

PERSONAL PROPERTY SECURITIES ACT 2008

BACKGROUND AND KEY CONCEPTS

KINGSTON CEO ROUND TABLE

Introduction

In October 2011 a series of legislative reforms will take effect in Australia. The key legislation is the Personal Property Securities Act 2008 (Cth) (“the PPS Act”).

The PPS Act and associated legislation has been in development for years. It is complex and thoroughgoing legislation which will have a significant impact upon the general business community both in the short term and also in the long term.

Any business that supplies goods (by way of sale, or by way of lease or on consignment) faces the risk of suffering significant loss if it does not come to grips with the PPS Act and takes appropriate steps to protect its rights.

Likewise, businesses that do make effective use of the Registrar to be established under the PPS Act should realise benefits because they will be better able to enforce rights over personal property in ways that have not previously been possible.

What is personal property?

The use of the word “Personal” in this context confuses many people.

Real property is generally understood in law to mean an interest in land such as a freehold interest, leasehold interest or mortgage interest. There are other categories of real property.

At law, personal property is any form of property other than land, buildings or fixtures which form part of that land.

In the business context personal property includes such items as:

- Motor vehicles;
- Plant and equipment;
- Machinery and crops;
- Intellectual property;
- Contract rights;
- Art;
- Livestock;
- Inventory.

Security Interest

In this context, a security interest is an interest in personal property that in substance secures payment of a debt or other obligation regardless of the form of the transaction.

In everyday commerce at present there are multiple ways by which a security interest in personal property might be created. They include:

- A mortgage over a motor vehicle that might be noted on an encumbrance register;
- A charge over company property that might be the subject of a registered charge with ASIC;
- A retention of title clause in a sale agreement whereby the purchaser has possession but the vendor retains title until the full price is paid;
- Financing leases where personal property is leased for payments that cover the cost;

- Goods supplied on consignment pending sale.

Problems with the current system

The current law in Australia regarding personal property securities has developed State by State and Territory by Territory. It is an ad hoc patchwork of legislation and registers.

Over the eight State and Federal jurisdictions within Australia there are at present 70 Acts of Parliament, some 25 separate government departments and three ministerial councils. Much of the current law goes back to legislation in England in the 1800's.

The key problems with the current arrangements are as follows:

- There is incomplete coverage. It is just not possible to register a security interest over some classes of property;
- Overlapping legislation. Sometimes the security interests must be noted in more than one register with the consequence that there can be confusing priority issues;
- Movement of property and security providers creates difficulties across multiple jurisdictions when either the property moves or the security provider moves. Sometimes the need to obtain appropriate protection means that registration in each different jurisdiction becomes necessary;
- There is a focus on form rather than substance. Security interest with different names have a different legal history even though they perform the same economic function;
- Confusing registration requirements;
- Cumbersome and expensive registration requirements.

The net consequence of the current arrangement is a confusing, complex and expensive regime. It increases the operating costs for users, both borrowers and lenders. Lenders and purchasers often have no simple means of checking whether property is unencumbered.

The lack of a simple and transparent regime to identify priority interests leads to dispute and litigation. All of this discourages lenders from lending on the security of personal property.

Economic benefits of change

In 2006 the Australian Attorney-General's Department commissioned Access Economics to investigate a report on the potential costs and benefits of reform to the current arrangements dealing with personal property security interests.

In a report published in 6 July 2006 Access Economics concluded that significant benefits and economies would be achieved by a uniform, national register for personal property securities interests provided that it met these requirements:

- It should be simple to create and register a security interest at low cost;
- It should establish a system where the security interests of parties were very clear;
- It should cost little to enforce security interests;
- It should operate as an effective commercial tool for lenders, given cost and other savings.

Access Economics referred to the experience in New Zealand where the adoption of a new and simpler regime has been effective. It concluded that the cost of debt to a business would be reduced to the extent that unsecured lending is replaced by secured lending, given that margin is reflective of risk.

Access Economics also noted that according to industry sources in New Zealand and Australia the reduction in the lending rate for a loan secured by personal property (in contrast to an unsecured loan) is likely to be in the range of 3% - 4%. That differential was thought likely to increase if the loan was secured by real property. However, bear in mind that the Access Economics report was prepared prior to the Global Financial Crisis.

What does the PPS Act do?

At the basic level, the enactment of the PPS Act will establish:

- A single, national, electronic register (or public record) of “Security Interests” in personal property;
- A new rule-based system to determine priorities between competing security interests. In other words rules to determine whose interest prevails when two or more security interests relate to the same item of personal property;

The new register will be managed by ITSA, the Insolvency and Trustee Service Australia, which until now has been primarily concerned with bankruptcy matters.

The Commonwealth Government does not have power under the Australian Constitution to deal with personal property legislation and so most of the States have enacted or will soon enact legislation to refer their own constitutional powers to the Commonwealth. Victoria has already done so.

Collateral

The PPS Act will apply to almost all personal property. However there are some very limited exceptions which include:

- A lien arising by operation of law, mainly concerned with the rights available to lawyers over a file or the proceeds of litigation, the rights of a repairer, the rights of someone holding goods in storage;
- Certain State based “Statutory Rights” (or licences or permits) such as taxi licences, gambling licences, racing licences, fishing licences and various mining/exploration licences or leases, unless the State agrees and
- Water rights.

Personal Property is to be treated as “collateral” if a security interest is attached to it.

The legislation also draws a distinction between consumer property (not associated with the furtherance of an enterprise) and commercial property (meaning any property that is not consumer property).

Likewise, there is a distinction drawn between inventory and non-inventory goods.

There are special rules that apply to “property that must be described by serial number”. Regulations to be made under the PPS Act will define such property to be:

- Motor Vehicles
- Water craft;
- Aircraft; and
- Certain Intellectual Property rights for which there is an established regime for allocation of a serial number or registration number. For example these include registered designs, patents, plant breeder rights, trademarks and so on.

Security Interest

Put simply, there are two ways for a “secured party” to obtain a “security interest” over “collateral”. This can be done by agreement or by the mere application of the PPS Act.

If an agreement in relation to personal property secures payment or performance of an obligation it will give rise to a security interest. It does not matter what title the agreement bears provided that there is an operative clause to that effect.

Some examples of the sorts of agreements that give rise to a security interest are:

- A charge;
- A chattel mortgage;
- A conditional sale agreement (including an agreement to sell subject to retention of title);
- A hire purchase agreement;

- A consignment of goods; and
- A lease of goods (whether or not it gives rise to a “PPS Lease” – see below)

In the interest of simplicity the PPS Act adopts a functional approach. It is the substance of the transaction that is all important rather than the title that a document or agreement may bear.

Beyond a security interest created by agreement, certain transactions are deemed by the PPS Act to give rise to a security interest. This is so regardless of whether the transaction in substance secures payment or performance of an obligation. Some notable examples include:

- A commercial consignment of goods; and
- A PPS lease.

PPS Lease

The concept of a “PPS Lease” created by the PPS Act is important. The key components of a PPS Lease are:

1. It covers both leases and bailments. In a commercial sense a bailment is the act of delivering goods or personal property to another in trust.
2. Generally (subject to point 3), the lease or bailment must be for more than one year (including options to renew). Alternatively, if the lessee or bailee retains substantially uninterrupted possession of the goods for one year or more, it will be deemed to be a PPS lease regardless of what the terms say;
3. For “serial numbered goods”, the lease or bailment (including options to renew) need only be 90 days for the lease or bailment to be a “PPS lease”. Alternatively, if the lessee or bailee retains substantially uninterrupted possession for 90 days or more, it will be a PPS lease;

4. Leases or bailments of any type of goods for an indefinite term will be caught by the definition;
5. The lessor or bailor must be engaged in the business of regularly leasing or bailing goods;
6. For bailments, the bailee must provide value. Thus a purely gratuitous loan of goods will not be caught.

Currently, it is likely that many businesses that provide personal property on hire or lease or even bailment, will do so for an indefinite term. Some examples that come to mind are drink refrigerators in convenience stores, coffee machines provided by coffee suppliers and so on. Unless such businesses adjust their terms of trade and business processes and/or register security interests, they risk having a deemed by unperfected security interest because the PPS Act deems them to be a lessor under a PPS Lease. They are at risk of losing their property entirely if a lessee or bailee becomes insolvent.

Secured Party and Grantor

To avoid the multiplicity of previous formats the PPS Act aims to adopt consistent terminology so as to simplify the arrangements.

In the new parlance, whenever a “security interest” is created there will be a “grantor” and also a “secured party”.

Generally it will be obvious in a transaction which is which. Thus it is obvious that when a bank lends money to a borrower and the borrower provides security for the loan it is the borrower that is the “grantor” and then bank is the “secured party”.

However, in other transactions the characterisation of the parties is not so straightforward.

An important example is when a supplier sells goods subject to a retention of title clause. In that instance it is the customer (who has possession) who is the grantor of a security interest and the supplier who becomes the secured party. That is so even if under the contract between the parties it is stated expressly that the supplier retains title and even though it is expressly stated that the customer does not get title to goods until they are paid for.

This arrangement is at odds with conventional thinking but it is how the PPS Act operates.

The same concepts apply with a lease or bailment arrangement. Effectively it is the party in possession that becomes the grantor and the other party becomes the secured party.

Attachment and Perfection

The PPS Act features key concepts concerned with attachment and perfection.

Put simply, a secured party will only be able to enforce its security interest against the grantor in respect of particular collateral when the security interest can be said to have “attached” to the collateral.

In the more common arrangements involving SMEs the PPS Act provides that a security interest attaches to goods when the grantor acquires rights in collateral. This is when a purchaser, a lessee or a bailee obtains possession of the goods.

Attachment is the first step. Perfection is the second step.

A secured party will generally perfect its security interest by:

- Making sure there is a written agreement that is signed or otherwise accepted by the purchaser, lessee or bailee; and
- Registering a financing statement on the PPS Register.

Financing Statement

A “secured party” should perfect its “security interest” by registering a “financing statement” on the Register. The financing statement must contain information about the parties, the type and class of collateral and, in some cases, the serial number.

There is no need to register the actual document or agreement that gives rise to the security interest. The financing statement by itself is sufficient.

Priority Rules

The PPS Act sets out basic rules to determine whose security interest prevails. These are the basic rules:

- A perfected security interest has priority over an unperfected security interest;
- Priority between perfected security interests is determined by the order of perfection;
- Priority between unperfected security interests is determined by the order of attachment;
- A perfected Purchase Money Security Interest or PMSI (dealt with below) has priority over perfected security interests.

So in essence the priority for a business owner should be to register the security interest as soon as possible as this achieves perfection and thus priority over later registered security interests.

Purchase Money Security Interest

This is a special interest created under the PPS Act which enjoys “super priority” over other types of security interests. It is for the protection of both suppliers of goods and lenders who finance the acquisition of specific assets. It is only available for certain security interests as follows:

- A security interest which secures all or part of the purchase price for the relevant collateral (e.g. sale by retention of title);
- A security interest which is taken by a financier who finances the purchase of collateral;
- The security interest of a lessor or bailor of goods under a PPS lease;
- The security interest of a consignor of goods under a commercial consignment.

To achieve this super priority a PMSI must be perfected (i.e. registered) within very strict time limits.

This category of super priority is important for the protection of suppliers of goods in circumstances where an earlier lender, typically a bank, will have provided finance and taken a security interest over “all present and after acquired property” of the borrower. In the absence of this super priority arrangement the goods supplied under a retention of title arrangement, lease or by way of bailment might have been caught up with the bank’s security interest.

Proceeds and Accessions

A business that does not register its security interest is at risk of losing its property or having its security interest invalidated. Conversely, a business that does register its securing interest will be better able to enforce its security interest in new ways.

For example, the PPS Act will allow a secured party to trace its security interest into the proceeds of sale (or other disposal) of the collateral. Thus, for example, if a supplier sells goods on the basis of a retention of title clause and protects its interest by registration and the customer then on sells those goods, the original supplier will have a security interest in the customer’s book debt in relation to that on sale or the proceeds of sale. This will be a benefit to suppliers of products where a retention of title clause has until now been more or less impractical. For example, a supplier of concrete or raw materials has little to gain from a retention of title clause but will now be better secured.

The PPS Act also introduces the concept of accession. For example, if a business supplies an item of plant and equipment such a motor that is subsequently installed in a truck an accession occurs. The PPS Act provides that a security interest in goods that become an accession to other goods continues in the accession. So in the example given, the supplier of the motor under retention of title clause will have a security interest in the motor even though it is now installed in a truck. Depending on the circumstances it may also have priority over a person with an interest in the whole truck.

Taking property free of security interest

The rules about priority are most likely to be relevant when the grantor of a security interest has become insolvent.

There is preservation of some protection for bona fide purchasers at arm's length that notice. The PPS Register of course gives notice.

One of the rules under the PPS Act provides that a buyer or lessee of personal property for value takes the personal property "free of any unperfected interest in the property", provided that the buyer or lessee was not a party to the transaction that created or provided for the unperfected security interest. Of course, if the security interest is perfected by notification on the register then the buyer or lessee cannot obtain a good title. This makes clearer the benefit for a business of protecting its security interests by registering financing statements.

Personal Property Security Register

The PPS Act will establish the PPS Register. It will be a single, national online register. Parties with a security interest will be able to use the register to search for and register security interests in personal property. It will replace the existing multiple State and Territory registers.

As part of the transitional arrangements, current information on the State, Territory and Commonwealth registers will be migrated to the new PPS register.

Things to do

The PPS Act introduces significant changes to the ways we do business. Here are some of the important things that business owners should prioritise:

- Review and amend standard documents. If goods are supplied on credit, on consignment or by lease or hire make sure that the standard documents are amended so as to embrace the provisions of the new legislation;

- Review structural documents like shareholder agreements or division 7A loan agreements to make sure they include security provisions with respect to personal property;
- Develop template financing statement templates and lodging protocols;
- When banking facilities fall due for review, arrange a discussion about interest rates. You may be able to negotiate more favourable terms if you can offer better security over personal property;
- When purchasing goods or a business always check the security register;
- Routinely monitor security registrations against your own business to make sure that only valid security interests are being registered;
- Review asset protection strategies as more assets may be at risk of being attached pursuant to a security interest;
- Critically appraise your business to identify whether the PPS Act applies to you;
- Review all future supply agreements and banking agreements as they are likely to include new security arrangements under the PPS Act

Checklist

With permission from Pitcher Partners I have attached that firm's a checklist and flowchart that might be useful.

Resources

Many of the larger legal and accounting firms have already published extensively on the PPS Act. However, the most comprehensive information is on a dedicated website set up by the Federal Government at:

www.ppsr.gov.au.

On that website you will find lots of information sheets, FAQs, newsletters and so on.

Disclaimer

This paper is intended to provide a summary only of the provisions of the PPS Act. The Act and associated legislative enactments provide for a complex new regime. Accordingly, this paper should not be relied upon as a substitute for professional advice as the circumstances of each reader will vary and the implications of the PPS Act likewise.

Acknowledgment

In the drafting of this paper the writer acknowledges:

- the report by Access Economics Pty Ltd for the Australian Attorney-General's Department entitled "The Costs and Benefits of Personal Property Securities (PPS Reform);
- a publication by the Legal Practitioners Liability Committee entitled "Personal Property Securities Act 2008 (Cth) Background and Key Concepts"

Author

This briefing paper was prepared by:

Anthony Burke
Burke & Associates Lawyers Pty Ltd
1127 High Street, Armadale
03 9822 8588
tony@burkes-law.com

as well as being principal of the firm, Anthony Burke is:

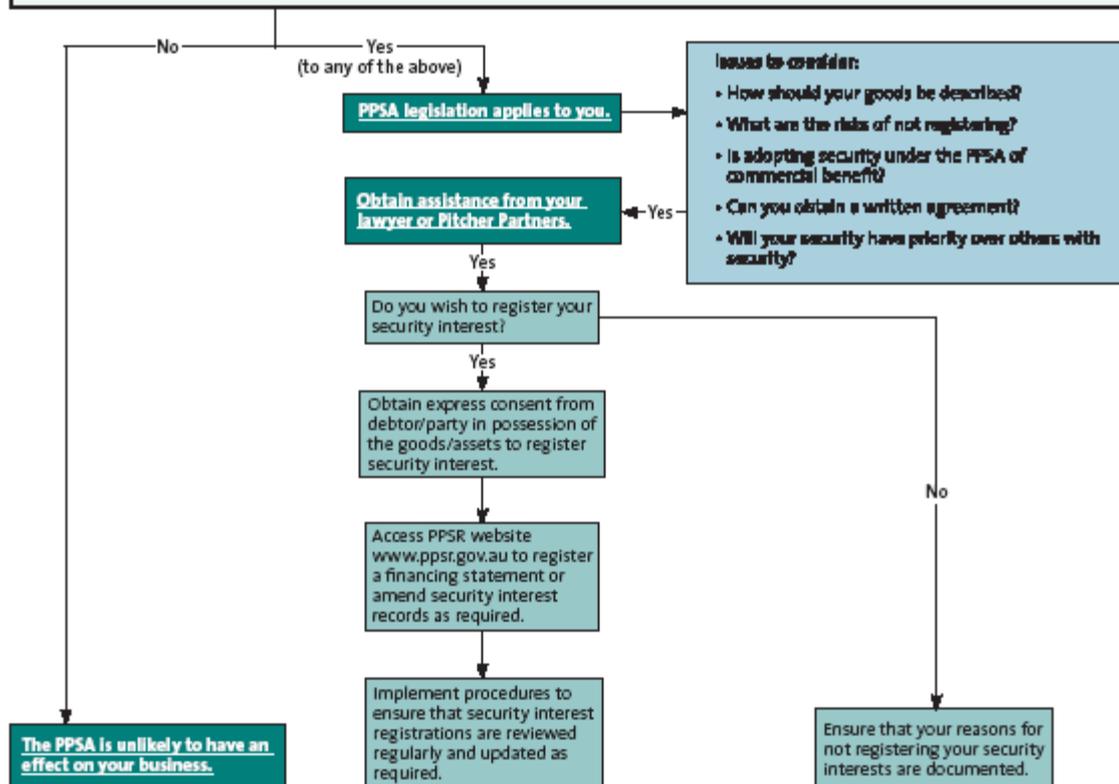
- the inaugural Chair of the SME Business Law Committee of the Law Council of Australia;
- a former President of the Law Institute of Victoria;
- a former Director of the Law Council of Australia;
- a member of the Australian Institute of Company Directors;
- an Accredited Business Law Specialist

DOES THE PERSONAL PROPERTY SECURITIES LEGISLATION AFFECT YOU?

Personal Property Securities Act (PPSA)

The Personal Property Securities Act 2009 was passed on 14 December 2009 that will make wholesale changes to the registration of security interests in personal property. The Act is expected to commence from October 2011. Many businesses will not be aware that the legislation will radically change the notion of legal title to assets. For those who do not understand how the legislation will affect them, their assets will be at risk.

Do you:	YES	NO
• Sell goods on credit	<input type="checkbox"/>	<input type="checkbox"/>
• Provide credit facilities in any form, including to related parties	<input type="checkbox"/>	<input type="checkbox"/>
• Make loans or advances of funds to anyone including related parties	<input type="checkbox"/>	<input type="checkbox"/>
• Have goods or assets located at other people's premises	<input type="checkbox"/>	<input type="checkbox"/>
• Rent, lease or hire goods or assets to others	<input type="checkbox"/>	<input type="checkbox"/>
• Supply goods on retention of title terms	<input type="checkbox"/>	<input type="checkbox"/>
• Supply goods on consignment and where these goods are stored elsewhere	<input type="checkbox"/>	<input type="checkbox"/>
• Grant licenses to other parties to use any of your products, trademarks or intellectual property	<input type="checkbox"/>	<input type="checkbox"/>
• Plan to enter into and pay a deposit for a conditional sale or purchase contract	<input type="checkbox"/>	<input type="checkbox"/>
• Intend to take security over certain assets	<input type="checkbox"/>	<input type="checkbox"/>
• Have guarantors with charging clauses in your favour	<input type="checkbox"/>	<input type="checkbox"/>
• Have assets or funds held on trust by other parties	<input type="checkbox"/>	<input type="checkbox"/>



www.pitcher.com.au

Pitcher Partners, including Johnston Rorke, is an association of independent firms
 An independent member of Baker Tilly International