personal property;
- (b) transaction – this will usually if not always be a consensual transaction¹⁸;
- (c) an interest in personal property – a sufficient interest includes a legal or equitable interest and seemingly captures proprietary rights; and
- (d) in substance secures payment or performance of an obligation – the test here may well be whether the arrangement gives the secured party a priority or advantage over other creditors.

17. 'In substance' security interests include the usual suspects such as mortgages and charges, but PPSA also contemplates that 'in substance' security extends to transactions which in substance secure payment or performance of an obligation¹⁹ and include:

- conditional sale agreement (including an agreement to sell subject to retention of title)²⁰;
- lease of goods;
- flawed asset arrangement (discussed below).

18. The ubiquitous retention of title (**ROT**) sale transaction found in virtually every reseller, distribution and goods supply contract will clearly give rise to a 'security interest', and is exemplified as such in s12(2).

Flawed asset arrangement

19. Under pre-PPSA law in Australia, it is not clear that a financier can take a charge over a deposit account held with it. Financiers such as banks typically proceed by taking agreements that allow them to set off money owed on the account against money owed to the bank. The 'flawed asset' arrangement refers to the additional element of such agreements that the bank need not repay the deposit until the borrower repays the loan.

20. Under PPSA, an authorised deposit-taking institution (**ADI**) can take a security interest in an ADI account kept with the ADI²¹. More generally, a person who owes payment or obligation may take a security interest in the obligee's right to require performance²².

21. Under PPSA, set-off is not itself a 'security interest' but a flawed asset arrangement is an 'in substance' security interest²³. There is no definition of the term 'flawed asset' and whilst it is recognizable in the context of the kind of security mentioned above the term may well catch other kinds of arrangement under which there is an agreement that payment or performance cannot be required until some other obligation is performed.

¹⁸ Canadian Imperial Bank of Commerce v 64576 Manitoba Ltd [1990] 5 W.W.R 419

¹⁹ s 12(2)

²⁰ General Motors Acceptance Corporation Australia and Another v Southbank Traders Pty Ltd (2007) 234 ALR 608

²¹ s 12(4)(b)

²² s 12(3A)

²³ s 12(2)(l)

'Deemed' security interests – ownership as a form of security interest

22. Interests under transactions that do not in substance secure payment or performance of an obligation can still be security interests under PPSA²⁴. These 'deemed' security interests are:

- the interest of a transferee of an account or chattel paper;
- the interest of a lessor or bailor under a 'PPS lease' (discussed below); and
- the interest of a consignor who delivers goods to a consignee under a 'commercial consignment' – defined in section 10 and essentially covering consignments for the purposes of sale, lease or other disposal where both consignee and consignor deal in goods of that kind.

23. Under PPSA, title is irrelevant and a purchaser, consignee or lessee can 'grant' a security interest in goods despite the fact that the secured party retains title to those goods²⁵. In effect an owner can be 'granted' a security interest in property that is already legally and beneficially owned by the owner.

24. It follows that if a consignee, purchaser, lessee or bailee grants a security interest in its present and future property to a bank, that security interest may extend to the goods possessed by it and subject to retention of title, consignment, lease or bailment but in fact owned by a third party. This is discussed further below.

Leases of personal property

25. An interest in personal property provided by a lease of goods, which in substance, secures payment or performance of an obligation, is a security interest under PPSA²⁶. It is thought that this might cover finance leases as opposed to operating leases, on the basis that a finance lease can really be thought of as analogous to a loan and charge with the leased property serving in substance as security and the lessee (not the lessor) enjoying the benefits of ownership.

26. However under the extended 'deemed' security concept PPSA has introduced the 'PPS lease', under which the interest of a lessor or bailor is a deemed security interest. A PPS lease²⁷ is a lease or bailment of goods:

- for a term of more than one year; or
- for an indefinite term; or
- for a term of more than 90 days if the goods subject to the lease may or must be described by serial number in a PPSR registration in accordance with the regulations.

The term 'lease' is not defined by the legislation but there seems no reason why it cannot catch transactions described as either lease or hire.

²⁴ s 12(3)

²⁵ See s 19(5) which deems possession to confer sufficient rights

²⁶ s 12(2)(i)

²⁷ s 13(1)

27. The goods that may or must be described by serial numbers in a PPSR registration are²⁸:

- motor vehicles (these are very widely defined and include attachments and trailers);
- watercraft; and
- aircraft and aircraft engines.

28. Consumer property (as distinct from commercial property) must be registered by serial number only and the identity of the grantor will not appear on the PPSR. For commercial property which is goods of the prescribed kinds referred to above, registration by serial number is not compulsory but is desirable as risks arise otherwise under the extinguishment rules discussed below.

29. An example of a PPS lease would be a lease of five cranes from a lessor to a lessee for an indefinite term. The lessor has been granted a 'security interest' in the five cranes by its lessee. On the other hand, a lease of a petrol engine forklift truck for 21 days would not be a PPS lease. Even though, a forklift truck could fall within the definition of 'motor vehicle', the lease is for a definite term that is less than 90 days.

30. Note that option terms must be taken into account in determining whether the one year or 90 day threshold is exceeded.

Transfer of an account or chattel paper

31. Transfer of an account or chattel paper is a 'deemed' security interest. This is intended to bring into PPSA factoring and invoice discounting arrangements. An 'account' under PPSA means a monetary obligation that arises from:

- disposing of property (whether by sale, transfer, assignment, lease, licence or in any other way); or
- granting a right, or providing services, in the ordinary course of a business of granting rights or providing services of that kind.

32. An account does not include an ADI account, chattel paper, intermediated security, investment instruments and negotiable instruments²⁹. As an example, A assigns the rights of rental payments under leases to its customers to B (assignee). Transfer of the right to the rental payments is a 'deemed' security interest, with A as the grantor and B as the secured party, and the account as the collateral.

33. Chattel paper means one or more writings that evidence both a monetary obligation and a security interest in, or a lease of, specific goods³⁰. Examples of chattel paper include leases, hire purchase agreements, and secured instalment sales contracts. As an example, A assigns all rights in a goods lease to B (assignee). Transfer of the lease to B is a 'deemed' security interest, with A as the grantor, B as the secured party, and lease (chattel paper) as the collateral.

²⁸ PPS Regulations

²⁹ s 10

³⁰ *ibid*

34. It is important to keep in mind exclusions under section 8 of PPSA. Certain transfers of an account such as sale of an account or chattel paper as part of a sale of business are excluded³¹.

PPSA's three stage process - creating and protecting a 'security interest'

35. Unlike existing statutory security regimes, PPSA is an attempt to provide a codification of the law of personal property security – not just a priority or registration regime.

36. PPSA itself commences with a code for the effective creation of security interests. It provides three qualities which, if all achieved, will provide the normally expected degree of protection to the secured party.

37. The following three elements need to be taken or achieved to create and protect a security interest:

- Attachment – section 19;
- Enforceability against third parties – section 20; and
- Perfection – section 21.

Attachment

38. Attachment refers to the time when the collateral becomes subject to the security interest and is a prerequisite for a security interest being enforceable against a grantor. It assumes the existence of a valid security agreement between the grantor and the secured party.

39. The attachment rule under PPSA is as follows³²:

A security interest attaches to collateral when:

- (a) *the grantor has rights in the collateral, or the power to transfer rights in the collateral to the secured party; **and***
- (b) *either:*
 - (i) *value is given for the security interest; or*
 - (ii) *the grantor does an act by which the security interest arises.*

40. The parties to a security agreement can agree for a security interest to attach at a later time³³.

41. The 'rights in the collateral' are not defined under PPSA and what are sufficient rights needs to be considered. Clearly ownership rights will be sufficient. However, the legislation goes further. Under section 19(5), a grantor will have rights in goods that are leased or

³¹ s 8(1)(f)

³² s 19(2)

³³ s 19(3)

bailed to the grantor under a PPS lease, consigned to the grantor, or sold to the grantor under an ROT arrangement when the grantor obtains possession of the goods.

42. Section 19(5) reflects the position found overseas. In *Kinetics Technology International Corp v Fourth National Bank of Tulsa (1983)*³⁴, Kinetics entered into a contract with Oklahoma Heat to build furnaces. Kinetics sent certain material to Oklahoma Heat to put into the furnaces. The supply of this material was based on an ROT arrangement; however Kinetics did not preserve its security interest in the material supplied. Oklahoma granted to a bank a general security interest (**GSA**) over inventory. The bank appointed receivers and a question was raised as to whether the bank's security extended to the materials supplied by Kinetics. It was held that Oklahoma had sufficient rights to grant a security interest over the materials supplied to it by Kinetics and the bank's GSA extended to cover that material.

Proceeds

43. If a collateral gives rise to 'proceeds' (whether arising from a dealing with the collateral or otherwise), the security interest will attach to the proceeds of that collateral unless the security agreement provides otherwise³⁵.

44. Under PPSA 'proceeds' means identifiable or traceable personal property of the types that include³⁶:

- personal property derived directly or indirectly from a dealing with the collateral;
- right to an insurance payment or other payment as indemnity or compensation for loss or damage to collateral;
- if collateral is an investment instrument such as shares, rights arising out of collateral, property collected on collateral and property distributed on account of the collateral.

Enforceability of security interests against third parties

45. A security interest is enforceable against a third party in respect of particular collateral only if³⁷:

- (a) the security interest is attached to the collateral; and
- (b) one of the following applies:
 - (i) the secured party possesses the collateral; or
 - (ii) the secured party has perfected the security interest by control; or
 - (iii) there is a security agreement evidenced by writing.

46. Considerable doubt surrounds the meaning of 'enforceable against third parties'. It is important to note at this point that achieving this element does not provide protection against

³⁴ 705 F.2d.396

³⁵ s 32(1)(b)

³⁶ See extensive definition in s 31

³⁷ s 20(1)

insolvency of the grantor or a wrongful dealing with the collateral. Nor does it assure priority of the security interest in any competition with other security interests. Those qualities generally depend on the additional element of perfection.

Perfection

47. Perfection will typically be critical to the secured party. Without perfection the security interest is vulnerable in insolvency and to third parties.

48. Perhaps the best way to think of perfection is that it is the quality that broadcasts the existence of the security to those who might otherwise be lured into providing credit by the 'apparent wealth' of the grantor.

49. A security interest in a particular collateral is perfected if all of the following apply³⁸:

- (a) the security interest is attached to the collateral;
- (b) the security interest is enforceable against a third party; and
- (c) one of three methods have been taken to perfect the security interest:
 - (i) registration;
 - (ii) possession by the secured party; or
 - (iii) control by the secured party.

50. Perfection of a security interest by control is possible for only certain kinds of collateral. These include:

- (a) an ADI account;
- (b) an intermediated security;
- (c) an investment instrument;
- (d) a negotiable instrument;
- (e) satellites and other space objects. Apart from this extraordinary exception a security interest in goods cannot be perfected by control.

51. For security interests over tangible property, and certainly in the case of leases, bailment, consignments and ROT it can be seen that the only realistic perfection method is registration. By their very nature these arrangements do not see the secured party retaining possession and perfection by control is not available unless the collateral is a satellite or space object.

52. The main reasons for perfection are to ensure that:

- the intended priority of competing security interests is preserved;
- the secured party is protected if the grantor becomes insolvent; and
- it protects against the 'taking free' or 'extinguishment' provisions under PPSA.

³⁸ s 21(1) and (2)

These aspects are discussed below.

Priority of security interests

53. PPSA introduces new and complex rules on priority of security interests which should replace the current common law and equitable rules. Knowledge of a competing security interest is almost irrelevant in resolving priority disputes under PPSA and notice is irrelevant for the principal priority rules in a PPSA-style regime³⁹.

54. Key priority rules under PPSA are as follows:

- unperfected security interests rank in order of attachment⁴⁰;
- a perfected security interest defeats an unperfected security interest⁴¹;
- perfected security interests rank in order of priority time, usually the earlier of registration time or time of first perfection by possession or control⁴²;
- a security interest perfected by control defeats a security interest perfected in another way⁴³;
- purchase money security interests ('PMSI's) have priority over non-PMSIs⁴⁴ (super priority).

55. Notably under PPSA the priority regime does not include (and therefore effectively abolishes) the rule in *Hopkinson v Rolt* and the principles of tacking. The concepts of notice of maximum prospective liability used by the Corporations Act 2001 (Cth) are also not adopted by PPSA and no longer apply.

Purchase money security interests – 'PMSI's

56. The special priority status of a 'PMSI' reflects the traditional priority accorded to ownership interests and also to security taken to secure amounts used to purchase the subject of the security. As we noted above, under PPSA ownership is now just another form of security interest and the PMSI rules also work to reinstate its significance in priority terms, to something approaching the pre-PPSA position.

57. A 'PMSI' is defined as any of the following⁴⁵:

- (a) a security interest taken in collateral, to the extent that it secures all or part of its purchase price;

³⁹ *The Robert Simpson Company Ltd v Shadlock and Duggan* (1981) 119 DLR (3d) 417

⁴⁰ s 55(2)

⁴¹ s 55(3)

⁴² s 55(5)

⁴³ s 57

⁴⁴ s 62(1)

⁴⁵ s 14(1)

- (b) a security interest taken in collateral by a person who gives value for the purpose of enabling the grantor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;
- (c) the interest of a lessor or bailor under a PPS lease;
- (d) the interest of a consignor who delivers goods to a consignee under a commercial consignment.

58. However 'PMSI' status is not itself a guarantee of super priority unless other steps are taken. When registering a security interest as a 'PMSI', the financing statement must state that it is a 'PMSI'. Also a 'PMSI' only has super priority for:

- inventory that is goods, if registered prior to the grantor obtaining possession and for other kinds of inventory if registered prior to attachment⁴⁶;
- for personal property that is not inventory, in the case of goods, if registered within 15 business days after the grantor obtains possession and for any other property within 15 business days after interest attaches⁴⁷.

Note that 'inventory' has a wide definition in section 10.

59. PMSI super priority also extends to proceeds⁴⁸ and to processed or commingled goods⁴⁹.

Vesting of unperfected or late-perfected security interest in a grantor

60. Regrettably, there are two separate pieces of legislation that contain vesting rules for PPSA security interests.

Vesting rules in the PPSA itself

61. The first set of these is in the PPSA itself. Under rules in Part 8.2, on insolvency of a grantor, an unperfected security interest will generally 'vest in' the insolvent grantor. This will apply when:

- a winding up order is made, or a resolution passed winding up a company ;or
- an administrator is appointed to a company, or a company executes a deed of company arrangement; or
- bankruptcy of an individual.

Some kinds of security interests are not affected by this rule⁵⁰. These include transfers of chattel paper and accounts, certain short term PPS leases and commercial consignments.

⁴⁶ s 62(2)

⁴⁷ s 62(3)

⁴⁸ s 62

⁴⁹ s 103

⁵⁰ s 268

62. The 'vesting in the grantor' rule in section 267 is one of the most radical aspects of PPSA. It appears clearly designed to 'vest in' insolvent grantors interests held not only by as mortgagees or chargees but also the ownership interests of the secured parties in ROT sales, and those PPS leases and bailments not exempted by section 268.

63. For example, if a manufacturer sells widgets to a reseller on an ROT arrangement, the retention of title would constitute an 'in substance security interest' under PPSA. If after delivery of the widgets to the reseller, the reseller goes into liquidation and the manufacturer has not perfected its security interest, the manufacturer's unperfected security interest will vest in the reseller and the manufacturer will lose its ownership of the widgets.

Vesting rules in the Corporations Act 2001 Cth

64. For grantors that are companies there is another additional vesting rule in section 588FL of the Corporations Act. The rule is in effect a vestige of the former Corporations Act rule about late-registered charges. Under those former rules if a charge was not registered within 45 days of its creation it was susceptible to becoming void in an insolvency as against a liquidator or administrator if that occurred within 6 months of registration. The idea was to avoid the charge if it was taken and not publicized by registration too close in time to the insolvency.

65. The new provision, section 588FL, is concerned with the case where a PPSA security interest has been perfected by registration but where this occurs more than 20 business days after the relevant security agreement comes 'into force'.

66. There is a similar range of exclusions of certain kinds of security interests as is provided in the PPSA vesting rule. However the exclusions are limited and the Corporations Act vesting rule can apply not only to things that were 'charges' under pre-PPSA law. It can also apply to the new 'title-based' PPSA security interests such as PPS leases and ROT.

67. Section 588FL applies if a company suffers an insolvency event of voluntary administration, winding up or execution of a deed of company arrangement and there is a security interest covered by section 588FL(2). Section 588FL (2) covers the security interest if it is perfected by registration 'and no other means'. The key requirement is in section 588FL(2)(b). It will cause the security interest to be covered if:

(b) the registration time for the collateral is after the latest of the following times:

(i) 6 months before the critical time;

(ii) the time that is the end of 20 business days after the security agreement that gave rise to the security interest came into force, or the time that is the critical time, whichever time is earlier

The 'critical time' is the time of the relevant insolvency event.

68. There is also provision for security interests coming into force under foreign laws and a power in the Court to allow a later date. The case law about extension of time under the former Corporations Act charges provisions may have some application in this context.

69. The operation of the Corporations Act vesting rule can be illustrated as follows:

Supplier and BakerCo sign an agreement for sale of a commercial oven. Supplier delivers the oven on the same day. The agreement provides that Supplier keeps ownership until BakerCo pays the full price.

Scenario 1

Supplier registers its security interest 10 business days after the agreement is signed. BakerCo becomes insolvent 30 business days after that date. Supplier would retain the oven, because Supplier registered the security interest within the required 20 business day period under section 588FL.

Scenario 2

Supplier registers its security interest 25 business days after the agreement. BakerCo becomes insolvent 2 months after the security interest is granted. The oven would vest in BakerCo because Supplier did not register the security interest within the required 20 business day period.

Scenario 3

Supplier registers its security interest 25 business days after the agreement. BakerCo becomes insolvent eight months after the agreement. Supplier would retain the oven because it registered its security interest prior to the six month period before the insolvency.

70. It is most regrettable that a powerful vesting rule applying to PPSA security interests was placed in the Corporations Act and not put where it really belongs – in the PPSA itself.

Critical timeframes for registration

71. The priority and vesting rules amount to an imperative to ensure that PPS registration is effected promptly. PMSI holders must be diligent in ensuring that PPS registrations are in place before the goods are delivered (or at least within 15 business days in the case of 'inventory' (as widely defined)). That ensures PMSI 'super-priority as explained elsewhere in this paper.

72. Secured parties must also be diligent to ensure that registration is in place within 20 business days of the date of the security agreement that 'gives rise to the security interest' if the grantor is a company.

73. The drafting of the Corporations Act provisions poses troubling questions for the operation of the PPS registration regime in context of ongoing hire and ROT sale agreements, where there are multiple hires or sales. What is it that is being registered under PPSA and in particular is it safe to have one registration protecting multiple security interests where those security interests arise *under more than one security agreement?*

74. The Government's understanding of its legislation is that because the PPS register is a 'notice board' (a phrase not found in the PPSA itself) security interests under multiple security agreements can be protected by a single registration. It would admittedly seem that there is little point in making a separate registration for each of multiple security agreements. However the

exact basis for the Government's view is not in the writers' view easy to discern and the point deserves more clarity in the legislation.

Taking free of security interests – the extinguishment rules

75. Under PPSA a security interest takes effect according to its terms⁵¹. Because equitable and legal rules are largely if not wholly displaced, PPSA provides for the circumstances in which a third party lessee or purchaser will take (buy or lease) free of the security interest. See Chapter 2, Part 2.5 of PPSA. Essentially these rules provide a code for when the third party may take free of interests even including ownership. PPSA therefore legislates significant further exceptions to the rule *nemo dat quod non habet*.

76. PPSA's main rule of 'taking free' is that a buyer or lessee of personal property, for value, takes the personal property free of an unperfected interest in property⁵². The only exception is when the buyer or lessee was party to the transaction that created the interest. Accordingly, constructive or even actual notice on the part of the buyer or lessee seemingly does not preclude the taking free.

77. The taking free rule also applies to personal property subject to a security interest (even if perfected) in cases which include:

- a security interest over personal property that may or must be described by serial number in a registration⁵³ but which is not registered by serial number and in respect of which a search of the PPSR would not disclose a registration that perfected the security interest;
- personal property sold or leased in the ordinary course of the seller's or lessor's business⁵⁴;
- personal property predominantly used for personal, domestic or household purposes with a market value of not more than \$5,000 or if a greater amount has been prescribed by regulations – that amount⁵⁵.

78. The 'taking free' rules are highly prescriptive and a detailed account of them is well beyond the scope of this paper. Outcomes will depend on:

- the nature of the collateral;
- whether 'value' or 'new value' was given by the lessee or purchaser;
- in some cases, whether the buyer or lessee had actual or constructive knowledge of the security interest and that the security agreement was breached by the sale or lease concerned.

⁵¹ s 18(1)

⁵² s 43

⁵³ s 44

⁵⁴ s 46

⁵⁵ s 47

Enforcement rules

79. Chapter 4 of PPSA contains extensive provisions in respect of the enforcement of security interests. However, it does not apply to certain deemed security interests that do not secure payment or performance of an obligation such as transfers of accounts or chattel paper, PPS leases and commercial consignments.

80. The remedies available under Chapter 4 include a right to seize, purchase, retain or dispose of the collateral. The enforcement rules under Chapter 4 are highly prescriptive and a detailed account of them is beyond the scope of this paper. Some notable features of Chapter 4 include:

- a power given to secured parties to use land law in respect of enforcement, where both land and personal property are the subject of security being enforced in respect of the same obligation⁵⁶.
- the ability to contract out⁵⁷ of some provisions where the collateral is not used predominantly for personal, domestic or household purposes.

Some other notable aspects of PPSA

Accessions

81. Under PPSA, an 'accession' to goods means goods that are installed in, or affixed to, other goods, unless both the accession and the other goods are required or permitted by the regulation to be described by a serial number⁵⁸. An accession preserves its identity once installed in or affixed to the other goods.

82. PPSA provides detailed provisions relating to priority interests in accessions and obligations on a secured party as to their removal⁵⁹. The default rule on priority is that a security interest in goods that is attached at the time when the goods become an accession has priority over a claim to the goods as an accession made by a person with an interest in the whole⁶⁰.

Processed or commingled goods

83. The identity of goods that are manufactured processed, assembled or commingled is lost in a product or mass if it is not commercially practical to restore the goods to their original state⁶¹.

84. A security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass⁶².

⁵⁶ s 117 and 118

⁵⁷ s 115

⁵⁸ s 10

⁵⁹ s 90 – 97

⁶⁰ s 89

⁶¹ s 99(2)

⁶² s 99(1)

Intellectual property

85. There are special rules about security interests over intellectual property. Notably, a licence of intellectual property is not itself a security interest⁶³ and there is no corresponding concept in the context of intellectual property licensed to that of the PPS lease in respect of goods. However, a licence itself is a kind of personal property and security interests over licences are essentially treated in the same way security interests over other kinds of personal property.

Section 105 provides, in effect, that intellectual property in relation to goods will become subject to a security interest in the goods if the secured party needs that intellectual property to exercise its rights as secured party in respect of the goods. So, for example, a security interest over specialised robots may include a security interest over the licence of intellectual property needed to operate them.

Section 106 provides that if a security interest is granted in an intellectual property licence, and the intellectual property is transferred, the licensor's successors in title will be bound by the security interest over the licence.

86. Certain intellectual property may or must also be described by serial numbers in the PPSR. The Regulations refer to:

- design;
- patent;
- plant breeder's right;
- trade mark; and
- licences of the above.

87. As noted earlier registration by serial number is not mandatory except for consumer property. However, failure to register correctly by serial number may have adverse implications for the secured party under the extinguishment rules.

Fixed and floating charges

88. The distinction between a fixed and floating charge and the concept of crystallisation are irrelevant under PPSA and various provisions in the Corporations Act 2001 are modified to take these changes into account. Under PPSA all security interests are best described as notionally fixed.

89. The ability of third parties to take free of a PPSA security interest is governed by the extinguishment rules discussed above, rather than rules particular to charges or depending on fixed or floating status. For example, a buyer takes free of a PPSA security interest if purchasing in the ordinary course of business under the extinguishment rule on section 46. This corresponds to, but supersedes, the existing rule in relation to floating charges.

⁶³ s 12(5)

90. In other PPSA-style jurisdictions, fixed and floating charges have been replaced by 'general security agreements' or GSAs, which serve essentially the same function commercially. The use of the terms fixed charge and floating charge is expected to cease over time⁶⁴.

91. Under PPSA, a charge created under a general security agreement or GSA is a security interest that attaches to the grantor's property as a 'security interest over all present and after-acquired personal property'. Secured parties and grantors still need to agree to the extent of the grantor's ability to deal with the collateral without the secured party's consent.

92. Insolvency law has relied on the fixed v floating dichotomy to establish rules about the application of assets on a liquidation – for example, employee claims rank ahead of floating charges in the distribution scheme. So as not to disturb those company law principles, the Corporations Act 2001 adopts a dichotomy between security interests over 'circulating assets' and security interests over 'non-circulating assets', to the same effect.

Transitional aspects

93. PPSA applies to security interests that:

- arise before PPSA commencement but still exist when PPSA commenced; or
- arise after PPSA commencement but do so under pre-PPSA security agreements that remain 'in force' when PPSA commenced⁶⁵.

94. Existing registered security interests have been 'migrated' to the new regime from the existing Federal, State and Territory registers (ASIC, REVS etc.) to the PPSR.

95. Transitional security interests that are not currently registrable on such registers (for example PPS leases, ROT and commercial consignments) would be exposed as unperfected without special provision and the transitional provisions therefore deem them⁶⁶ to be attached and perfected from immediately before the 'registration commencement time'.

96. However they are only deemed perfected for 24 months. This period is intended to allow businesses to adjust to the new system and to give time for transitional security interests to be registered in an orderly way. PPSA allows transitional security interests to be perfected by actual registration and once this step is taken the temporary 'deemed' transitional perfection will no longer need to be relied on. For example:

Bailfinco has vehicles on floor plan with a dealer as at 30 September 2011. Under PPSA this would be a 'transitional security interest' in the form of a PPS lease. In January 2012 on commencement of the PPSR, Bailfinco's security interest was deemed attached and perfected. If by 31 January 2014 Bailfinco has not perfected its security interest, it will become unperfected.

97. Section 320 summarises, by way of a 'guide' the priority rules for transitional security interests.

⁶⁴ Part 9.5

⁶⁵ s 308

⁶⁶ s 322

The PPSR

98. The PPSR replaces approximately 30 Federal, State and Territory security registers, including notably the REVS registers in each State and Territory, bill of sale / security interest in goods registers and the ASIC charges register. Those registers have ceased to operate but will have some ongoing relevance in determining priority disputes between competing transitional security interests.

99. Part 5.3 of PPSA outlines the registration process and part 5.4 sets out requirements for effective registration.

100. Instead of registering the security agreements, a financing statement may be registered on PPSR through an on-line process. Registration in advance is now possible⁶⁷, however a person is not to register a security interest unless the person believes on reasonable grounds that the person described in the financing statement as the secured party is or will become a secured party in relation to the collateral⁶⁸.

101. A financing statement with respect to a security interest is to consist of data that complies with the table set out in section 153 of PPSA and relevant regulations.

Authors

Oliver Shtein
Executive Lawyer

and

Elena Klishkovska
Lawyer

Bartier Perry Pty Limited

⁶⁷ s 161

⁶⁸ s 151