An introduction to the Personal Property Securities Act

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

1. Personal property security (PPS) reform has transformed a substantial part of the law affecting 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. The new law extracts a high price for failure to perfect (usually by registration) these new kinds of deemed security interests. As experience with the introduction of a PPSA-style regime in New Zealand and now Australia shows, it is this aspect that is most likely to catch the unwary. The policy objective of PPSA appears to be to attack the ‘evil of apparent wealth’ – that an entity may seem to own assets that in fact are owned or claimed by others.

4. The PPSA is a reform of such scope and complexity that no paper of this kind can hope to do more than sketch it. There are already several large 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.

5. 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. The body of Australian case law continues to grow also.

New vocabulary

6. In addition to the extended definition of ‘security interest’ that will be discussed below, PPSA introduces a new vocabulary2 of other terms. These include:

   collateral – personal property subject to a security interest

   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

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1 www.ppsr.gov.au
2 s 10: primarily
secured party - a company, individual or other entity that has a security interest in collateral

Scope - PPSA affects personal property

7. PPSA regulates security interests in 'personal property'. The definition of 'personal property' in section 10 of PPSA 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 PPSA.

8. '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 fixtures. Differences between the PPSA definition of 'fixture' and the general law concept of a fixture may raise issues in determining the scope of PPSA.

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

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

10. 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'?

11. 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.

   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. They seem to be in the new regime because of the perceived danger that people will be misled as to true ownership.

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

13. 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 accounts;
(b) rights under general law or under the relevant State and Federal statutes in relation to the control, use or flow of water;\(^9\)

(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 interest;\(^11\)

(d) a lien, charge or any other interest in personal property, that is created, arises or is provided by operation of the general law;\(^12\)

(e) certain interests in property created under the Bankruptcy Act 1966;\(^13\)

(f) an interest in a fixture;\(^14\)

(g) particular statutory rights granted by relevant State or Federal statutes which are declared not to be personal property for the purposes of PPSA.\(^15\) For example, commercial fishing licences under the Fisheries Management Act 1994 (NSW) are to be so declared.

The functional test – ‘in substance’ security interests

14. 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).\(^16\)

15. 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 transaction;\(^17\)

(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.

16. ‘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 obligation\(^18\) and include:

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\(^9\) For example Water Management Act 2000 (NSW)
\(^10\) s 8(1)(i)
\(^11\) s 8(1)(b)
\(^12\) s 8(1)(c)
\(^13\) s 8(1)(g)
\(^14\) s 8(1)(j)
\(^15\) s 8(1)(k)
\(^16\) s 12(1) The architects of the Australian legislation saw fit to expand PPSA beyond its overseas equivalents in many respects. For example as originally enacted the definition in section 12 referred to interests ‘in relation to’ personal property.
\(^17\) Canadian Imperial Bank of Commerce v 64576 Manitoba Ltd [1990] 5 W.W.R 419 and now see the Australian case of Dura (Australia) Constructions Pty Ltd (ACN 004 284 191) (in Liquidation) (Receivers and Managers Appointed) v Hue Boutique Living Pty Ltd (formerly SC Land Richmond Pty Ltd) (ACN 106 117 506) 2014 VSCA 326.
\(^18\) s 12(2)
• conditional sale agreement (including an agreement to sell subject to retention of title),\textsuperscript{19}
• lease of goods;
• flawed asset arrangement (discussed below).

17. 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

18. Under pre-PPSA law in Australia, it was not clear that a financier could 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.

19. Under PPSA, an authorised deposit-taking institution (ADI) can take a security interest in an ADI account kept with the ADI.\textsuperscript{20} More generally, a person who owes payment or obligation may take a security interest in the obligee’s right to require performance.\textsuperscript{21}

20. Under PPSA, set-off is not itself a 'security interest' but a flawed asset arrangement is an 'in substance' security interest.\textsuperscript{22} 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. The vagueness of the 'flawed asset' has led to calls for its removal from the legislation.

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

21. Interests under transactions that do not in substance secure payment or performance of an obligation can still be security interests under PPSA.\textsuperscript{23} 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.\textsuperscript{24}

22. 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 goods.\textsuperscript{25} In

\textsuperscript{19} General Motors Acceptance Corporation Australia and Another v Southbank Traders Pty Ltd (2007) 234 ALR 608
\textsuperscript{20} s 12(4)(b)
\textsuperscript{21} s 12(3A)
\textsuperscript{22} s 12(2)(l)
\textsuperscript{23} s 12(3)
\textsuperscript{24} And the consignee is not known generally to be dealing in goods of others e.g. see Re Arcabi Pty Limited (Receivers & Managers Appointed) (in liq) [2014] WASC 310
\textsuperscript{25} See s 19(5) which deems possession to confer sufficient rights
effect an owner can be ‘granted’ a security interest in property that is already legally and beneficially owned by the owner.

23. 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

24. 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 PPSA. It is thought that this covers 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 mortgage, with the leased property serving in substance as security and the lessee (not the lessor) really enjoying the benefits of ownership. The commercial interchangeability of, say, a goods mortgage and a finance lease or hire purchase as a means by which a person may obtain goods for the substance of their useful life, with an obligation to pay their price and a charge for the ‘time cost of money’ supports this approach.

25. However under the extended ‘deemed’ security concept PPSA has gone even further and introduced the ‘PPS lease’, under which the interest of a lessor or bailor is a deemed security interest. A PPS lease 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. At the time of writing there is a Bill before Federal Parliament to abolish this shorter 90 day period so that a uniform threshold of one year would apply.

26. 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. It is accepted that the new law catches hire agreements. An indefinite hire for example is caught even if it has only been on foot for a very short time.

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

- ‘motor vehicles’ (these are very widely defined and include attachments and trailers). The definition as originally prescribed by regulation was amended to narrow the class of motor vehicles with effect from 1 July, 2014;
- 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. There are a number of subtleties in the definition of ‘PPS lease’ in section 13 that only emerge on close consideration.

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. It is important to keep in mind exclusions under section 8 of PPSA. For example, certain transfers of an account such as sale of an account or chattel paper as part of a sale of business are excluded.29

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

33. Unlike existing statutory security regimes, PPSA is an attempt to provide a substantial codification of the law of personal property security – and more than just a priority or registration regime.

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

35. 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

36. 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.

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29 s 8(1)(f)
37. The attachment rule under PPSA is as follows:³⁰

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.

38. The parties to a security agreement can agree for a security interest to attach at a later time.³¹

39. 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 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.

40. Section 19(5) reflects the position found overseas. In *Kinetics Technology International Corp v Fourth National Bank of Tulsa (1983)*,³² 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 perfect 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.

41. The Australian cases so far accept this approach³³ so there is no doubt that Australian lawyers must rethink any preconception that contractual retention of ownership will always provide protection in insolvencies – at least without considering PPSA.

**Enforceability of security interests against third parties**

42. A security interest is ‘enforceable against a third party’ in respect of particular collateral only if:³⁴

(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

³⁰ s 19(2)
³¹ s 19(3)
³² 705 F.2d.396
³³ For example see *In the matter of Maiden Civil (P&E) Pty Ltd; Richard Albarran and Blair Alexander Pleash as receivers and managers of Maiden Civil (P&E) Pty Ltd & Ors v Queensland Excavation Services Pty Ltd & Ors* [2013] NSWSC 852
³⁴ s 20(1)
(iii) there is a security agreement evidenced by writing.

43. 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 insolvency of the grantor or a wrongful dealing with the collateral. So in that sense the phrase ‘enforceable against a third party’ is somewhat misleading. 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. In practice the main point of section 20 is that to satisfy the second element necessary for perfection a security interest must be evidenced by writing or demonstrable by control or possession. In practice documentation is the most common way that the second element can be satisfied and to that extent section 20 can be thought of as imposing a writing requirement for personal property securities.

**Perfection**

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

45. 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.

46. A security interest in a particular collateral is perfected if all of the following apply:\(^{35}\)
   
   (a) the security interest is attached to the collateral (first element above);

   (b) the security interest is enforceable against a third party (second element above); 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.

47. 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.

48. 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.

\(^{35}\) s 21(1) and (2)
49. 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.

These aspects are discussed below.

**Priority of security interests**

50. 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 typically irrelevant for the principal priority rules in a PPSA-style regime.\(^{36}\)

51. Key priority rules under PPSA are as follows:
   - unperfected security interests rank in order of attachment;\(^{37}\)
   - a perfected security interest defeats an unperfected security interest;\(^{38}\)
   - perfected security interests rank in order of priority time, usually the earlier of registration time or time of first perfection by possession or control;\(^{39}\)
   - a security interest perfected by control defeats a security interest perfected in another way;\(^{40}\)
   - purchase money security interests (‘PMSIs’) have priority over non-PMSIs\(^{41}\) (super priority).

52. Notably under PPSA the priority regime does not include (and therefore effectively negates in the PPSA context) the rule in *Hopkinson v Rolt* (1861) 11 ER 829 and the principles of tacking. The concepts of notice of maximum prospective liability used by the Corporations Act 2001 (Cth) for securities granted by companies are also not adopted by PPSA and no longer apply.

**Purchase money security interests – ‘PMSIs**

53. Before PPSA arrived, title-based financing (e.g. leasing or retention of title arrangements) offered the owner a simple remedy when the customer or borrower became insolvent. It was really only necessary to prove continued ownership and then retrieve the personal property out of the insolvency. Subject to some statutory exceptions or impediments (for example the rights of an administrator to keep possession of the property under Part 5.A of the Corporations Act), the assertion of ownership was a powerful tool.

54. However under PPSA an owner’s interest is just another security interest and the owner must compete with other owners or bank lenders. The special priority status of a ‘PMSI’ gives back the traditional priority accorded to ownership interests and also to security taken to secure amounts used to purchase the subject of the security. The PMSI rules

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\(^{36}\) The Robert Simpson Company Ltd v Shadlock and Duggan (1981) 119 DLR (3d) 417
\(^{37}\) s 55(2)
\(^{38}\) s 55(3)
\(^{39}\) s 55(5)
\(^{40}\) s 57
\(^{41}\) s 62(1)
also work to reinstate its significance in priority terms, to something approaching the pre-
PPSA position.

55. A 'PMSI' is defined as any of the following:42

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

(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.

56. 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 attachment;43

- for personal property that is not inventory, in the case of goods, if registered within 15 business days after the grantor (or someone on the grantor’s request) obtains possession and for any other property within 15 business days after interest attaches.44

Note that ‘inventory’ has a wide definition in section 10.

57. PMSI super priority also extends to proceeds45 and to processed or commingled goods.46

58. The operation of PMSI super priority can be illustrated as follows:

In April 2015 Grantor gives Bank a security interest over all its assets (‘all present and after-acquired property’ in PPSA-speak). Bank registers the security interest on the PPSR.

In August 2015 Grantor takes a forklift on lease from Leaseco. Leaseco has registered its security interest on the PPSR as a PMSI before the truck was delivered to Grantor.

Leaseco’s security interest has priority over Bank’s charge even though it was created and perfected later.

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

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

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42 s 14(1)
43 s 62(2)
44 s 62(3)
45 s 62
46 s 103
Vesting rules in the PPSA itself

60. 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 body corporate; or
- an administrator is appointed to a company or a body corporate, or it executes a deed of company arrangement; or
- bankruptcy of an individual.

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

61. 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.

62. 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.

63. The operation of the vesting rules in the PPSA has been demonstrated in a number of Australian decisions.

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 publicised 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.

47 s 268
48 For instance - In the matter of Maiden Civil (P&E) Pty Ltd; Richard Albarran and Blair Alexander Pleash as receivers and managers of Maiden Civil (P&E) Pty Ltd & Ors v Queensland Excavation Services Pty Ltd & Ors [2013] NSWSC 852
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.

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.

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 more than six months before the insolvency.

It is most regrettable that a powerful (and arguably unnecessary) vesting rule applying to PPSA security interests was placed in the Corporations Act and not in the PPSA itself. For an example of a hire business falling foul of s.588FL see Carrafa & Others v Doka Formwork Pty Ltd [2014] VSC 570.

Critical timeframes for registration

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 goods that are not ‘inventory’ (as widely defined). That ensures PMSI ‘super-priority’ as explained elsewhere in this paper.

72. Because of s.588FL of the Corporations Act, 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. The drafting of the Corporations Act provisions poses some troubling questions for the operation of the PPS registration regime in context of ongoing hire and ROT sale agreements, where there are multiple hire or sale contracts. 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? Under the PPSA itself this seems safe enough and 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 scheme of the relevant Corporations Act provisions seems to focus on the date of the security agreement. The point deserves more clarity in the legislation.

Taking free of security interests – the extinguishment rules

73. Under PPSA a security interest takes effect according to its terms.49 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.

74. 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 property.50 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.

75. 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 must51 be described by serial number in a registration 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. Taking a security interest over a passenger motor vehicle for example, the secured party can make a ‘general’ registration which only notifies an interest in a motor vehicle or the secured party may choose to make a specific registration by serial number (the VIN in the case of a passenger motor vehicle).

A general registration will protect the secured party’s interest in an insolvency of the grantor. But were the grantor to sell the vehicle to a third party wrongfully and there is no serial number specific registration the third party will take free of the secured party’s interest;

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49 s 18(1)
50 s 43
51 Depending on whether it is consumer property
52 s 44
• personal property sold or leased in the ordinary course of the seller’s or lessor’s business - a necessary rule to allow people to deal with businesses in the ordinary course without worrying about the existence of security interests;
• 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 amount.

76. 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.

Enforcement rules

77. 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.

78. 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 obligation.
• the ability to contract out of some provisions where the collateral is not used predominantly for personal, domestic or household purposes. This ability has led to the proliferation of the typical ‘PPS clause’ sought by financiers and retention of title suppliers seeking waiver of the Chapter 4 rights that might otherwise impede enforcement.

Proceeds accessions and processed and commingled goods

79. 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 otherwise. Under PPSA ‘proceeds’ means identifiable or traceable personal property of the types that include:
• personal property derived directly or indirectly from a dealing with the collateral;

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53 s 46
54 s 47
55 s 117 and 118
56 s 115
57 s 32(1)(b)
58 See extensive definition in s 31
• 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.

80. 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 number. An accession preserves its identity once installed in or affixed to the other goods.

81. PPSA provides detailed provisions relating to priority interests in accessions and obligations on a secured party as to their removal. 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 whole.

82. PPSA also allows for the continuation or tracing of a security interest into a product or mass. 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 mass. The identity of goods that are manufactured processed, assembled or commingled is considered lost in a product or mass if it is not commercially practical to restore the goods to their original state.

83. The PPSA rights to proceeds, accessions and product are likely to enhance the return to financiers and retention of title suppliers, in particular in customer insolvencies as tracing into proceeds, other goods or a product or mass was problematic to varying degrees under the previous law.

Intellectual property

84. There are special rules about security interests over intellectual property. Notably, a licence of intellectual property is not itself a security interest so there is no corresponding concept in the context of licensed intellectual property 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.

85. Section 105 provides a rule to assist a secured party where goods are subject to a security interest and the secured party needs the grantor’s 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 a patent needed to operate them. The section does not on our reading actually deem there to be a security interest over the intellectual property but it does operate to alleviate problems under

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59 s 10
60 s 90 – 97
61 s 89
62 s 99(1)
63 s 99(2)
64 For an overview of PPSA and intellectual property see PPSA – Key Points for IP Practitioners by O.Shtein & K.Wong Lexis Nexis Intellectual Property Law Bulletin 2015 Vol.28 No.1
65 s 12(5)
section 20 and section 21 which might otherwise arise where an interest that can otherwise be implied is not specifically identified and specifically registered.

86. 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.

87. 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.

88. 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**

89. The distinction between a fixed and floating charge and the concept of crystallization 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.

90. 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.

91. 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 time.⁶⁶

92. 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.

93. 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 adopts a dichotomy between security interests over 'circulating assets' and security interests over 'non-circulating assets', to the same effect.

⁶⁶ See Part 9.5 and particularly s.339 which broadly substitutes ‘security interest’ for ‘charge’in various statutes and instruments.
94. It is worth noting that the current form of financing statement, that a secured party must complete in order to make a registration in respect of a security interest, includes a box to be ticked indicating whether or not the collateral is ‘inventory’. That term however has its ordinary meaning and not the meaning given to the same word by s.10 of the PPSA. Even more confusingly the ‘inventory question’ is authorised by the legislation only for the purposes of Part 9.5. As Part 9.5 is a transitional provision dealing with fixed and floating charges this makes the question extremely difficult to answer. If a secured party is making a registration in respect of a retention of title interest (which is clearly not a charge covered by Part 9.5) is it correct to tick the ‘inventory box’ even if the goods are inventory?67

Transitional aspects

95. 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 commenced.68

96. 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.

97. Transitional security interests that were never 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 them to be attached and perfected from immediately before the ‘registration commencement time’.

98. However they were only deemed perfected for 24 months. This period was 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 allowed 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 had 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 had not perfected its security interest, it became unperfected.

99. Section 320 summarises, by way of a ‘guide’ the priority rules for transitional security interests.

The PPSR

100. The PPSR replaced a plethora of 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 all ceased to operate but will have some ongoing relevance in determining priority disputes between competing transitional security interests.

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67 See s.153 and the regulation prescribed for Item 8 of the table in that section and see Part 9.5 and particularly ss.339 and 341.
68 s 308
69 s 322
101. Part 5.3 of PPSA outlines the registration process and part 5.4 sets out requirements for effective registration.

102. Instead of registering the security agreements, a financing statement may be registered on PPSR through an on-line process. Registration in advance is now possible,\(^{70}\) 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 collateral.\(^{71}\)

103. 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.

104. It is widely agreed that the PPSR is far too complicated and could be much simpler. Regrettably it is also clear that unless guided by expert advice typical businesses are likely to make fatal errors in making registrations. It is simply not safe to approach the PPSR before gaining a sound understanding of the PPSA.

**PPSA reform**

105. The PPSA required that a review be conducted of the Act. The Government commissioned Mr Bruce Whittaker, a finance lawyer, to undertake that review and his report was imminent at the time of writing. It is evident from the review that the original architects of the Australian PPSA saw fit to expand on the overseas equivalents in many ways and this has produced complexity, risk and uncertainty in a number of areas. It is to be hoped that at least some of this needless complexity is removed. Some likely outcomes of the review could include simplification of the register, removal of the flawed asset concept, narrowing the scope of the ‘transfer of accounts’ and bailment deemed security interests and reduction in the scope of serial number registration.

106. Some alleviation of the legislation’s impact on the hire industry is particularly to be hoped for. The writer advises the Australian Hire & Rental Industry Association in relation to PPSA and the Whittaker review. The hire industry has certainly struggled with the complexities of the law. The industry pointed out (rightly in the writer’s view) that the draconian PPSA sanction of loss of ownership of assets of a hire businesses is out of all proportion to any policy benefit gained by attacking the perceived ‘evil of apparent wealth’.

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10 March, 2015

\(^{70}\) s 161
\(^{71}\) s 151