

# Personal property securities - new rules of the game

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## Background

### What is the PPSA?

In Australia, there are more than 70 Commonwealth, State and Territory Acts which regulate personal properties security. Over the last few years the Federal Government has been developing the *Personal Properties Securities Act 2009 (PPSA)* to create a legislative regime which will simplify and unify these various laws, providing a 'one stop shop' via a single online register.

All forms of security interests over property, other than land and certain rights or entitlements granted under Commonwealth or State Law (such as water rights<sup>1</sup>), will be governed by the new legislation. This includes charges over company assets, security arrangements over motor vehicles, finance leases of plant and equipment, chattel mortgages, retention of title arrangements and factoring of book debts.

Individuals are able to offer as collateral any item of personal property. Businesses can offer machinery, inventory and accounts receivable, crops and livestock as collateral. Intangible assets such as intellectual property and contractual rights will also be able to be used.

### When is it coming?

The Act was passed in Parliament on 26 November 2009, although

the introduction of the legislation has been delayed until May 2011.

The Bill's passing requires a referral of power from the State Governments to the Commonwealth. The *Personal Property Securities (Commonwealth Powers) Act 2009* was assented to by the Queensland Parliament on 22 September 2009. New South Wales passed similar legislation in June 2009. All other jurisdictions have passed or are passing equivalent legislation, as agreed under a COAG<sup>2</sup> agreement.

The PPSA will result in fundamental changes to the law governing personal property securities in Australia. It is important to understand that we will be moving away from a regime where legal title is paramount in determining priority in secured collateral. Instead, attachment and perfection will determine priority.

## Key concepts

### Requirements for enforceability of personal property security

The PPSA relies on the concepts of attachment and perfection in determining when a security interest has been created over property. For a personal property security to be enforceable against the grantor, the security interest must **attach** to the personal property being offered as collateral.

The interest must then be **perfected**, to allow a secured party to obtain **priority** against third parties in relevant circumstances. (*The Northern Territory Government will shortly be introducing legislation*).

### Attachment

A security interest is only effective if it has attached to collateral under section 19. The Explanatory Memorandum defines 'attachment' as *'the creation of a security interest in personal property which could be enforced against that property'*.<sup>3</sup>

A security interest attaches to personal property when the necessary steps for its creation have taken place. These include the secured party being given value, the grantor or debtor having a transferrable interest in the collateral, and the debtor agreeing to a security agreement under the PPSA, or the secured party actually holding the collateral.

### Perfection

The Explanatory Memorandum defines 'perfection' as:

*'A security interest could be perfected by registration, possession, control or temporary perfection and perfection would always confer priority over unperfected security interests in collateral.'*<sup>4</sup>



Perfection is essentially the process by which the security holder is given priority over other claimants to the collateral under the PPSA priority rules. Section 21 PPSA outlines the main rule regarding perfection.

A security interest is perfected if it is attached, and the relevant agreement has been registered on the PPSR or the secured party has possession or control of the collateral, other than by repossession.

### Priority

The new legislation sets up default rules regarding the priorities of competing security interests in section 55. In summary:

- where there are two unperfected securities in the same collateral, priority is determined by order of attachment;
- a perfected security has priority over an unperfected security in the same collateral; and
- where there are two currently perfected securities in collateral, priority is determined by the order in which the priority time for each interest occurs.

Section 55(5) PPSA defines the priority time for a security interest as the earliest of the registration time for the collateral, the time the security party first takes possession of the collateral or the time the

security interest is perfected by the Act.

A time only remains a priority time for a security interest if once the interest is perfected, it remains continuously perfected.<sup>5</sup> A security interest is continuously perfected after a particular time if the security interest is, after that time, perfected pursuant to the PPSA at all times.<sup>6</sup>

## Enforcement and Remedies

### The PPSA is not a code

The Explanatory Memorandum provides that the PPSA does not intend to codify the rights, duties and obligations of parties to a security agreement, as the parties are at liberty to negotiate their own contractual terms, subject to the provisions of the *Consumer Credit Code*, to the extent that the legislation can operate concurrently.<sup>7</sup>

### Enforcement generally

Chapter 4 of the PPSA governs the enforcement of security interests.

Any secured party, regardless of priority, will be able to commence enforcement action under the legislation. This enables secured parties to negotiate between themselves regarding enforcement. Higher ranked secured parties will, however, be able to protect their interests by obtaining possession of collateral

from a lower ranked enforcing party.

Enforcement under the PPSA does not require secured parties to obtain judgment against a debtor before exercising rights against secured assets. It is important to note, however, that the PPSA does not diminish the rights and remedies available to parties by virtue of the security agreement itself or any Commonwealth or State or Territory Law or the rule of law or equity.<sup>8</sup> The rights conferred by the PPSA can be used in conjunction with any other rights or remedies available to a secured party.

The enforcement provisions do not prevent persons with an interest in secured property, other than a security interest, from enforcing their rights through court proceedings.

### Chapter 4 Exclusions

Chapter 4 does not apply to all security interests. In particular it does not apply to:

- security interests in goods located outside of Australia;
- a transaction that does not secure the payment or performance of an obligation; or
- where a party has perfected its security interest in an investment entitlement by taking possession or control.<sup>9</sup>



The PPSA does not apply to property of a business subject to a receiver or controller appointed under part 5.2 of the *Corporations Act 2001*.<sup>10</sup> Interestingly, this exclusion does not appear to extend to liquidators or administrators. Priority does not appear to come to an end because of insolvency or bankruptcy.

#### Part 4.2 – Important rules regarding enforcement

Section 108 PPSA sets out the important rules regarding enforcement. These are:

- a general standard of honesty and commercial reasonableness is to apply to enforcement actions;<sup>11</sup>
- parties can contract out of specified provisions dealing with enforcement;<sup>12</sup>
- if the same obligation is secured by both personal property and an interest in land, a secured party may enforce the personal property interest in the same way as the interest in the land, or enforce the security pursuant to the provisions of Chapter 4;<sup>13</sup> and
- rules for the enforcement of security interests in certain liquid assets (accounts, chattel paper and negotiable instruments) provide that a secured party may seize proceeds or send a notice requiring payment.<sup>14</sup>

## The New Zealand experience

### International influence

The PPSA was modelled on New Zealand, Canadian and US legislation. It also draws on the United Nations Commission on International Trade Law (UNCITRAL) and the International Institute for the Unification of Private Law (UNIDROIT).

### Personal Property Securities Act 1999

The *Personal Property Securities Act 1999* (PPSANZ) came into force in New Zealand in May 2002. As with the PPSA, it established a new priority regime for competing interests reliant on concepts of attachment and perfection rather than traditional notions of legal title.

New Zealand has experienced a radical overhaul of the law relating to personal property securities as a result of this legislation. This is evident from High Court decisions, the outcome of which could conceivably occur under the new Australian legislation.

### *Graham v Portacom New Zealand Ltd* [2004] 2 NZLR 528

In this matter, the debtor (NDG Pine Limited) gave a security interest over all its property to HSBC to secure a loan.

When the PPSANZ came into force, HSBC registered its interest on the PPS Register (PPSR). Portacom New Zealand Limited leased five portalooos to NDG, but did not register its interest on the PPSR. Portacom retained legal ownership of the portalooos throughout the course of the lease. NDG fell into default and HSBC appointed a receiver which took possession of NDG's property, including the five portalooos. The receiver asserted its right under the PPSANZ to take possession and sell the portalooos.

The Court held that all assets of NDG were charged under the agreement, including the leased portalooos, as it is possible to grant a security interest in leased property. HSBC was therefore entitled to enforce its security interest in preference to Portacom, even though Portacom retained legal ownership of them.

### *Waller and Ors v New Zealand Bloodstock Limited and Anor* [2005] 2 NZLR 549

Glenmorgan Farm Limited gave a general security interest over all of its property in favour of S H Lock Limited. S H Lock registered its interest on the PPSR when it came into existence.

New Zealand Bloodstock Limited leased a racehorse to Glenmorgan, however, retained legal ownership of the racehorse. New Zealand Bloodstock did not register its interest.



Glenmorgan defaulted and New Zealand Bloodstock terminated the lease and repossessed the horse. Glenmorgan then defaulted under its finance agreement with S H Stock and a receiver was appointed. The receiver asserted its right under the PPSANZ to take possession of and sell the horse in priority of New Zealand Bloodstock's claim.

The Court applied the *Portalo* case and held that the leased horse was included in the collateral charged to S H Lock and that Glenmorgan could pass good title to the leased horse, even though it did not have legal title itself.

The Court further held that the termination of the lease and repossession of the horse by New Zealand Bloodstock did not improve its legal position. Taking possession by way of seizure did not perfect the security interest in the collateral.

In this case, the Court was required to determine the priority of competing security interests in the same collateral (the horse). SH Lock had a security interest in the horse by virtue of the security agreement and had perfected that interest by registration on the PPSR. New Zealand Bloodstock had a security interest in the horse by virtue of the lease but had not perfected that interest by registration, so in essence, the perfected security was found to take priority over the unperfected security.

### Lessons from New Zealand

The New Zealand experience demonstrates that under the PPSA, actual ownership or legal title to goods may become irrelevant. The essential requirement for successful enforcement may be prior registration on the PPSR.

Therefore, suppliers of goods by way of lease or hire purchase who retain legal title must protect their property by registering their security interest on the PPSR.

### Transitional provisions in the Australian PPSA

The transitional provisions which have been incorporated in the PPSA may alleviate the risk of a Portacom or NZ Bloodstock situation occurring in Australia.

After the commencement of the PPS legislation, any non-migrated security interest (an interest not transferred across from a pre-existing register), will be deemed 'temporarily perfected' for the period starting immediately before the registration commencement time and ending at the earlier of the following times:

- the time when the security interest ceased to be continuously perfected otherwise than by temporary perfection; or
- the end of the month that is 24 months after the registration commencement time.<sup>15</sup>

After the 24 month transitional period ends, the priorities will be determined under the substantive provisions of the legislation.

### Conclusions and recommendations

The PPS legislation is going to have a dramatic impact on the way business is conducted in Australia, particularly in the area of securities and lending. Its introduction is imminent and it is essential that all business people, as well as their legal and accounting advisers, take the time to understand this very important piece of legislation.

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#### Footnotes:

1. Tradeable water rights or water access entitlements within the meaning of the Water Act 2007 (Cth) will be excluded.
2. Council of Australian Governments
3. Explanatory Memorandum Personal Properties Security Bill 2009 (2008-2009) at page 6.
4. *ibid* at page 9.
5. Section 55(6).
6. Section 56.
7. Section 254(1).
8. Section 110.
9. Section 109.
10. Section 116.
11. Section 111.
12. Section 115.
13. Sections 117 and 118.
14. Section 120.
15. Section 322.