



PPSA in Practice

Big Trouble

in Little Security

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PPSA in Practice – Big Trouble in Little Security

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1. This paper addresses, in no particular order, some of the practical issues the authors have encountered in advising clients on the operation of the *Personal Property Securities Act 2009* (Cth) (**PPSA** or **Act**) and related legislation, particularly where the perfection or priority of PPSA security interests may be questioned.
2. There is a focus in this paper on goods especially on retention of title and ‘lease’ (a term which the Act sometimes uses in a way including hire and bailment) interests. These are the areas where PPSA now reaches, with its draconian¹ consequences, where no security registration regime has previously gone. They are also the areas which have in our experience caused the most grief to businesses, as the case law does tend to confirm. We expect this to continue.
3. Other articles available on our website at www.bartier.com.au/insights/articles deal with various aspects of the PPSA and include:
 - *An Introduction to Personal Property Securities Act*. This is an overview of the Act and its scope and looks at when a security interest arises both under the ‘in substance’ principles and the deemed security interests such as PPS leases and commercial consignments.
 - *Business Acquisitions and the Personal Property Securities Register (PPSR)* – which looks at the various ins and outs of searching the PPSR before acquiring an asset.
 - *PPSA – Key points for IP practitioners* - which looks at the operation of the Act to transactions involving intellectual property.

The change to the definition of PPS leases

4. In an earlier version of this paper we looked at the changes that narrowed the scope of the PPS lease. These comprised:
 - (a) the removal of the 90 day threshold for certain PPS leases of serial number registrable collateral;
 - (b) the narrowing of the definition of ‘motor vehicle’ so that the vehicle has to have a top speed more than 10kph as well as having more than a 200W motor.

As we noted in that paper, these changes, whilst sought by the hire industry did not go far enough especially as indefinite term leases continued to be caught under the PPS lease definition, as well as fixed term leases of one year or more.
5. Amendments to the PPSA in May 2017 brought significant relief to the equipment hire industry and made important changes to the definition of PPS lease to address the issues noted above. The two significant changes were:

¹ The word used by Sifris J in *Carrafa & Others v Doka Formwork Pty Ltd* [2014] VSC 570 mentioned below.

- (a) to remove 'indefinite' hire from the 'PPS lease' definition;
- (b) to extend the PPS lease time threshold to two years.

6. The following examples illustrate this change:

Examples

- (a) *HireCo and customer enter into hire of a jackhammer for 'as long as you need it'. Now not a PPS lease at inception.*
- (b) *HireCo and customer enter into indefinite hire of jackhammer on 19 May, 2017. PPS lease from inception – not covered by the new test under the transitional rules in the amending legislation.*
- (c) *HireCo and customer enter into hire of a jackhammer for 18 months with customer option to extend for a further seven months. This is a PPS lease from inception.*
- (d) *HireCo and customer enter into indefinite hire of jackhammer. Eighteen months into the hire, customer tells HireCo – 'the job I am on is going to last for another year'. HireCo rep says – 'No problem, keep the jackhammer until then.' PPS lease at that time.*

When is a bailment a PPS lease?

7. For arrangements that are clearly 'leases', a term which includes the ubiquitous equipment hire, PPS lease issues typically turn around the contractual or actual term of the lease. However the definition in section 13 of the PPSA is not limited to leases. It covers leases *or bailments*. The only qualifier as to bailments is in section 13(3):

This section only applies to a bailment for which the bailee provides value.

8. The term 'value' is defined in section 10 of the PPSA to include nominal consideration:

"value " :

- (a) *means consideration that is sufficient to support a contract; and*
- (b) *includes an antecedent debt or liability; and*
- (c) *in relation to the definition of purchase money security interest --has a meaning affected by section 14.*

9. Section 13 assumes therefore that there is a kind of bailment, for which the bailee provides value, but which is not captured by the concept of a lease. The problem with which many advisers have wrestled is whether this 'non-lease' bailment might be found in many commercial arrangements involving a bailment. The following are only a few examples where this seems to arise:

- (a) a warehousing or logistics agreement under which A gives goods to B for B to store and transport them for a fee payable by A to B;
- (b) an arrangement under which A gives medicine in powder form to B for B to package the medicine in capsules;

- (c) an arrangement under which an IT company provides a broad range of IT services to a customer including use of a server in exchange for a monthly fee;
- (d) an arrangement under which a broadcaster, A, places a telecommunications transceiver on B's land in exchange for a fee which A pays to B. The agreement also provides that B can use the device for its own business purposes and B agrees to clean it regularly.
10. The critical question is whether the bailee is *providing value for the bailment*. Some advisers perceive risk (quite rightly given the consequence of getting it wrong) in not making a registration, in a circumstance where a Court may find value for the bailment as somehow wrapped up in the overall deal.
11. Our view has been that this outcome should not easily flow in cases like 9(a) and 9(b). However in the examples in 9(c) and 9(d) it does not seem a stretch to see value passing 'for the bailment'.
12. This kind of question came before the Courts in *Bredenkamp v Gas Sensing Technology Corporation, in the matter of Welldog Pty Ltd (In Liq) (Receivers and Managers Appointed)* [2017] FCA 1065 (7 September 2017).
13. The case was about whether Gas Sensing Technology Corporation (**GSTC**) was entitled to recover certain gas sensing equipment in the insolvency of Welldog Pty Limited. The receivers of Welldog claimed that GSTC had an unperfected PPS lease with Welldog. GSTC was the parent of Welldog. GSTC was a technical services company operating in the resource sector. Sometimes GSTC would store equipment with Welldog between projects. Welldog also used the equipment on the basis that it would be returned to GSTC. The case was decided under the pre-May 2017 law under which an indefinite term lease could be a PPS lease.
14. GSTC won the case primarily because the Court found it was not in the business of bailing the equipment and therefore did not satisfy that element of the definition of PPS lease. However the Court also considered whether the arrangements were a bailment for value in terms of section 13(3). GSTC's arguments were accepted.

146. Broadly, I accept the submissions made on behalf of GSTC that "value" sufficient to support a contract was not provided in respect of the bailments of the relevant equipment. At what might be referred to as the "global level", the provision of the relevant equipment by GSTC to the company was to enable the company to conduct the Australian Business.....

.....I am inclined to adopt the view expressed in Duggan and relied on by GSTC, that the relevant value must be more specific than a global financial or business arrangement

Without intending to suggest that some business arrangements, which might involve some quid pro quo of a nature not involving direct payment for goods supplied on bailment, may never constitute "value" as defined in s10, I have real difficulty in concluding that the financial benefits identified here should be considered consideration sufficient to support a contract. The "consideration" is, in my view, quite uncertain. It is also too indirectly related to the provision of the goods to support the ready conclusion that the goods were bailed for such benefits.

15. The receivers' attempt to argue that value in a global sense could attract the PPS lease definition was rejected. The judgment is a welcome confirmation that for there to be a PPS lease, there must be value for the bailment – that is to say, commercially focussed as being for the bailment.
16. Nonetheless caution is still advised. As the Court noted in *Bredenkamp* there may still be '*some business arrangements, which might involve some quid pro quo of a nature not involving direct payment for goods supplied on bailment*' that might be bailments for value. In any kind of borderline case a registration will be cheap insurance if the goods are valuable. Our assessment of the examples above would remain the same as indicated at paragraph 11.

PPSA's unforgiving priority and timing rules

17. Part 2.6 of the Act contains the rules to be applied in order to determine the priority between competing security interests in the same collateral. Key priority rules under PPSA are as follows, and we will focus here on the last one below:
 - (a) unperfected security interests rank in order of attachment;
 - (b) a perfected security interest defeats an unperfected security interest;
 - (c) perfected security interests rank in order of priority time, usually the earlier of registration time or time of first perfection by possession or control;
 - (d) a security interest perfected by control defeats a security interest perfected in another way;
 - (e) a purchase money security interest (**PMSI**) has priority over a non-PMSI (**super priority**).
18. Before PPSA arrived on the scene, title-based financing (e.g. leasing or retention of title arrangements) offered the owner a simple remedy when the customer 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 during an administration to keep possession of the property under the Corporations Act), ownership was a powerful right.
19. However, under PPSA an owner's interest is just another security interest and the owner must compete with other parties, typically bank lenders. The special super 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. But PPSA also lays a number of traps.
20. A 'purchase money security interest' is defined in section 14 as any of the following:
 - (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 – but note that a sale and lease-back is not a PMSI;

- (d) the interest of a consignor who delivers goods to a consignee under a commercial consignment.

21. 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.

The traps

22. It is important to be aware that PMSI status is not itself a guarantee of super priority unless other steps are taken.
23. When registering a security interest as a PMSI, the financing statement must state that it is a PMSI.
24. In addition, under section 62 of the Act, a PMSI only has super priority:
- for inventory that is goods, if registered as a PMSI prior to the grantor obtaining possession and for other kinds of inventory if registered prior to attachment;
 - for personal property that is not inventory, in the case of goods, if registered as a PMSI 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 the interest attaches.
25. Note that 'inventory' has a wide definition in section 10. It seems safest not to rely on the 'extra' 15 business days to register. This is not just because of the width of the definition of 'inventory' but because there is always a possibility of grantor insolvency or wrongful sale during that period and the extra 15 business days does not apply to defer the operation of vesting or extinguishment rules, which are separate perils of life under PPSA.

At what time do you need to register an indefinite lease or bailment under the PPSA?

26. Hire businesses and others providing goods on 'lease or bailment' that fall within the PPSA's reach still need to rely on their PPSR registered 'purchase money security interest' (PMSI) 'super priority' status. If PMSI super priority status is not achieved, an earlier registered security interest takes priority.
27. This raises an important question for any lessor/bailor business. Should you register before you deliver the goods ie at the outset of the lease or bailment? Or is it safe to wait up to two years when the application of the PPSA is looming? The answer is in the PPSA and also (if the customer is a company) in section 588FL of the Corporations Act 2001 (Cth).

28. Section 62 of the PPSA confers priority status, where there is a PMSI registration before the 'grantor obtains possession'. Where the goods are not 'inventory' there is a 15 business day grace period. The time a 'grantor obtains possession' is clearly a critical moment as it sets the time for registering a security interest as a PMSI. Leave it too late to register and the bank may take the equipment! It can also be difficult to fix a late-registered PMSI.
29. A recent decision of the South Australian Supreme Court – *Allied Distribution Finance Pty Ltd v Samwise Holdings Pty Ltd* [2017] SASC 163 (**Allied Case**) adopts a common sense interpretation of section 62 and one that is consistent with the approach overseas.

The Allied Case

30. The South Australian Supreme Court has now held that the reference in section 62 to a grantor obtaining possession of goods is a reference to obtaining possession as a grantor rather than in some other capacity. The facts in the case were complex but can be boiled down as follows.
- In 2014 Samwise registered on the PPSR a general security interest over all Bill's Motorcycles' assets.
 - On 12 April, 2016, Bill's executed a Bailment Agreement for floor plan finance from Allied.
 - On 14 April, 2016, Allied made a PPSR registration against Bill's to protect the goods bailed to Bill's from time to time.
 - On 18 April, 2016 notices were issued the effect of which was to bring 40 motorbikes under the Bailment Agreement with Allied.

The critical complication was that before Allied registered, Bill's was already in possession of the motorcycles. That possession was a result of arrangements between Bill's and its outgoing financier CDF.

31. On 16 June 2016, Bill's Motorcycles was placed into administration. As PMSI holder, Allied no doubt expected its PMSI priority easily to trump Samwise's non-PMSI security interest. But Samwise saw the opportunity to argue that Allied had not registered before Bill's obtained possession.
32. Allied won the case. Blue J held that section 62 relevantly refers to the grantor obtaining possession as grantor of the purchase money security interest in the property in question. The fact that Bill's had possession of the bikes in some other capacity, before actually becoming a PPSA 'grantor' to Allied, was irrelevant.

Implications for leases and bailments that may cross the two year threshold

33. Some commentators have written that registration would be needed at the outset of an indefinite lease or bailment. On this view, one could not wait until the two year PPS lease threshold becomes imminent.
34. However there are a number of problems with that view, including the following.
- Cases on similar legislation overseas don't support that view in similar contexts.

- Section 62 refers to possession being obtained by the 'grantor' which is a term defined in the PPSA in a way that assumes there is already a security interest – not just the possibility of one.
- The view leaves unanswered how one can register something that is completely outside the PPSA and might never be subject to it because it might never be a PPS lease. Many businesses genuinely have no idea when a given customer might end up keeping the goods for more than two years.
- The expressly stated purpose of the 2017 amendments to the PPSA was to relieve hire businesses from the PPSA until they cross the PPS lease time threshold. In the Minister's second reading speech he said (emphasis added) – 'The Bill will amend the Act's definition of PPS Lease to ensure that it captures only leases which are long enough to necessitate registration on the PPS Register to meet the Act's policy objectives. **Leases with an indefinite term will only require registration once they have exceeded two years in length.**'

35. Now, applying the Court's reasoning in *Allied* case to the scenario of an indefinite lease or bailment will not, in our view, be in possession as a grantor of a PMSI until such time as a PPS lease actually arises. It is true that *Allied* was not a case about the PPS lease but the remarks by Blue J below can be seen as some support the application of the same analysis to leases and bailments that turn into security interests.

By contrast, the person who subsequently becomes the grantor of a purchase money security interest might hold possession of the property before acquiring ownership of the property financed by mortgage finance. For example, the person might simply be hiring goods on a weekly basis. That person might later negotiate with the owner to purchase the goods and obtain mortgage finance to finance the purchase. Lenders to the hirer who become security holders during the period in which the hirer is hiring the goods do not obtain a security interest over the ownership of the goods because the ownership is retained by the owner. Such lenders would not be prejudiced by the subsequent grant of a security interest to the mortgagee lender providing the finance to the hirer to acquire ownership of the goods. Such lenders would not be misled by the hirer's possession of the goods.

What about section 588FL of the Corporations Act?

36. Section 588FL can invalidate a security interest if registration is not made within 20 business days of the date of creation of the security agreement. To survive section 588FL, at least six months have to pass between the registration and any insolvency of the grantor.
37. Section 588FL may (we trust) be gone soon if the recommendations of the Whittaker Report are enacted.
38. In the meantime, it is clear enough that the 20 business day period doesn't start to tick until there is a 'security agreement'. Our view is that a contract for an indefinite lease or bailment (assuming of course it is not an in substance security) simply is not a 'security agreement' - again until the two years PPS lease threshold is breached. We think that the points noted above would, along with the approach in the *Allied* Case, apply here too.

39. It may well be excessively cautious to think that an indefinite lease or bailment could be a 'security agreement' from day one even though the PPSA does not yet apply to it. If one registers six months before there is a security interest – ie just prior to 18 months into the arrangement, then arguably section 588FL can't operate anyway because there will always have been a registration six months before any insolvency that could threaten any security interest.

Conclusion - when to register when a lease or bailment starts as indefinite?

40. In our view:
- (a) if there is a subsequent agreement that the lease or bailment will last more than two years (including any option) – the time to register is at the time the parties agree to that because that is when a security interest arises; or
 - (b) if the arrangement is indefinite but could possibly exceed the two year threshold – the time to register is just before 18 months into it. The 18-month timeframe adopts the most cautious view of section 588FL, until section 588FL is repealed.

What to do about a late registration – PPSA and Corporations Act

41. We commonly encounter registrations by lessor businesses and retention of title sellers that don't meet the requirements for PMSI super priority. This may be because they have been made (or could only be made) outside the timeframe required by section 62. Or it may be that they are timely, but the PMSI box has not been ticked in the PPSR registration or there is some other defect that means that the registration does not perfect the interest as a PMSI.
42. The wording of section 62 gives the secured party only one shot at obtaining PMSI super priority within the timeframes stated in section 62. Whilst the interest is still going to be a PMSI it will lack PMSI super priority unless section 62 has been satisfied. In these cases it is necessary to consider what steps can be taken to gain the necessary priority.
43. A search of the PPSR may well disclose no interest that would have priority over the client's interest. In that case nothing further usually need be done. More often however, there is a bank with general security over the lessee/purchaser/grantor and that prior registered interest will trump any subsequent interest that doesn't have PMSI super priority – even if the subsequent interest is ownership. It may be possible to negotiate with the bank(s) for a priority agreement to address the problem.
44. Another solution may be to terminate the financing, lease or sale and start over again this time with a PMSI registration in place. This will require the agreement of the customer unless there is a particularly strong PPSA provision in the agreement. It would also at least require the secured party to regain possession and to enter into a fresh contract. Even then, if the process is started again in the context of the same goods being made the subject of a fresh contract and re-delivered, in the case of a lease there are some concerns that this may not sufficiently break the nexus with the earlier PPS lease. It is not clear whether the lease or bailment referred to in section 13's definition of 'PPS lease' is a concept of a discrete contract or whether possession (including broken possession) under any number of contracts, is what is being targeted.
45. Sometimes a supplier business can easily 'swap in' another unit under a new contract once the correct registration is in place and address the problem that way. But in

other cases it may be impracticable, or at any rate difficult, to regain possession - for example the collateral may be a piece of hired equipment deep within a remote mine.

46. Where the grantor is a company, a related but different problem arises, not under the PPSA per se, but under section 588FL of the Corporations Act where there is a late registration. 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'.
47. 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;...*
 - (iv) *a later time ordered by the Court under section 588FM.*
48. The 'critical time' is the time of the relevant insolvency event. In effect a late-registered security interest granted by a company will be vulnerable for six months following its registration. If the grantor goes into a relevant insolvency proceeding in that time the interest vests in the company grantor. For an example of a hire business falling foul of s.588FL see *Carrafa & Others v Doka Formwork Pty Ltd* [2014] VSC 570.
49. Another complication worth noting in passing is that the wording of the section means that any security interest granted by an external insolvency administrator will typically fall foul of section 588FL. Such a security might be given as part of a restructuring of an insolvent company as was the case in CBS's recapitalization of the Ten Network - *Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed)* [2017] FCA 1144.
50. Each of the Corporations Act and the PPSA offer possible solutions where a secured party has either failed to make a registration or has made a defective registration which results in the secured party losing the PMSI super priority they otherwise would have had and/or being exposed to the vesting rules in section 588FL.

Corporations Act section 588FM

51. Section 588FM of the Corporations Act provides that the Court may make an order fixing a later time for the purposes of section 588FL(2)(b)(iv). The Court may make the order if it is satisfied that:
- (a) the failure to register the collateral earlier:

- (i) was accidental or due to inadvertence or some other sufficient cause; or
 - (ii) is not of such a nature as to prejudice the position of creditors or shareholders; or
- (b) on other grounds, it is just and equitable to grant relief.

PPSA section 293

52. Under section 293, the Court may grant an extension of the time for registration of the PMSI in such a way that it will gain PMSI super priority. In making an order to extend the relevant period, the court must take into account the following matters:
- (a) whether the need to extend the period arises as a result of an accident, inadvertence or some other sufficient cause;
 - (b) whether extending the period would prejudice the position of any other secured parties or other creditors;
 - (c) whether any person has acted, or not acted, in reliance on the period having ended.

The question of prejudice

53. Whilst each of section 588FM and section 293 contain a requirement that the Court consider prejudice to creditors, it should be noted that the nature of the prejudice (if any) that would be affected on creditors if the order were made, is not the same.
54. The prejudice referred to in section 588FM(2)(a)(ii) is prejudice to the position of creditors or shareholders from the failure to make a timely registration. This involves a comparison of the position of the creditors if an extension is granted, with their position if an effectively timely registration had been made. In most cases, there will be no difference in position.
55. However, the prejudice referred to in section 293(3)(b) is prejudice arising from “extending the period”. Rather than a consideration of the impact of the delay in registration, this involves a consideration of the impact of making an order to extend the period. A comparison of the position of creditors if an extension is granted, to their position if no extension is granted, will usually evidence a difference because priorities will be disturbed as a result of making the order.
56. This issue of prejudice under each of section 588FM and section 293 was discussed at length in the *Accolade Wines* case, which is discussed further below.

Curing late or defective registrations by Court order – the approach in Accolade Wines².

57. The *Accolade Wines* decision is an excellent illustration of how the provisions referred to above can be used, perhaps as a last resort, to remedy the otherwise difficult problems of late or defective registrations.³

² *In the matter of Accolade Wines Australia Limited and other companies* [2016] NSWSC 1023

³ See *In the matter of Duke Contracting Australia Pty Ltd* [2017] NSWSC 767 and *In the matters of 4 in 1 Wyoming Pty Ltd & the companies listed in Schedule A to the Originating Process* [2017] NSWSC 407 which also dealt with applications under section 588FM of the Corporations Act and section 293 of the Act to cure defective registrations

58. In the case, the plaintiffs were two Alleasing Group companies (**Alleasing**), who had tried to perfect their security interests by registration on the PPSR. However, Alleasing's financing statements were registered against the corporate ABN of each of many lessee grantors rather than the ACN, a defect which potentially invalidated the registrations given the grantors were not operating as a trust. Had they been trustees, the registrations could only have been validly made against the trust ABN (and not the corporate ABN) in any event.
59. Having realized the mistake, Alleasing sought to remedy the situation by the registration of new financing statements on the PPSR (correctly referring to ACNs) and made an application to Court seeking:
- (a) an order pursuant to section 293 of the PPSA extending time beyond the requisite 15 business day period stipulated in the PPSA to perfect the interests with PMSI super priority; and
 - (b) an order pursuant to section 588FM of the Corporations Act, fixing a time later than the requisite 20 business days after entry into the relevant security agreement for the registration of the security interests.
60. Alleasing made the application *ex parte* arguing this was appropriate because of the large number of grantors (Accolade was just one of many lessees) who would otherwise have to be joined as a party. Justice Brereton disagreed and found that the fact that there had been earlier (though ineffective) registrations over the collateral was no reason to deprive the grantors of an opportunity to be heard. His Honour did acknowledge that Alleasing had given all grantors notice of the application and because no grantor had indicated opposition or sought to appear, that significantly mitigated the objections to proceeding *ex parte*. His Honour agreed to hear the application *ex parte* but warned that it should not be assumed the same approach would be acceptable to the Court in future cases.
61. Alleasing led evidence from their CEO that the employees who effected the initial registrations utilised a third party service provider platform which provided no alert as to the significance of the choice between a grantor's ABN and ACN and those employees were not aware that this made any difference to the status of the security interest. On that evidence, his Honour was satisfied that the discretion to fix a later time in the case of inadvertence had been enlivened.
62. In considering the factors that the Court should take into account in determining whether to make an order under section 293, his Honour noted that:
- the need to extend time must arise as a result of inadvertence (the same issue as pursuant to section 588FM); and
 - although any holders of general security (a registration over all of the entity's assets) will lose priority to the later registered PMSIs, that was not conclusive evidence of prejudice in the present circumstances as:
 - (a) there was already a PMSI registration on the PPSR (albeit a defective one against the corporate ABN);
 - (b) a general security is always liable to be trumped, in respect of specific after-acquired collateral, by a PMSI in respect of that specific collateral;

- (c) to the extent that an earlier general security holder will be prejudiced, it is only by losing a 'windfall' it had obtained by another secured party's inadvertence; and
 - (d) notice that there was an earlier PMSI in respect of specific collateral is unlikely to have been material to a secured party's decision to provide financial accommodation in the first place.
63. His Honour also confirmed that where an application is made under section 293, any secured party whose interest is liable to be postponed ought ideally to be joined as a party to the application. In this case he ordered they be given notice and liberty to apply.
64. The comment by the Court mentioned in paragraph 62(a) reinforces that, despite the fact that a valid registration could have been made solely against the ACN of each grantor company, the Court felt it relevant that a search against an ABN would have shown the registration (albeit wrongly made). This comment is interesting as in no case would a registration against the corporate ABN have been valid – as we will see below. The plaintiffs introduced evidence that standard practice amongst lawyers advising banks would be to do a search against corporate ABN, ACN and name, as well as against any trust ABN. This provided some assurance to the Court that no general security holder was likely to have been led astray by the lack of a correct registration against the ACN of the companies concerned.
65. The comments mentioned in paras (b), (c) and (d) are in our view somewhat telling in terms of the policy justification of the necessity for the PPS lease, when put up against the harsh consequences of getting a registration wrong. In effect the Court seems to be saying that general security holders such as banks don't really assume that they will get security over hired or leased assets. This is consistent with the submissions the hire industry made to the Government about the PPS lease and the ability of the vesting and priority rules in the PPSA to damage or even destroy hire businesses that fail to make correct and timely registrations.
66. The closer that the grantor gets to insolvency, the harder it will be to obtain any order. Prospects will almost certainly vanish once formal insolvency supervenes. An adviser to a company that has an issue under section 588FL or section 62 undoubtedly has a duty to raise with his or her client the ways that these defects might be cured including by an approach to the Court before any opportunity to cure is lost. A very recent decision (again concerning Alleasing's defective practice of registering against corporate ABNs) drives the point home.
67. *In the matter of OneSteel Manufacturing Pty Limited (administrators appointed)* [2017] NSWSC 21, Alleasing had leased to OneSteel Manufacturing Pty Limited plant and equipment said to be worth \$23 million. The fact that the lease was covered by PPSA was not in dispute. Registrations were lodged notifying Alleasing's interest in the goods, but by reference to OneSteel's ABN, not the ACN.
68. Alleasing first argued that the security interest had in fact been perfected on the bases that:
- (a) by making the first registrations with reference to the ABN, the nine digit ACN had in fact been included on the Register. The ABN contained the ACN as its last nine digits.
 - (b) a belated post-administration registration could in effect be backdated to be effective prior to the date of appointment of the administrators.

69. The Court found for the administrators on the basis that a search of the Register by ACN alone would not reveal the registrations, and so they were defective. The Court also refused to perfect the security interest retrospectively, as the subsequent registration was done after the critical date on which the administrators were appointed to OneSteel. It seems Alleasing's interest in the Onesteel equipment missed the lifeboat Alleasing found for Accolade Wines and other leases.
70. Allleasing also raised a Constitutional argument, essentially that Alleasing's property had been acquired on unjust terms in a manner not permitted by the Constitution. Fans of Australian film will remember this principle as 'the vibe' raised by the suburban solicitor Dennis Denuto in the film *The Castle*. Unfortunately for Alleasing the Court found no 'vibe' and the argument was rejected essentially because the Court held that the relevant part of the PPSA is a law for adjusting the right of creditors in insolvencies and not a kind of law that the Constitution will strike down.

Limitations on section 293

71. An application under section 293 to extend the time for PMSI registration enabling super priority can only be made in respect of section 62(3). It is therefore not available when the collateral is 'inventory' (as defined in section 10). So for example, it will not it seems be available when the grantor has been supplied stock in trade or is a hire business, as collateral on-hired appears to be 'inventory' under that definition.

'Overclaiming' PMSI status

72. Another trap the Act lays is that a registration will be ineffective⁴:

if the registered financing statement (as amended, if at all) indicates that a security interest in the collateral is a purchase money security interest (to any extent)— [and] the security interest is not a purchase money security interest (to any extent) in the collateral

A failure to appreciate that a sale and lease-back is not a PMSI could spring this trap, for example.

73. Some commentators have raised a further scenario:

Supplier sells two machines to Retailer on retention of title terms. The retention of title clause is 'all moneys' so the two machines secure not just their own purchase price but also any other money Supplier owes Retailer. Retailer pays Supplier for the two machines (and Supplier acknowledges this) and supplies one other machine. That other machine is then quickly sold.

The position is now that Retailer has in its possession two machines which have been paid for and owes the price of the machine that has been sold. Arguably the retention of title interest in the new machine is now not a PMSI to any extent because the purchase price of that machine has been paid.

If the Retailer goes into administration the Supplier will not only have no priority in respect of the machine, it may find its security interest has vested in the administration of Retailer because PMSI status has been 'over claimed'.

⁴ See s 164(1)(b) and s 165(c)

74. There is an order of payments rule in section 14 of the PPSA which may assist in some cases. However it does seem prudent that where an all moneys retention of title is in place there should be both PMSI and nno-PMSI registrations.

Transitional time bomb – when is it no longer safe to rely on a transitional registration?

75. The decision of the Victorian Court of Appeal in *Central Cleaning Supplies (Aust) Pty Ltd v Elkerton* [2015] VSCA 92 highlights one aspect of the importance of knowing whether a security interest is transitional or not. In the *Central Cleaning* case it was critical for the supplier secured party to show that its security interest was transitional as there was no registration and the supplier needed to rely on the transitional period (now expired) of two years from the start of PPSA.
76. The facts of the case were as follows:
- Central Cleaning Supplies (Aust) Pty Ltd (**Central Cleaning**) supplied cleaning equipment and products to Swan Services Pty Ltd (**Swan Services**). In September 2009, the financial controller of Swan Services signed a credit application. The credit application included a statement that the supply of goods was governed by Central Cleaning's 'Standard Terms and Conditions'.
 - Central Cleaning proceeded to supply Swan Services with cleaning equipment and products from time to time. Printed at the bottom of each relevant invoice was a retention of title 'condition of sale' which stated that the goods the subject of the particular invoice remained the property of Central Cleaning until the whole of the purchase price had been paid by Swan Services for those goods.
 - In May 2013 Swan Services went into administration and subsequently into liquidation. Central Cleaning claimed the return of the cleaning equipment supplied to Swan Services on the basis that it had a perfected transitional security interest in those goods. The liquidators rejected that claim on the basis that the cleaning equipment had vested in Swan Services.
77. The main method of perfecting a security interest is to register the interest on the PPSR. However, transitional provisions of the Act provided an automatic perfection of transitional security interests for two years. The question for the Court's determination in this case was whether Central Cleaning had a transitional security interest in the goods it supplied to Swan Services.
78. A 'transitional security interest' is defined⁵ to mean a security interest provided for by a 'transitional security agreement' if, in the case of a security interest arising at or after 30 January 2012:
- (a) the transitional security agreement as in force immediately before 30 January 2012 provides for the granting of the security interest; and
 - (b) the Act applies in relation to the security interest.
79. A 'transitional security agreement' is defined⁶ as a security agreement that is in force immediately before 30 January 2012, and that continues in force at and after that time.

⁵ s 308

80. A 'security agreement' is defined⁷ to mean:
- (a) an agreement or act by which a security interest is created, arises or is provided for; or
 - (b) writing evidencing such an agreement or act.
81. The Court referred to the Replacement Explanatory Memorandum to the Personal Property Securities Bill 2009 (**Memorandum**) which stated that the legislation would apply to security interests existing before the legislation came into operation with the transitional provisions generally allowing security holders to maintain their existing priority and preserve their rights for 24 months from the time the Act commenced.
82. The Memorandum also provided that "A security agreement would be able to expressly provide for ongoing supplies and therefore result in a series of security interests...Where there is no formal agreement providing for ongoing supplies, generally each supply would be considered to be a separate contract or security agreement..."
83. The court found that in this case, a transitional security agreement between the supplier and its customer had come into effect when the first supply (purchase order and acceptance) was made pursuant to the signed credit application. The court's conclusion is in the final paragraph of the judgment as follows [emphasis added]:
- 'On this view, an agreement came into force — at the time of the first supply of equipment — which did 'provide for the grant of' a security interest in relation to all future supplies of equipment. That agreement was a 'transitional security agreement', and each of the security interests granted in respect of equipment supplied subsequently was a 'transitional security interest'. Central is therefore able to enforce the ROT clauses notwithstanding the absence of registration.'*
84. The decision of the Court of Appeal is in effect that a signed pre-PPSA credit application and attached terms become a transitional security agreement when the first supply is made under them, thereby creating an ongoing and 'over-arching' agreement that can 'provide for' all future supplies that are subsequently made. This contract can be said to be 'in force' before the commencement of PPSA.
85. In the early days of PPSA, and before the decision in *Central Cleaning*, some hire businesses and retention of title suppliers took the precautionary approach of making both a transitional and a non-transitional registration out of abundant caution even if they had pre-PPSA overarching terms and conditions agreed already. However, the sting in that approach was that a non-transitional registration attracted a registration fee and the amount could be significant for a business with a large customer base. Some businesses therefore decided only to make transitional registrations. In doing so they ran the gauntlet of section 337A of the Act. In simple terms this provides that a registration that states that the interest is transitional is ineffective to protect an interest that is in fact not-transitional.
86. Certainly the *Central Cleaning* decision has been a good thing for those relying solely on transitional agreements and corresponding registrations to protect post-PPSA hires and other supplies. We think the Court of Appeal's reasoning is most tenable and properly reflects the legislation and the Memorandum. The Memorandum

⁶ s 307

⁷ s 10

contains examples which are most supportive of the analysis and these are extracted and referred to in the decision.

87. But how long will it be safe to rely on those (free) registrations? It is inevitable that suppliers will be amending their standard terms from time to time – for example to take account of changes to the law such as the new restrictions on unfair small business contracts. What happens if the standard terms have been amended post-PPSA? We have encountered challenges by liquidators who assert that if there is a change to the standard terms then the security interest loses its transitional status because there is a ‘new agreement’.
88. If the agreement in place pre-PPSA provides for amendment (as typically it does – for example by notice to the customer) it is difficult to see how the analysis in the *Central Cleaning* case supports an attack. The Court in our view accepted the idea that the ‘over-arching’ contract could cover future supplies as long as it was activated by the first pre-PPSA supply.
89. The case suggests to us that the contract can be varied whilst remaining on foot. The concept of an agreement ‘providing for’ hires does not seem to us to require that every contractual term of supply is known at the time of contract. If it did then the outcome in *Central Cleaning* would have been different. That in turn suggests to us that amendment does not negate the over-arching agreement.
90. Certainly this is an area where care is needed. It is easy to imagine that over time some businesses may unwittingly ‘ungrandfather’ their interests – for example by writing to customers in a way that implies a whole new agreement is being entered into, rather than that an existing agreement is being varied.

Doing the deal – searching and registering – what is acceptable practice?

How to register

91. The questions of registering and searching are two sides of the same coin. Effectively, an intending secured party or purchaser/lessee needs to search the identifiers against which a valid registration can be made. The topic is in fact quite complex because the rules about how to identify the grantor for PPSA purposes are complex.⁸
92. It is not always enough just to know how the registration would now be made, but how it could have been validly made or migrated. For example:
 - a migrated PPSA registration coming from the ASIC charges register and made against a company ACN will be effective even if the grantor company is a trustee of a trust with an ABN.⁹
 - a purchaser of a scissor lift needs to search against the collateral class ‘motor vehicle’ as well as ‘other goods’ because a valid registration of a security over that kind of equipment could have been made pre-PPSA in the motor vehicle class up until the change to the Regulation discussed above.

⁸ For a full discussion regarding this issue, see our article *Business Acquisitions and the Personal Property Securities Register (PPSR)*

⁹ *ibid*

The second kind of problem may emerge in other contexts as the Act is amended for the Whittaker Report.

When is it OK to register?

93. Section 161 of the Act provides that a security interest in personal property may be registered before or after:
- (a) a security agreement is made covering that personal property; or
 - (b) a security interest attaches to the personal property.
94. However, despite the ability of a person to make an advance registration in respect of personal property, section 151(1) of the Act limits the circumstances in which it is proper for them to do so. That section provides as follows:
- “(1) A person must not apply to register a financing statement, or a financing change statement, that describes collateral, unless the person believes on reasonable grounds that the person described in the statement as the secured party is, or will¹⁰ become, a secured party in relation to the collateral (otherwise than by virtue of the registration itself).”*
95. The section goes on to impose penalties on individuals and corporations that make registrations in contravention of the section. There is a possibility of a claim for loss by the grantor¹¹.
96. Sections 151(2) and (3) provide some protection for a grantor against the possible adverse consequences of a party making an advance registration against them, by requiring the registrant of the financing statement to remove the registration within five business days if the nominated secured party does not in fact have a security interest from the grantor in respect of the collateral described in the registration, and there are no longer any reasonable grounds for the belief referred to in section 151(1). If a secured party refuses to remove the registration, a grantor may utilise the amendment demand process set out in Part 5.6 of the Act.

Statutory and general law liens – how are they affected by PPSA?

97. Liens can entitle a creditor to hold goods ‘hostage’ until payment has been received for those goods. Many Australian jurisdictions have their own legislation regarding liens and many of those Acts continue in force following introduction of the PPSA. Liens are useful and valuable in terms of the rights and priority that they confer. In certain circumstances, holders of a statutory or general law lien can assert their lien in priority to secured creditors who hold a perfected security interest under the PPSA.
98. Examples of a statutory lien include:
- (a) an unpaid seller’s lien under the *Sale of Goods Act 1923* (NSW); and
 - (b) a warehouseman’s lien under the *Warehousemen’s Liens Act 1935* (NSW).
99. Examples of a general law lien include:

¹⁰ The Whittaker Report recommends this threshold be reduced essentially so that it is enough if the secured party *may* have the interest.

¹¹ s271 for example could be one source of this.

- (a) a possessory lien claimed by, for example, a mechanic who carries out repairs to a motor vehicle and is entitled to maintain possession of that vehicle until full payment for the repairs have been made;
 - (b) a solicitor's lien which allows a solicitor to retain a client's documents until payment of all debts owed to the solicitor by the client;
 - (c) an equitable lien in favour of a purchaser who has paid instalments but not obtained title to property, or a vendor who has conveyed title but not been paid.
100. Section 8(1)(b) and (c) of the PPSA expressly exclude statutory and general law liens respectively from the operation of the Act except in relation to section 73 of the PPSA¹² (discussed in further detail below). However it is important to note that the exclusion of statutory liens under section 8(1)(b) does not apply if:

'the person who owns the property in which the interest is granted agrees to the interest'.

101. Accordingly, it seems that if an owner expressly agrees to a statutory lien, the PPSA can apply to it. If the parties agree to the creation of a statutory lien over the relevant goods, and the PPSA thus applies to that statutory lien this means the interest may need to be perfected and have priority under the normal rules to be relied on.
102. Although section 8(1) of the Act generally excludes liens from the operation of the Act, section 73 of the Act will apply to liens (provided certain requirements are met). Section 73(1) provides that a statutory or general law lien over goods has priority over all security interests in the same collateral if:¹³
- (a) the goods or services provided which gave rise to the lien were provided in the ordinary course of business; and
 - (b) the person who holds the lien provided those goods or services; and
 - (c) no other law provides for the priority of the lien and the security interest; and
 - (d) the holder of the lien did not know that the creation of the lien constitutes a breach of the security agreement that provides for the security interest.
103. In the context of a statutory lien,¹⁴ if the State law giving rise to the lien:
- (a) specifically declares that section 73(2) of the Act applies to statutory interests of that kind; and
 - (b) the statutory interest arises **after** the declaration comes into effect,

then priority is determined by the State law. By way of example, section 4A of the *Storage Lien Act 1973* (Qld) expressly provides that the storer's lien on goods is a statutory interest to which section 73(2) of the PPSA applies and that has priority over all security interests in relation to the goods. Section 3(3) of the *Warehousemen's*

¹² s8(2)

¹³ Note that by virtue of s73(1)(a)(i), a statutory lien will fall within the ambit of the PPSA if the person who owns the collateral in which the lien is granted, agrees to the lien

¹⁴ see s73(2)

Liens Act 1935 (NSW) similarly provides that section 73(2) of the PPSA applies to a warehousemen's lien.

104. Section 73 could operate as follows on a general law lien:

Sam's Semis Transport Co finances its trucks through a facility provided by a finance company. The finance company has registered its security interest in the vehicles. The finance agreement states that Sam may not allow any other interests to arise in the trucks. Sam delivers one of the vehicles to Bill's Motors for some repairs but does not pay the repair cost. Bill is vaguely aware that some of Sam's vehicles could be 'on finance', but is not aware of the terms of any securities. Bill's repairer's lien over the trucks will have priority over the finance company's interest.

105. Similarly, in the context of a statutory lien, section 73(2) could operate in conjunction with State law as follows:

ABC Pharmaceuticals acquires goods from Manufacturing Co. Those goods are subject to retention of title terms. Manufacturing Co registers its security interest in the stock and its terms of trade prohibit ABC Pharmaceuticals from creating, or permitting to be created, other interests in the goods. ABC Pharmaceuticals does not have sufficient storage facilities and so stores those goods with Joe's Storage Co for a fee. ABC Pharmaceuticals goes into liquidation. It has not paid for the goods acquired from Manufacturing Co, and has not paid the storage fees owing to Joe's Storage Co. Joe has a warehouseman's lien in respect of the goods arising under the Warehousemen's Liens Act.

106. The provisions of the Warehousemen's Liens Act relevantly provide as follows:

Warehouseman shall mean a person lawfully engaged in the business of storing goods as a bailee for hire.

3 Declaration of warehouseman's lien

- (1) every warehouseman shall have a lien on goods deposited with him or her for storage...
- (2) A warehouseman's lien over property has priority over any other interest in the property and may be enforced accordingly.
- (3) Section 73(2) of the Personal Property Securities Act 2009 of the Commonwealth is declared to apply to a warehouseman's lien.

107. Joe's warehouseman's lien will it seems have priority over Manufacturing Co's security interest. The state of Joe's knowledge does not seem to matter.

Accessions, processed or commingled goods and proceeds – does the security attach?

108. This is an area where the PPSA has brought about a considerable strengthening in the rights of owners, sellers and lenders.

Accessions

109. Security interests in accessions to personal property are dealt with in Part 3.3 of the Act. Under the Act, an 'accession' 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 regulations to be described by a serial number. The general rule is that a security interest in goods that become an accession to other goods continues in the accession¹⁵.
110. The Act contains detailed provisions governing priority interests in accessions and the obligations on a secured party as to their removal. The default priority rule is that a security interest in goods 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.
111. However, there are exceptions relating to interests in the whole created after the accession is affixed and before the security interest in the accession is perfected. For example, a security interest arising in an accession after it is affixed will ordinarily be subordinate:
- (a) to an existing interest in the other goods (unless, for example, the holder of the existing interest agrees otherwise); and
 - (b) to a later interest in the other goods that arises before the interest in the accession is perfected.

Processed or commingled goods

112. Security interests in processed or commingled goods are dealt with in Part 3.4 of the Act. The Act also allows for the continuation or tracing of a security interest into a product or mass.
113. The general rule is that 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.
114. For the purposes of section 55 of the Act (default priority rules), perfection of a security interest in goods that subsequently become part of a product or mass is to be treated as perfection of the security interest in the product or mass.
115. Any priority that a security interest continuing in the product or mass has over another security interest in the same product or mass is limited to the value of the goods on the day on which they became part of the product or mass.
116. The default priority rules in relation to processed or commingled goods are set out in section 102 which generally provides as follows:
- (a) a perfected security interest continuing in a product or mass has priority over an unperfected security interest continuing in the same product or mass;
 - (b) if there is more than one perfected security interest continuing in the same product or mass, each perfected security interest is entitled to share in the

¹⁵ s 88

product or mass according to the ratio that the obligation secured by the perfected security interest bears to the sum of the obligations secured by all perfected security interests in that product or mass;

- (c) if there is more than one unperfected security interest continuing in the same product or mass, each unperfected security interest is entitled to share in the product or mass according to the ratio that the obligation secured by the unperfected security interest bears to the sum of the obligations secured by all unperfected security interests in the same product or mass.

117. Notwithstanding the default priority rules noted above, a perfected purchase money security interest (PMSI) in goods that continues in the product or mass has priority over:

- (a) a non-PMSI in the goods that continues in the product or mass; and
- (b) a non-PMSI in the product or mass given by the same grantor.

Proceeds

118. If 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 otherwise¹⁶. The security interest also continues in the collateral (although subject to the extinguishment rules).

119. 'Proceeds' is extensively defined in section 31 of the Act, and means identifiable or traceable personal property of the types that include:

- (a) personal property derived directly or indirectly from a dealing with the collateral;
- (b) a right to an insurance payment or other payment as indemnity or compensation for loss of, or damage to, the collateral;
- (c) if the collateral is intellectual property, in addition to any other proceeds, the right of a licensor of the property to receive payments under any licence agreement in relation to the collateral.

120. Under section 32(5) for the purpose of the priority rules, the time of perfection of the original security interest is also the time that the interest in the proceeds is deemed perfected. This means that the security interest in proceeds should have the same priority as the original security interest.

121. However one common exception to this is if the grantor has given security over its accounts (for example to a factoring company) and that other secured party has given a notice under section 64, it will have priority over the accounts and proceeds of them. Section 64 was necessary as otherwise the supplier of goods on retention of title could use the proceeds provisions in the PPSA to trump receivables financiers in respect of receivables arising from the sale of inventory.

122. The rights to proceeds, accessions and processed and commingled goods under the Act enhance the return to financiers and retention of title suppliers and hire businesses. This is particularly so in customer insolvencies as tracing into proceeds,

¹⁶ s 32

other goods or a product or mass was problematic to varying degrees under the previous law. That is not to say that the issues are straightforward. For example, the problem typically encountered by a secured party will be that it needs to identify that its collateral gave rise to given proceeds. It then needs to demonstrate that the proceeds are still traceable, usually meaning still in the hands of the insolvent customer. There will often be difficult factual issues of identification and forensic accounting. Insolvency practitioners, who often look to available cash, debtors and stock to fund their administrations are often not exactly falling over themselves to assist secured parties in these circumstances!

123. The general law has developed a substantial body of case law regarding the extent to which a person can trace an interest in their property into proceeds, or into other property that is substituted for their property. Tracing at general law is principally an equitable remedy. The law is generally understood to require a fiduciary relationship as a pre-condition to tracing. The PPSA does not require a fiduciary relationship¹⁷, and proceeds are traceable whether or not there is a fiduciary relationship between the person who has a security interest in proceeds and the person who has rights in or has dealt with them. It remains to be seen how the Courts will apply tracing principles to proceeds under the PPSA.

Update on the reforms recommended by the Whittaker Report

124. The Government is still considering the report of the Whittaker review into the PPSA, although an exposure draft of an amending Bill is said to be in the offing. The Report was tabled in March 2015 and contained 394 recommendations - so an account of those is obviously well beyond this paper.
125. Some of the Whittaker Report's conclusions we think are worth noting here are as follows:
- the register itself would be greatly simplified as the Report acknowledges that many of the questions it asks are unnecessary and confusing.
 - the PMSI box would no longer be part of the register.
 - section 588FL of the Corporations Act and its associated provisions would be repealed.
 - registrations would no longer be made against trust ABNs.
 - the definition of 'PPS lease' would no longer refer to 'bailments'.
 - the vesting rule in section 267 would no longer apply to PPS lease security interests. However the Report does not propose to remove the priority rules from PPS leases. Accordingly owners will still be exposed to loss of their property to banks and other general security holders where there happens to be a security with better priority.

For more information, contact:

¹⁷ s 31(2)



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