

Australia's Personal Property Securities Regime

An overview





The *Personal Property Securities Act 2009* (Cth) is one of the most significant pieces of legislative reform for the Australian financial sector, and commerce generally, for many years. While the Act has its greatest impact on financiers, the changes also impact in some way on virtually all commercial enterprises, and many individuals.

The PPS Act rewrote previous Australian law relating to:

- how security interests are formed
- how security interests can be enforced
- how priority disputes are to be resolved where more than one security interest is given over the same property
- the circumstances in which a security interest can be extinguished against the wishes of the secured party.

The Act also rewrote a number of established principles of commercial law.

The changes made by the Act affect business documentation and procedures, the way businesses conduct their trading relationships, and the extent to which they can rely with confidence on the terms of those relationships to provide them with the level of security and certainty that they had previously expected.

The PPS regime commenced operation in Australia on 30 January 2012.

The Act applies to almost all property other than land

The Act applies to security interests over almost all types of property other than land, fixtures and water rights. It applies both to physical assets, and to intangible property such as intellectual property, licences, payment obligations and financial instruments such as shares and debentures.

Security interests – A new “functional” approach

The Act takes a “substance over form” approach to determining what is a security interest. This is a substantial shift from traditional Anglo-Saxon legal thinking, which generally has regard to the legal form of a transaction to determine its consequences, rather than its underlying commercial effect. Under the Act, a **security interest** is:

“an interest in personal property provided by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property).”

The Act applies to traditional forms of security such as fixed and floating charges, legal and equitable mortgages, and liens. Because of the “functional” definition, though, the Act also applies to many commercial arrangements that had not previously been treated as securities, such as retention of title arrangements, hire purchase agreements, leases and title transfer or flawed asset arrangements. The Act also deems some transactions (transfers of accounts or chattel paper, commercial consignments and longer-term leases, known as **PPS leases**), to be security interests whether or not they are in substance a security.

New rules for creating security interests

The Act established new rules for the creation of effective security interests. Different rules apply to determine:

- when a security interest will be enforceable against the grantor (known as attachment)
- when a security interest is enforceable against third parties
- what steps can be taken to protect a security interest from being defeated by a competing interest (known as perfection).

Attachment

A security interest **attaches** to personal property (that personal property is then referred to in the Act as **collateral**), making the security interest enforceable against the grantor, if:

- the grantor has rights in the collateral (or the power to transfer rights in the collateral), and
- either value is given for the security interest, or the grantor does an act that causes the security interest to arise.

These requirements should generally be easy to satisfy.

Enforceability against third parties

For a security interest to be enforceable against a third party in respect of particular collateral, the security interest needs to be attached to the collateral, and either:

- the secured party must possess the collateral, or have perfected the security interest by control (these concepts are discussed further below), or
- there must be a security agreement providing for the security interest, and that security agreement must “cover” the collateral.

A security interest will “cover” collateral if:

- it is evidenced by writing, and that writing is signed (or adopted in another specified manner) by the grantor, and
- the writing contains a description of the collateral.

While most traditional security interests will satisfy these requirements, the requirements are likely to cause problems for some commercial relationships that have not previously been regarded as security interests, such as retention of title provisions under supply arrangements.

Perfection

Even if a security interest has attached to collateral and is enforceable against third parties, it will be important in most cases that the security interest also be perfected. If it is not perfected, the secured party will be exposed to the risk that its security interest could rank behind other security interests in a priority dispute, or even be extinguished entirely (for example, if the grantor transfers the collateral to another person). Most security interests, if they are not perfected, are also at risk of being extinguished if the grantor is wound up or bankrupted.

A security interest that has attached to collateral can be perfected in up to five different ways, depending on the nature of the collateral.

1. Registration	The Act establishes a securities register called the Personal Property Securities Register. The Register, a key component of the PPS reform package, is maintained in electronic form, and is readily accessible online. A secured party is able to perfect its security interest by entering required details in relation to that security interest in the Register. Importantly, a secured party does not need to wait until the security interest has been granted before entering it on the register, and can register a security interest before it has been granted as well.
2. Possession	A secured party can perfect its security interest by taking possession of the collateral.
3. Control	A secured party can perfect its security interest over some types of personal property, being bank accounts and certain other financial instruments (and, somewhat curiously, “satellites and other space objects”), by taking “control” of the collateral in a manner specified in the Act.
4. Temporary perfection	The Act provides for a number of situations in which a security interest will be taken to be temporarily perfected without any act by the secured party – for example, where property that is subject to a security interest is brought into Australia, or collateral that is subject to a perfected security interest is disposed of in circumstances where the security interest is not extinguished by the disposal.
5. Deemed perfection	In some limited situations, the Act also deems a security interest to be automatically perfected – for example, in some circumstances where collateral under a perfected security interest is disposed of, and the security interest attaches to the proceeds.

Rules for resolving priority disputes between security interests

The Act established new rules for resolving priority disputes between security interests over the same collateral. Broadly, the priority rules work as follows:

- Priority between two or more perfected security interests is determined by their respective “priority times”- generally, this is the order in which they were perfected.
- A perfected security interest has priority over an unperfected security interest.
- Priority between unperfected security interests is determined by their order of attachment.

These rules are subject to numerous exceptions. For example, a security interest that is perfected by control will usually have priority over all other security interests, even if they were perfected first. The Act also introduced a new concept of **purchase money security interest (PMSI)**. A PMSI is a security interest taken in certain types of collateral to secure all or part of its purchase price or to secure funding that was used to acquire the collateral. It also includes the interest of a lessor of goods under a PPS lease, and the interests of a consignor under a commercial consignment. In most cases, a PMSI will have priority over other security interests even if the other security interests were perfected first (unless the other security interest is perfected by control).

Rules to determine when a security interest can be extinguished

The Act sets out a number of rules to determine when a security interest may be extinguished.

When the collateral is dealt with

The Act provides as a general rule, if collateral is disposed of, that the security interest remains attached to the collateral in the hands of the transferee. In a number of circumstances, however, a transfer of collateral can result in the security interest being extinguished, for example:

- if the security interest was unperfected, and the transferee paid new value
- if the property was sold or leased by the grantor in the ordinary course of its business of selling or leasing property of that kind
- certain disposals of shares or other investment assets (for example, on a stock exchange)
- a transfer of a motor vehicle or other serial-numbered property, if it is not registered by its serial number
- low-value personal, domestic or household property.

On a winding up of the grantor

The Act provides that most unperfected security interests (including most deemed security interests) vest in the grantor if the grantor is wound up or bankrupted. In the case of deemed security interests (such as PPS leases), in particular, this may result in a significant windfall gain for the liquidator or trustee in bankruptcy at the expense of the secured party.

Special rules for particular types of property

The Act contains special rules relating to agricultural property, accessions, commingled or processed goods and intellectual property.

The provisions relating to agricultural property include a quasi-PMSI regime that is intended to assist farmers to obtain finance for their farming inputs.

The rules relating to accessions deal with the conflicts that arise between competing interests when goods are attached or affixed to other goods. The commingling and processing rules similarly deal with the competition between interests that arise when property (such as wheat) is commingled or used in a manufacturing process.

The Act also contains some specific rules relating to intellectual property rights and intellectual property licences.



Rules for enforcing security interests

The Act contains detailed rules that deal with the way in which a secured party can enforce a security interest in personal property.

These rules will not always apply. For example, the rules do not apply to property of a corporate grantor if the property is in the hands of a receiver or receiver and manager. The rules also do not apply to “deemed” security interests, and most of the rules do not apply to a person who has perfected a security interest in shares or other investment property by taking possession or control. It is also possible to contract out of a number of the rules.

Where the enforcement rules do apply, they impose a number of restrictions on the way in which a secured party may enforce its security interest. The rules will also require that the secured party exercise its enforcement rights under the Act both honestly and in a “commercially reasonable manner”.

Conflict of laws rules

The Act contains a set of rules that regulate whether Australian or a foreign law is to be used to determine the validity, perfection and consequences of perfection (or non-perfection) of a security interest. The applicable law depends on factors such as the type of the personal property, and the location of the personal property or the grantor.

These rules only determine which jurisdiction’s laws are to apply to the security interest itself. Parties continue to be free to choose the law that is to apply to the other contractual obligations in their security agreements.

Transitional arrangements

The Act sets out a number of complex arrangements for the transition from the previous law to the regime established by the Act. The complexity is driven in part by constitutional constraints, in particular section 51(xxxi) of the Constitution, which provides that the Commonwealth can only make laws acquiring property “on just terms”. Because of this constraint, the Act cannot alter the relative priority of security interests in the same property that were in existence at the time the Act commenced operation, unless:

- the priority is to be determined following a bankruptcy or insolvency, or
- an existing secured party has assented to the Act (for example, by voluntarily registering its interest on the PPS Register).

The Act provided for the automatic migration of security interests from some existing registers onto the PPS Register. Where this was not possible (for example, because the information on the existing register was not adequate, or a pre-PPSA security interest was not registrable), the secured party has the ability to “opt in” to the regime by registering its security interest on the PPS Register. A secured party will be able to do this for up to 24 months after commencement to preserve its priority position.

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The Personal Property Securities Act has revolutionised the law of secured finance in Australia. For help with assessing how the Act affects your business, please contact one of our experts.



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