Bulletin

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Personal Property Securities Act 2009 (Cwlth) – background and key concepts

The *Personal Property Securities Act 2009* (Cwlth) (PPS Act) commenced on 30 January 2012. Since then LPLC has received claims every year for mistakes by practitioners in dealing with PPS Act issues.

This bulletin contains background information about the PPS Act and key concepts.

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Background

NB: The PPS Act has had as big an impact on the law of personal property as the Torrens Title system had on real property.

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, prior to the PPS Act there was a plethora of state and commonwealth statutes that governed personal property rights as well as numerous registries (both state and commonwealth) where security interests could be registered. For anyone seeking to take a security interest or search for other security interests, it was a challenge just to locate all relevant registries. Most registries were not electronic and required manual lodgement and searching. There was an enormous potential for gaps, overlaps and conflicts between different systems.

The PPS Act replaced all 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 Act is not just about replacing the old registers. Its effect goes far beyond all existing laws and applies to many transactions we previously would not even have considered to involve any sort of security interest.

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

At the simplest level, the PPS Act consists of:

- a single, national, electronic, register (or public noticeboard) of 'security interests' in personal property managed by Australian Financial Security Authority (AFSA)
- a new rule-based system to determine priorities between competing security interests – one or more security interests that are attached to the same item of personal property.

Key concepts

Collateral

The PPS Act applies to almost all personal property – 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 the PPS Act does not apply to including:

- 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', licences or permits including taxi licences, gambling licences, racing licences, fishing licences as well as various mining/exploration licences or leases
- water rights.

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

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There is an important distinction within personal property. Personal property held by an individual and not held in the course or furtherance of an enterprise is referred to as **consumer property** while **commercial property** is 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
- certain intellectual property rights including designs, patents, plan breeder's rights, trademarks and a licence over any such intellectual property right.

While all sorts of personal property including TVs, whitegoods and 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.

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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 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
- a lease of goods (whether it is a 'PPS lease' or not – 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
- 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:

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- it covers both leases and bailments
- the lease or bailment must be for a period as specified below:

Entry date	Period of PPS lease
From 20 May 2017	2 years
From 1 October 2015 – 19 May 2017	1 year

- the lessor or bailor must be engaged in the business of regularly leasing or bailing goods
- for bailments, the bailee must provide value. Accordingly, a purely gratuitous loan of goods will not be caught.

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.

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 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.

While it can be difficult to accept that a customer who has no title to goods can be seen to be a grantor of a security interest to a supplier who has never given away title, that is how the Act operates.

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.

NB: The identity of the grantor and secured party can be counter-intuitive and challenging for lawyers to come to grips with. However, that is how the Act operates and, challenging though it may be, it is something that all lawyers need to understand and accept.

Attachment and perfection

The rules of priority depend a great deal on timing, 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 as well as esoteric financing transactions and interests such as flawed asset arrangements, so-called 'chattel paper', investment instruments and intermediated securities, the rules about attachment can be 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.

The rules about perfection can also be 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 there is a written agreement with the purchaser, lessee or bailee that has been signed or otherwise accepted by the purchaser, lessee or bailee
- registering a financing statement on the PPS Register.

Financing statement

A 'secured party' will generally perfect their 'security interest' by registering a 'financing statement'. The financing statement needs 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'.

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 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.

Purchase money security interest

A 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 the following certain specific security interests.

- A security interest which secures all or part of the purchase price of the relevant collateral, for example 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 consigner of goods under a commercial consignment.

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

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

If the collateral is not inventory, 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.

Proceeds and 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 customer's book debt relating 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 previously been practically ineffective.

An '**accession**' occurs where goods are installed in or affixed to other goods such as when a gearbox is put into a truck. 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.

NB: A buyer or lessee of personal property for values takes the personal property free of any unperfected interest in the property.

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. If unregistered, they could lose the interest entirely.