


Personal Property Securities Act 2008 (Cth)


Background and Key Concepts

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IMPORTANT ...



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Why is it important?

In **October 2011**, the Personal Property Securities Reform (**the PPS Reform**) will commence and a single national online register of security interests in personal property (the Register) will become operational. The key piece of legislation is the *Personal Property Securities Act 2008* (Cth) (**the PPS Act** or **the Act**).

Without a doubt, this will have a profound impact upon the general business community both in the short and long term. Any business that supplies goods (whether by way of sale, or by way of lease or even by way of bailment) faces a real risk of suffering significant losses in the future if it does not come to grips with the reform and take the necessary steps to protect its rights.

Conversely, businesses that do make appropriate use of the Register will reap real benefits by being able to enforce rights over personal property in ways that have not been previously available.

LEGAL PRACTITIONERS' LIABILITY COMMITTEE

Of all the recent legislative reforms, this one stands out as the one that has the most obvious potential to lead to more claims being made against practitioners, because:

1. A huge number of businesses face the risk of significant losses in the future if they ignore the PPS Reform.
2. The PPS Act is a complicated piece of legislation and can be very counter-intuitive for lawyers.
3. The PPS Reform entails a fundamental change in the law of personal property, and cuts across many established and well known legal principles.
4. The PPS Reform is similar to the GST in that it has the potential to give rise to some sort of issue or question for consideration in virtually every transaction in any area of legal practice.

It is therefore vital that all lawyers become aware and understand the PPS Reform, even if only to be aware of its existence and recognise the need to get specific detailed advice when required.



The PPS Reform will have as big an impact upon the law of personal property as the Torrens Title system has had on real property

Why has it come about?

The law governing the title to and security over personal property has developed in a fragmented and haphazard manner. Apart from various general law principles, there are a plethora of State and Commonwealth statutes that govern personal property rights, and numerous registries (both State and Commonwealth) where security interests can be registered. For anyone seeking to take a security interest or search for other security interests, it can be a challenge just to locate all relevant registries. Most registries are not electronic and require manual lodgment and searching. There is an enormous potential for gaps, overlaps and conflicts between different systems.

The PPS Reform replaces all of the different registers with a single national electronic register, and a single body of law that sets out in detail the rules governing priorities between competing security interests.

However, the PPS Reform is not just about replacing the old registers. Its effect goes far beyond all of the existing laws. It applies to many transactions that previously we would not even have considered to involve any sort of security interest.

Whilst the Torrens Title system, with its underlying principle of 'title by registration', is fundamentally different to the PPS Register, the PPS Reform will have as big an impact upon the law of personal property as the Torrens Title system has had on real property.

Ultimately, the PPS Reform will improve the ability of individuals and businesses, particularly small-to-medium size businesses, to use more of their property in obtaining credit and raising capital.

What is it?

At the simplest level, the PPS Reform consists of:

- a single, national, electronic, register (or public noticeboard) of 'security interests' in personal property managed by ITSA; and
- a new rule-based system to determine priorities between competing security interests, i.e. one or more security interests that are attached to the same item of personal property.

Key Concepts - Collateral

The PPS Reform applies to almost all personal property, i.e. any property other than land. It applies to tangible property as well as intangible property (including intellectual property, contractual rights, book debts, business inventory and company shares).

There are some types of rights in personal property to which the Act does not apply, such as:

- liens arising by operation of law (including a solicitor's lien over a file and/or over the fruits of litigation);
- certain State based 'statutory rights' (or licences or permits) including taxi licences, gambling licences, racing licences, fishing licences, and various mining/exploration licences or leases; and
- water rights.

Personal property is known as '**collateral**' if a security interest is attached to it.

There are distinctions that are important in various ways such as the distinction between:

- **consumer property** (personal property held by an individual and not held in the course or furtherance of an enterprise); and

- **commercial property** (any property that is not consumer property).

In certain circumstances, there is also an important distinction between **inventory** and **non-inventory goods**.

Special rules apply to 'property **that must be described by serial number**'. The regulations define such property to be:

- motor vehicles;
- watercraft;
- aircraft; and
- certain IP rights (including designs, patents, plant breeder's rights, trademarks, or a licence over any such IP right).

Whilst all sorts of personal property (TVs, whitegoods, power tools) may have a physical serial number attached, they are not 'property that must be described by serial number' unless they fall into the categories defined in the regulations.

NB

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Key Concepts - Security Interest

In essence there are two ways for a 'secured party' to obtain a '**security interest**' over 'collateral': either by agreement or simply because the Act says so.

A security interest will arise if a transaction provides for an interest in personal property that, in substance, secures payment or performance of an obligation. It almost goes without saying that a charge or chattel mortgage creates a security interest.

However, the Act specifies a number of other transactions that may give rise to a security interest, including most notably:

- 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 a 'PPS lease' – discussed below).

It is important to note that the Act clearly favours a functional approach. The substance of a transaction is all important. The form of the transaction or the identity of the person who has title is irrelevant.

In addition, certain transactions are deemed by the Act to give rise to a security interest regardless of whether the transactions in substance secures payment or performance of an obligation. These transactions include most notably:

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

The concept of a '**PPS lease**' is very important and provides a significant extension to the operation of the Act. The necessary components of a PPS lease are:

1. It covers both leases and bailments.
2. Generally, subject to point 3 below, 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 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 of the goods 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. Accordingly, 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 on the basis of an indefinite term. After all, it is often in the commercial interests of the lessor for the goods to be out on lease for as long as possible. Unless such businesses adjust their terms of trade and business processes and/or register security interests, they are at risk of having a deemed but unperfected security interest (as a lessor under a PPS lease) and could lose their property entirely if a lessee or bailee becomes insolvent.

NB

If a lessor or bailor of goods does not adjust its terms of trade and/or register its interests, it could lose its property entirely if a lessee or bailee becomes insolvent

Key Concepts – Secured Party and Grantor

Whenever there is a 'security interest', there is a 'grantor' and a 'secured party'.

In some transactions the identity of each of these parties is intuitive and straightforward. For example, when a bank lends money to a borrower and the borrower provides some security for the loan, then it is quite obvious that the borrower grants a security interest to the bank. The borrower is the 'grantor' and the bank is the 'secured party'.

However, in other transactions the identity of these parties is counter-intuitive and can be very challenging for lawyers to accept or come to grips with.

For example, when a supplier sells goods on the basis of a retention of title clause, it is the customer who is the grantor of a security interest and the supplier who is the secured party. It does not matter that under the retention of title clause the supplier retains title and the customer does not get any title to the goods until they have been paid for.

For anyone who is used to traditional notions of legal title, it can be difficult to accept that a customer who has no title to goods can nevertheless be seen to be a grantor of a security interest to a supplier who has never given away title. However that is how the Act operates and, challenging though it may be, it is something that all lawyers need to understand and accept.

Similarly, when a lessor or bailor provides goods on lease or bailment to a lessee or bailee, the Act provides that the lessee or bailee is the 'grantor' of a 'security interest' and the 'secured party' is the lessor or bailor. It does not matter that the lessor or bailor is at all times the owner of the goods, nor that the clear intention is that lessee or bailee will never obtain title or any interest other than a possessory interest.



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Key Concepts – Attachment and Perfection

The rules of priority depend a great deal on timing and, in particular, when a security interest 'attaches' to personal property and whether and when the security interest is 'perfected'.

A secured party can only enforce their security interest against the grantor in respect of particular collateral if the security interest has 'attached' to the collateral.

Because the Act covers such a diverse range of personal property and, in particular, applies to intangible property and all sorts of complex and somewhat esoteric financing transactions and interests (such as flawed asset arrangements, so-called 'chattel paper', investment instruments, intermediated securities etc) the rules about attachment can be quite complex.

However, for most small businesses the most important transactions that will be caught by the Act are a sale of goods on a retention of title basis, and a PPS lease. For these types of transactions, the Act provides that a security interest attaches to such goods when the grantor acquires rights in collateral, which is when the purchaser, lessee or bailee obtains possession of the goods.

In the same way, the rules about perfection can be quite complex. For example when dealing with security over certain types of intangible property, satellites or other space objects it is possible to obtain perfection by 'control'.

However, for a supply of goods on a retention of title basis, or a PPS lease, a secured party will generally perfect their security interest by:

- ensuring that there is a written agreement with the purchaser, lessee or bailee that has been signed or otherwise accepted by the purchaser, lessee or bailee; and
- registering a financing statement on the PPS Register.

Key Concepts – Financing Statement

A 'secured party' will generally perfect their 'security interest' by registering a 'financing statement'. The financing statement will need to contain information about the 'secured party', the 'grantor', the type and class of the 'collateral', and in some cases, the 'serial number'.

It is not necessary for the 'secured party' to register the actual document or agreement that gives rise to the 'security interest'.

Key Concepts – Priority between Competing Security Interests

In simple terms, the priority between competing security interests will be decided in accordance with the following 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 (described further below) has (super) priority over other perfected security interests.

Because the main way of perfecting a security interest is by registering it, in most instances you could read these rules by replacing the word 'perfected' with 'registered' and retain essentially the same understanding.

Key Concepts – Purchase Money Security Interest

A Purchase Money Security Interest (or **PMSI**) is a special type of security interest that enjoys a 'super priority' over other types of security interests. It protects both suppliers of goods and lenders who finance the acquisition of specific assets.

A PMSI is only available for certain specific security interests as follows:

- A security interest which secures all or part of the purchase price of 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.

Moreover, to obtain this super-priority a PMSI must be perfected (i.e. generally registered) within very strict time limits.



To obtain this super-priority a PMSI must be registered within very strict time limits

If the collateral is inventory then the security interest must be registered before the security interest attaches to the collateral (usually before a purchaser, lessee or bailee takes possession of goods).

If the collateral is not inventory then the security interest must be registered within 15 business days after the security interest attaches to the collateral.

The necessity for a special type of security interest that has super-priority becomes apparent when we consider the common scenario of a conditional sale. When a supplier sells goods on a retention of title basis, the supplier’s security interest attaches to those goods the moment the purchaser of goods takes possession. However, commonly a bank will have previously provided finance to the purchaser, taken a security interest over ‘all present and after acquired property’ of the purchaser, and registered that interest well before the purchaser even becomes a customer of the supplier. In that case, the bank’s prior perfected security interest will also attach to those particular goods as soon as the purchaser takes possession of the goods from the supplier. However, if the bank’s security interest took priority simply because it was perfected earlier that would be an unfair and undesirable result. Hence, there was the need for some sort of super-priority to protect suppliers of goods on a retention of title basis, lessors and bailors.

Key Concepts – Proceeds, Accessions

Like most reforms, the Act contains a carrot as well as a stick. Businesses who do not register their security interests will face a real risk of losing their property or having their security interest invalidated. On the flip side, businesses who do register their security interests will enjoy substantial benefits from being able to enforce their security interests in new ways.

The Act has detailed provisions which are designed to allow a secured party to trace their security interest into the **proceeds** of sale (or other disposal) of the collateral. For example, if a supplier sells goods on the basis of a retention of title clause, and the customer then on-sells those goods, the original supplier will have a security interest in the customers’ book debt in relation to that on-sale or the proceeds of sale.

This is a significant extension to the effectiveness of simple retention of title clauses, and may be of particular assistance for suppliers of goods where a retention of title clause has been hitherto practically ineffective (e.g. a supplier of concrete).

Where goods are installed in or affixed to other goods (e.g. a gearbox is put into a truck) then that is an '**accession**'. The Act provides that a security interest in goods that become an accession to other goods continues in the accession. In the example given, a supplier of a gearbox under a retention of title clause will have a security interest in the gearbox. Even after the gearbox is installed in the truck, the supplier will continue to have a security interest in the gearbox and, depending on the circumstances, may have priority over a person with an interest in the whole truck. This again provides an extension to the effectiveness of retention of title clauses.



A buyer or lessee of personal property for value takes the personal property **free of any unperfected interest in the property**

Key Concepts – Taking property free of security interests

The rules as to priority of security interests will most commonly apply when the grantor of a security interest has become insolvent.

However, there are other ways in which a secured party may lose their security interest. In particular, there are detailed rules (Part 2.5) that allow for personal property to be bought or leased free of both perfected and unperfected security interest in certain circumstances.

Given the complexity of the rules, it is beyond the scope of this bulletin to cover all of them.

However, it is worth noting that one of those rules 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. This underlines the importance of businesses perfecting their security interests by registering financing statements. otherwise they could lose them entirely.

Further Bulletins

The LPLC will be issuing further bulletins about the PPS Reform and all practitioners should look out for and take note of them. The bulletins will cover the following topics:

1. Practicalities, including:
 - (a) Practical examples of where security interests might arise
 - (b) What businesses need to do to prepare
 - (c) How some existing registered security interests will be migrated
 - (d) The information that a financing statement will need to contain
 - (e) The consequences of errors in financing statements
 - (f) Searching the register
 - (g) On-going maintenance of security interests
 - (h) The role of law firms in registering and ongoing maintenance

2. The impact on the practice of law, including:
 - (a) Acting for the purchaser or vendor in the sale of a business
 - (b) Advising on business structures for asset protection purposes
 - (c) Acting for financiers
 - (d) Commercial leases
 - (e) Whether practitioners need to do an audit of old files

3. Answers to common questions.

Further Resources

The LPLC will also include a session about the PPS Reform at our Risk Management Intensive seminars in July and August.

Practitioners should avail themselves of other resources to ensure they fully understand the issues raised by this reform. For example, there is a Government website (www.ppsr.gov.au) which has lots of information sheets, FAQs, newsletters etc. There are also a huge number of articles and advertised seminars on the internet (easily accessible by typing '**Personal Property Securities**' into Google).

In addition CCH Australia Limited have published a paperback entitled *Understanding Personal Property Securities Law*, by Del Cseti. LexisNexis and Thompson Reuters have services which are both entitled *Personal Property Securities in Australia* in online and hardcopy (looseleaf) format.

Ultimately, practitioners who take the time to read the PPS Act itself and the explanatory memorandum (which is a reasonably easy read) will be the most informed.

Legal Practitioners' Liability Committee
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