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Practical Problem caused by the Personal Property Securities Act

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Contents

1. Introduction of the new regime

By two Acts – the *Personal Property Securities Act* 2009 (Cth) (the '**PPSA**') and the *Personal Property Securities (Consequential Amendment) Act* 2009 (Cth) – the federation of Australian governments fundamentally changed the law regarding property and interests in it in Australia.

Section 243 of the PPSA outlines the Constitutional basis for the regime for its operation in the 'referring States' and in the 'non-referring States', and the territories. It is intended to operate in all areas to the extent available:

- In referring States (defined in s 244) and in non-referring States based on s 51(xxxvii) of the *Constitution*;
- In the Territories based on ss 122 and 51(xxxvii) of the *Constitution*; and
- Externally to Australia, based on ss 51(xxix) and 51(xxxvii) of the *Constitution*.

All States have passed a version of the *Personal Property Securities (Commonwealth Powers) Act* and are therefore referring States. The PPSA therefore applies throughout Australia.

The PPSA received Royal Assent on 14 December 2009 and commenced on 15 December 2009. The regime was to come into effect in May 2011, but that date was postponed to October 2011. In the result it came into effect on 31 January 2012.

The scope of the reform is significant:

- 77 Commonwealth and State Acts and Regulations have been replaced; and
- 30 Commonwealth, State and Territory Agencies have been affected.

2. Overview of the new regime

The PPSA fundamentally changes interest in property in Australia. It regulates the process of creation, registration and enforcement of securities in personal property.

It involves significant concepts:

- 'personal property', considered at point 3 below;
- 'security interests', considered at point 4 below;
- 'attachment', considered at point 5 below;
- 'perfection', considered at point 7 below;
- priority rules, considered at point 8 below;
- 'purchase money security interest', considered at point 9 below; and

- the register, considered at point 10 below.

What will be 'personal property' is discussed at point 3 below, but in short it is all property other than land and certain excluded property. It is extremely broad. The regime of personal property regulation before the PPSA was far less certain than that under the PPSA, certainty being one of the objectives of the PPSA regime.

Also considered in detail below is a 'security interest', which has two elements. It is fundamental to all security interests that there is secured property (collateral) and secured moneys (obligations). The collateral is there as a back up to satisfy the obligations if the debtor cannot. The PPSA concerns itself with personal property in which there is a security interest.

As with real property law, the system of priorities is important. It is only when disputes between competing rights in the same property arise that the law is called on to determine the matter. The PPSA replaced a series of general law property and priority rules. In their place the concept of 'perfection' of a security interest takes the focus.

Before the introduction of the PPSA it was often difficult to determine the extent of another person or entity's interest in personal property. That was both as to whether any interest was held a particular item of personal property *and* if so the extent of that interest. Potential creditors now turn to the PPSA for more guidance.

In broad terms the PPSA considers assets are available for realisation by creditors unless a 'security interest' has been 'perfected' by the person who has such an interest. The perfected security interest would give its holder priority over other creditors. Consequentially title is no longer the determinant of rights over assets where registered security interests are involved; it is a substantive approach to security that matters.

It assists to consider the PPSA's effect as discreet matters:

- the PPSA introduces a regime of 'security interests' in personal property and also alters some commercial law considerations – such as the assignability of contracts and negotiability.
- the PPSA takes a 'substance over form' approach in determining whether there is a 'security interest', with certain arrangements deemed to be a 'security interest' whether or not they secure an obligation.[1]
- who holds title being largely irrelevant, perfection is essential in order to ensure priority with respect to competing security interests.

[1] Such as leases, bailments and assignments of some accounts receivable.

- perfection can be effected via registration, possession or (with respect to some financial assets) control.
- there are rules with respect to 'priority', and when an asset can be assigned free of security interests.
- notwithstanding that the person buying or taking security over the asset has knowledge with respect to the earlier security interest, an 'all asset' security may not have first priority.

It is also to be noted that the provisions deal with security interests provided by consent; interests created by the operation of the law (such as certain liens) are excluded from the PPSA regime. The PPSA can also be contracted out of.[2]

The taking of good security under the PPSA is a three-step process. Namely, that a 'security interest':

- must ***attach*** to collateral – this makes the security interest enforceable against the entity which granted it;
- are ***enforceable against third parties*** - which usually will require an agreement in writing; and
- are ***perfected*** – perfection is the essential element of the PPSA.[3]

Perfection is required to ensure priority, provide protection against wrongful sale by the grantor and ensure the security interest will survive the grantor's insolvency. That is, pursuant to the regime, a security interest cannot be enforced:

- against the grantor until it has 'attached' to the relevant property – which is evidenced by an intention to create a security interest or the occurrence of some act to create a security interest – such as the entry into a written agreement;
- against a third party (e.g. another security holder) or an insolvency situation where there are competing interests in the same collateral – unless it is both 'attached' and 'perfected'. Perfected means registration (or in some circumstances – possession and control).

The PPSA also provides for the establishment of a national on-line register, known as the personal properties security registry (**'PPSR'**).

[2] Other than for certain consumer property.
[3] For most security interests, perfection is effected by registration on the relevant register. However, in certain circumstances, possession or control may perfect a security interest.

3. What is 'personal property'?

The PPSA is concerned with 'personal property', which is extremely broad. Section 10 of the PPSA is the 'Dictionary' and it defines 'personal property'. It relevantly provides:

> ***"personal property"*** means property (including a licence) other than:
>
> (a) land;[4] or
>
> (b) a right, entitlement or authority that is:
>
> (i) granted by or under a law of the Commonwealth, a State or a Territory; and
>
> (ii) declared by that law not to be personal property for the purposes of this Act.
>
> Note: This Act does not apply to certain interests even if they are interests in personal property (see section 8).

Personal property therefore captures all property except for land (as defined) and certain statutory rights that are declared under the relevant State or Federal statutes not to be personal property. Broadly speaking, 'personal property' is defined, and includes, tangible and intangible property such as inventory, stock in trade, goods of all kinds, crops and livestock, intellectual property, marketable securities, investment instruments and accounts, and certain contractual rights.

This is an enormous scope given the emerging importance of various types of "new" property such as software and intellectual property rights,[5] not to mention the stores of value in shares, bonds and other financial property to which the PPSA will also apply.

(a) What will not be personal property

Section 8 then provides a list of interests in property that are not 'personal property' and therefore not within the PPSA regime. For instance, the regime does not apply with respect to:

- any right of set-off or right of combination of account (paragraph 8(1)(d));
- rights under general law or under the relevant State and Federal statutes in relation to the control, use or flow of water (paragraph 8(1)(i));

[4] Section 10 also states '***"land"*** includes all estates and interest in land, whether freehold, leasehold or chattel, but does not include fixtures'.

[5] One need only sit in on some of Federal Court's hearing of Apple v Samsung the potential for this new property to cause litigation.

- a lien, charge or any other interest in personal property that arises under the relevant State or Federal statutes (other than the PPSA), unless the person who owns the property in which the interest is granted agrees to the interest (paragraph 8(1)(b));
- a lien, charge or any other interest in personal property that is created, arises or is provided by operation of the general law (paragraph 8(1)(c));
- certain interests in property created under the *Bankruptcy Act 1966* (Cth) (paragraph 8(1)(g));
- an interest in a fixture (paragraph 8(1)(j));
- particular statutory rights granted by a relevant State or Federal statute which are declared not to be personal property for the purposes of the PPSA (paragraph 8(1)(k)).

A good discussion of the various exclusions pursuant to s 8(1)(k) of the PPSA is contained in Meehan, *The PPS Guide,* Woof Creative, 2011 at [7.006]-[7.029].

(b) Categorising personal property

Personal property may be grouped into four major categories for the purposes of the PPSA: (1) goods; (2) financial property; (3) intermediated security; and (4) intangible property. This is not merely a characterisation for convenience of explanation. It may be necessary to determine the category of personal property that is subject to a particular security interest because there may be different rules (such as mode of perfection and taking free - i.e. extinguishment) that may apply depending on the type of personal property.

4. What is a 'security interest'?

Determining whether there is a 'security interest' is a precondition for the purposes of engaging the PPSA. Specifically, the PPSA is enlivened when there is a 'security interest' that relates to personal property.

As stated at point 1 above, there are essentially two elements to the definition of 'security interest' pursuant to the PPSA:

- there must be secured property (i.e. collateral;); and
- there is secured moneys (i.e. the obligation).

That is, a transaction that both grants an interest in personal property (i.e. the collateral) and in substance secures the payment or performance of an obligation , will most likely satisfy the definition of 'security interest'. It needs to be ensured that there is an interest *in* personal property. As a result (and for example) personal rights of action for the repayment of a debt

or other amounts such as guarantees, indemnities, letters of comfort and contractual subordination agreements (subsection 12(6) of the PPSA) are not security interests, as they do not grant interests *in* personal property. Rather, such transactions only provide rights to take action with respect to another party so as to satisfy a secured obligation.

(a) The starting point

Section 10 of the PPSA defines 'security interest' by reference to s 12, which employs a simple definition in s 12(1) that is expanded and affected in the balance of s 12. Section 12(1) of the PPSA provides:

> A ***security interest*** means an interest in personal property provided for 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).

Subsection 12(2) then lists 12 examples[6] of transactions that, 'in substance' would be security interest if they secure payment or the performance of an obligation.

Subject to subsection 12(3) of the PPSA discussed below, the essential element of a 'security interest' is that it, *in substance*, secures payment or secures the performance of an obligation. It is a 'substance' over 'form' test. Further, the entity that has title to the personal property is irrelevant for the purposes of the creation of a security interest.

In order to determine whether there is a security interest, the following elements will need to be established:

- personal property;
- a transaction, this will usually if not always be a consensual transaction;
- an interest in personal property – a sufficient interest includes a legal or equitable interest and seemingly captures proprietary rights; and
- in substance secures payments or performance of an obligation – the test may be whether the arrangement gives the secured party a priority or advantage over other creditors.

(b) Expanding the definition

Subsection 12(3) expands this definition in important ways. The PPSA expands the concept of security interest, beyond traditional interests, to affect any financier or other business that

[6] '(a) a fixed charge; (b) a floating charge; (c) a chattel mortgage; (d) a conditional sale agreement (including an agreement to sell subject to retention of title); (e) a hire purchase agreement; (f) a pledge; (g) a trust receipt; (h) a consignment (whether or not a commercial consignment); (i) a lease of goods (whether or not a PPS lease); (j) an assignment; (K) a transfer of title; (l) a flawed asset arrangement.'

consigns, bails, supplies or leases goods, and relies on its ownership of the goods to protect their position (i.e. which may be deemed security interests pursuant to subsection 12(3) of the PPSA). Subsections 12(3) provides:

> (3) A ***security interest*** also includes the following interests, whether or not the transaction concerned, in substance, secures payment or performance of an obligation:
>
> (a) the interest of a transferee under a transfer of an account or chattel paper;
>
> (b) the interest of a consignor who delivers goods to a consignee under a commercial consignment;
>
> (c) the interest of a lessor or bailor of goods under a PPS lease.

It should be noted that the enforcement provisions contained in Part 4 of the PPSA does not apply to deemed security interests contained in subsection 12(3) of the PPSA, unless the deemed security interest secures the payment or performance of an obligation.[7]

(c) Analysing a security interest

From the starting point and the expansion of the definition it can be seen that a dichotomy of 'security interests' is available; a security interest can be classified as either an:

- 'in substance' security interests (see subsection 12(1) of the PPSA and the examples contained in subsection 12(2) of the PPSA); or
- 'deemed' security interests (subsection 12(3) of the PPSA).

(d) Charge backs

Subsections 12(3A) and (4) of the PPSA allow for charge-backs. For example, a deposit taking institution may take security over an account held by one of its customers. Those subsections provide:

> (3A) A person who owes payment or performance of an obligation to another person may take a security interest in the other person's right to require the payment or the performance of the obligation.
>
> (4) Without limiting subsection (3A):
>
> (a) an account debtor, in relation to an account or chattel paper, may take a security interest in the account or chattel paper; and
>
> (b) an ADI may take a security interest in an ADI account that is kept with the ADI.

[7] See s 109 of the PPSA.

(e) What is not a security interest

Certain items are expressly excluded from being a 'security interest'. Subsection 12(5) of the PPSA provides that:

> A security interest does not include:
>
> (a) a licence;
>
> (b) an interest of a kind prescribed by the regulations for the purposes of this section.

Although a licence is not of itself a security interest it can, if transferrable, be collateral to which a security interest may attach. The only interest prescribed in the *Personal Property Securities Regulation* 2010 (Cth) (the '**PPS Regs**') as something which is not a security interest is r 1.8 of the PPS Regs, providing that the extinguishment of a beneficial interest in an account or chattel paper is not a security interest.

Subsection 12(6) of the PPSA expressly excludes subordination agreements from the PPSA, by providing that:

> A security interest is not created only by an agreement or undertaking to do either of the following:
>
> (a) to postpone or subordinate a person's right to payment or performance of all or any part of a debtor's obligation to another person's right to payment or performance of all or any part of another of the debtor's obligations;
>
> (b) to postpone or subordinate all or any part of a secured party's rights under a security agreement to all or any part of another secured party's rights under another security agreement with the same grantor.

Section 61 of the PPSA is here relevant and provides:

> (1) A secured party may (in a security agreement or otherwise) subordinate the secured party's security interest in collateral to any other interest in the collateral.
>
> (2) The subordination:
>
> (a) is effective according to its terms between the parties; and
>
> (b) may be enforced by a third party if the third party is the person, or one of a class of persons, for whose benefit the subordination is intended.

Consideration of the effect of common commercial dealings – such as processing or co-mingling goods, selling an asset that was collateral and accession to goods – is discussed

below at point 13, being the Practical Problems with the PPSA.

5. Attachment

Subsection 19(1) of the PPS provides that:

> A security interest is enforceable against a grantor in respect of particular collateral only if the interest has attached to the collateral.

In a general sense attachment of a security interest is established if the grantor of a security interest has rights in the collateral and either the secured party has given value for the security interest, or the grantor does an act by which the security interest arises.

Subsection 19(2) of the PPSA provides that:

> A security interest attaches to collateral when:
>
> (a) the grantor has rights in the collateral, or the power to transfer rights in the collateral to the secured party; and
>
> (b) either:
>
> (i) value is given for the security interest; or
>
> (ii) the grantor does an act by which the security interest arises.

A common, and straight forward, example of what parties may undertake to enliven subsection 19(2) of the PPSA is:

- a grantor will have 'rights' in collateral by owning or possessing it;
- a secured party could 'give value' by lending money on the value of the security; and
- a grantor may do 'an act by which the security interest arises' by executing a security agreement with the secured party.

It should be noted that whilst attachment is required for the creation of a security interest, attachment is not essential for priority. Indeed, a security interest may be registered on the PPSR by lodging a financing statement before attachment has occurred, or before a security interest has been entered into.

The time the security interest attaches to the collateral is dealt with in 19(3) and (4) of the PPSA. They provide:

(3) Subsection (2) does not apply if the parties to a security agreement have agreed that a security interest attaches at a later time, in which case the security interest ***attaches*** at the time specified in the agreement.

(4) To avoid doubt, a reference in a security agreement to a floating charge is not a reference to an agreement that the security interest created by the floating charge attaches at a time later than provided under subsection (2).

That is, the parties may agree when a security interest attaches (i.e. it may be later than the date of a security agreement which purports to attach the interest to collateral). That it cannot be made earlier is consistent with the general law on trustees and beneficiary's rights to retrospectively regulate their conduct, but possibly not with the general law on contractual parties to do so.[8]

6. Enforceability against third parties

[8] The courts are willing to give retrospective effect to instruments (deeds, contracts, etc) if the parties intend them to have effect, and govern their relationships, from a particular date.

Justice Megaw said in *Trollope & Colls Ltd v Atomic Power Constructions Ltd* [1962] 3 All ER 1035 at 1040:

> Frequently in large transactions a written contract is expressed to have retrospective effect, sometimes lengthy retrospective effect; and this in cases where the negotiations on some of the terms have continued up to almost, if not quite, the date of the signature of the contract. The parties have meanwhile been conducting their transactions with one another, it may be for many months, on the assumption that a contract would ultimately be agreed on lines known to both the parties, though with the final form of various constituent terms of the proposed contract still under discussion. The parties have assumed that when the contract is made – when all the terms have been agreed in their final form – the contract will apply retrospectively to the preceding transactions. Often, as I say, the ultimate contract expressly so provides. I can see no reason why if the parties so intend and agree, such a stipulation should be denied legal effect.

This case was cited in *Gilsan v Optus (No 2)* NSWSC 38 and in *Dong v Monkiro Pty Ltd* [2005] NSWSC 749. Both these cases expressed the view that an instrument can have retrospective effect if the parties intend it to.

In relation to trusts and superannuation funds specifically it seems that the ability to retrospectively change will bind the parties but not third parties to the instrument. This was explained by Hill J in *Davis v FCT; Sirise Pty Ltd v FCT* [2000] FCA 44:

> The parties to an agreement can not effect a change to an agreement retrospectively so that the agreement between them is altered as against the rest of the world. The parties can, no doubt, enter into an agreement, binding as between them, that a prior agreement they have entered into will be construed in a particular way from the moment the prior agreement was entered into. But the original agreement will, so far as the Commissioner is concerned, govern their relationship until the time of its amendment. For example A and B may enter into an agreement which provides, *inter alia,* that certain income will, for the term of the agreement, be held by A in trust for B. Later the parties may as between them agree to alter the arrangement *ab initio* to provide that that income will not be held in trust for B, but will always be treated as belonging to A beneficially. The agreement will be binding inter partes, but for income tax purposes the income will, until the date of agreement, still be treated as beneficially the income of B.

A security agreement is 'enforceable against third parties' where attachment has occurred and either:

(a) the collateral is either controlled or possessed by the secured party; or

(b) there is a written security agreement between the grantor and secured party, signed by the grantor, which adequately describes the collateral or nature of the security interest.[9]

Subsection 20(1) of the PPSA provides that:

> A security interest is enforceable against a third party in respect of particular collateral only if:
>
> (a) the security interest is attached to the collateral; and
>
> (b) one of the following applies:
>
> (i) the secured party possesses the collateral;
>
> (ii) the secured party has perfected the security interest by control;
>
> (iii) a security agreement that provides for the security interest covers the collateral in accordance with subsection (2).

7. Perfection of a security interest

Perfection is essential, as it enables a secured party to achieve priority as against any competing security interest, which will also protect the secured party in the event of a debtor's insolvency. That is, perfection is fundamental for the protection of a secured party's interest in collateral. The consequences of unperfected securities include that it is:

- subordinated to the interests of a creditor that has seized the collateral;
- subordinated to a perfected security in the same collateral; and
- subordinated to the buyer/lessee of the collateral.

The main reasons for perfection are to ensure that:

- the intended priority of competing security interests is preserved;
- the secured party is protected if the grantor becomes insolvent;
- it protects against taking free or extinguishment provisions under the PPSA; and
- an unperfected security interest vests in a debtor upon insolvency.

[9] It should be noted that security agreements exchanged electronically and accepted by grantors using electronic signatures or audio recordings are also acceptable.

(a) How do you perfect?

Perfection of a security interest occurs when a secured party effectively provides notice to third parties of its security. It may be done via the 'main rule' (s 21 of the PPSA) or by the 'goods possessed by a bailee' rule (s 22 of the PPSA).

Section 21 of the PPSA provides:

> (1) A security interest in particular collateral is ***perfected*** if:
>
> (a) the security interest is temporarily perfected, or otherwise perfected, by force of this Act; or
>
> (b) all of the following apply:
>
> (i) the security interest is attached to the collateral;
>
> (ii) the security interest is enforceable against a third party;
>
> (iii) subsection (2) applies.
>
> (2) This subsection applies if:
>
> (a) for any collateral, a registration is effective with respect to the collateral; or
>
> (b) for any collateral, the secured party has possession of the collateral (other than possession as a result of seizure or repossession); or
>
> (c) for the following kinds of collateral, the secured party has control of the collateral:
>
> (i) an ADI account;
>
> (ii) an intermediated security;
>
> (iii) an investment instrument;
>
> (iv) a negotiable instrument that is not evidenced by a certificate;
>
> (v) a right evidenced by a letter of credit that states that the letter of credit must be presented on claiming payment or requiring the performance of an obligation;
>
> (vi) satellites and other space objects.
>
> Note: For what constitutes possession and control of collateral, see Part 2.3.
>
> (3) A security interest may be perfected regardless of the order in which attachment and

any step mentioned in subsection (2) occur.

(4) A single registration may perfect one or more security interests.

Broadly speaking, the 'perfection' of a security interest occurs when a secured party acquires a 'priority time' in relation to competing security interests in the same capital. A security interest is 'perfected' where:

- the security interest is 'attached' to collateral and is 'enforceable against third parties'; and
- the secured party has either:
    - registered its interest on the PPSR;
    - taken possession of the collateral; or
    - with respect to certain collateral, taken control of collateral (i.e. if it is subsection 21(2) Property).

Depending on the type of collateral, perfection may occur by:

- registration of a 'financing statement' in a PPSR;
- the secured party takes possession of collateral – other than by seizure or repossession;
- the secured party has control of the collateral; and
- situations where the PPSA provides for temporary perfection (where there is a change or transfer of collateral).

It is important to note that a security interest is only effective if it attaches to collateral.

A further note of importance is perfection in the context of insolvency. Indeed, subject to certain limited exceptions, an unperfected security interest 'vests' in the grantor. As a result, a secured creditor will lose its security, and become unsecured. That is, even if an asset is owned by a particular party, if that party has a security interest in that asset which has not been perfected, that party may lose the asset on the insolvency of a counter-party, with the party becoming a mere unsecured creditor.

In summary 'perfection' is essential so as to:

- attempt to sure up (i.e. secure in priority) security interests. Generally speaking, perfected securities have priority over unperfected securities (subsection 55(3) of the PPSA). Amongst perfected security interests, generally speaking perfected security interests have priority by reference to the 'priority time' (i.e. the time in which a

security interest is perfected). However, some security interests have priority over others, such as purchase money security interests and security interests perfected by control.

- avoid a security interest vesting in a grantor, upon the grantor entering into bankruptcy, administration or liquidation (see section 267 of the PPSA).
- ensure that there is an ability to appoint a receiver over an administrators, or to appoint administrators (see sections 441A and 441B of the *Corporations Act 2001 (Cth)* (the '**Corporations Act**'));
- ensure that a securities interest covers proceeds. A security interest attaches to proceeds with respect to collateral – whether obtained via disposal of the collateral or otherwise (see subsection 32(1) of the PPSA). However, a security interest must be perfected against proceeds (paragraph 33(1)(b) of the PPSA).
- avoid extinguishment of unperfected security interests upon disposals of collateral. That is, unperfected securities may be extinguished when the collateral is dealt with for value, notwithstanding that the buyer / lessee knows of the unperfected security interests (section 43 of the PPSA).

8. Priority rules

The priority of common law security interests (non-PPSA, not ASIC registrable charges) depends on the nature of the security interest (legal or equitable) in question, the time of its creation, whether there is any knowledge of prior interests and many other factors. The PPSA carries its own – but different – complexities.

The PPSA rewards effort – it gives priority to those who perfect their securities. Although not an unqualified statement, it can be said the PPSA adopts a 'first-in-time' rule in the context of priority disputes. As a result:

- priority between two unperfected security interests is determined by the order of attachment; and
- priority between two perfected security interests is determined by order of the 'priority time'.

The priority as between security interests with respect to the same collateral includes:

- ***determining the type of security*** - for example, is the collateral a purchase money security interest or an ordinary security interest;

- ***class of collateral*** - for example, is there a requirement for a special form of perfection (e.g. registration of purchase money security over collateral which will be inventory for the grantor); and
- ***method of perfection*** - for example, is the collateral of a type that permits perfection by control.

Perfected security interests have priority over unperfected securities. Perfection by control has priority over perfection by any other method. Section 55 of the PPSA sets out the default priority rules applicable to other types of secured personal property. It provides:

- a 'perfected' security interest in collateral has priority over an unperfected security interest; and
- priority between perfected interests amongst themselves, and unperfected interests amongst themselves, is determined on a first-in-time basis.

Key priority rules under the PPSA are as follows:

- unperfected security interest rank in order of attachment (subsection 55(2));
- a perfected security interest defeats an unperfected security interest (subsection 55(3));
- perfected security interest rank in order of priority of time, usually the earlier of registration time or time of first perfection by possession or control (subsection 55(5));
- a security interest perfected by control defeats a security interest perfected in another way (section 57); and
- a purchase money security interest has priority over non-purchase money security interest (subsection 62(1)).

With respect to perfected security interests, the 'priority time' is the 'registration time', which is effective from when it becomes available for search in the PPSR.[10] Once the requirement for perfection is met, the 'priority time' goes back to the 'registration time' – but only if the perfection is continuous. That is, the first party to register a security interest has priority. However, the 'first-in-time' priority rule is subject to an exception, with respect to purchase money securities.

(a) Priority Waterfall

[10] It should be noted that a security interest may be registered before attachment and before the existence of security agreement).

Meehan, *The PPS Guide,* Woof Creative, 2011 at [18.012] provides a 'priority waterfall' that shows where a security interest will fall in the hierarchy. It provides for eleven spaces of priority:

first – creditors receiving payment of a debt. Section 69 of the PPSA provides that:

(1) The interest of a creditor who receives payment of a debt owing by a debtor through payment covered by subsection (3) has priority over a security interest (whether perfected or unperfected) in:

(a) the funds paid; and

(b) the intangible that was the source of the payment; and

(c) a negotiable instrument used to effect the payment.

(2) Subsection (1) does not apply if, at the time of the payment, the creditor had actual knowledge that the payment was made in breach of the security agreement that provides for the security interest.

(3) Payments made by a debtor are covered by this subsection if they are made through the use of:

(a) an electronic funds transfer;

(b) a debit, transfer order, authorisation, or similar written payment mechanism executed by the debtor when the payment was made; or

(c) a negotiable instrument.

second – general law liens, and statutory liens and charges . Subsection 73(1) of the PPSA provides that:

An interest (the priority interest) in collateral has priority over a security interest in collateral if:

(a) the priority interest arises (by being created, arising or being provided for):

(i) under a law of the Commonwealth, a State or a Territory, unless the person who owns the collateral in which the priority interest is granted agrees to the interest; or

(ii) by operation of the general law; and

(b) the priority interest arises in relation to providing goods or services in the ordinary course of business; and

(c) the person who holds the priority interest provided those goods or services; and

(d) no law of the Commonwealth, a State or a Territory provides for the priority between the priority interest and the security interest; and

(e) the person who holds the priority interest acquired the interest without actual knowledge that the acquisition constitutes a breach of the security agreement that provides for the security interest.

third – acquisitions of interests in chattel paper, negotiable instruments and negotiable documents of title – sections 70, 71 and 72 of the PPSA;

four – control – section 57 of the PPSA.

five – accounts – section 64 of the PPSA;

six – 'priority' purchase money security interests (i.e. purchase money security interests of sellers, lessors and commercial consignors, provided that they comply with the purchase money security interest rules);

seven – other purchase money security interest rules – section 62 of the PPSA;

eight – perfected securities interests – earliest in time has priority – subsections 55(4) and 55(5) of the PPSA;

nine – perfected and unperfected securities – perfected securities interest has priority (subsection 55(3) of the PPSA);

ten – execution creditors defeat unperfected security interests – section 72 of the PPSA; and

eleven – unperfected securities interest – that which attaches first has priority – subsection 55(2) of the PPSA.

(b) Perfection by control

There are types of personal property that can defeat the security provided by prior registration on the PPSR by taking 'control' of the property that is security. That is, one may take control of certain types of collateral can defeated a registered security interest in the PPSR, even if they have notice of the prior interest, and even if they intend to defeat the prior registered interest.

Subsection 57(1) of the PPSA provides that:

> A security interest in collateral that is currently perfected by control has priority over a security interest in the same collateral that is currently perfected by another means.

For competing security interests that are both perfected by control, subsection 57(2) of the PPSA provides that the first in time prevails. Further, knowledge of a competing security

interest is almost irrelevant in resolving priority disputes under the PPSA and notice is irrelevant for the principal priority rules in the PPSA regime.

(c) Control as against Purchase money security interests

An issue to consider is what the real 'super –priority' under the PPSA. Although purchase money security interests are said to have 'super priority' under the PPSA because they defeat all other types of security, they do not trump security interests perfected by control.

However, unlike perfection by control, a purchase money security interest can operate with respect to any type of personal property, and not just s 21(2) of the PPSA property. The two priorities will only compete where s 21(2) property is collateral (which would include, for example, lending for shares, derivatives and other financial products).

(d) How is section 21(2) property controlled?

The concept of 'control' for subsection 21(2) property is set out in sections 25 to 29 of the PPSA, which prescribes rules with respect to control of ADI accounts, intermediated securities, investment instruments, letters of credit and uncertified negotiable instruments.

Importantly, section 27 of the PPSA deals with control of investment instruments (e.g. shares). That is, section 27 of the PPSA provides that a person has control of an investment instrument if (and only if) one of the following occurs:

- the person (other than a debtor or a grantor of the security interests themselves) becomes the registered owner of the investment instrument; or
- if the investment instrument is evidenced by a certificate – the person takes possession of the certificate and has the power to either:
  - transfer the instrument to themselves or to another person; or
  - otherwise deal with the instrument; or
- if the investment instrument is not evidenced by a certificate, the secured party and debtor or grantor must agree that the secured party is able to initiate or control sending instructions by which the investment instrument could be transferred or otherwise dealt with; or
- if the investment instrument is not evidenced by an instrument, a person may also control it where:
  - the registered owner (who is not the debtor or grantor) acknowledges in writing that the investment instrument is held on behalf of the person, or the investment instrument is registered to a third party on behalf of the person; and
  - there is an agreement by which the person has the power to direct the transfer of or otherwise deal with the investment instrument.

As it will usually be unlikely that a secured party may become the registered owner of the secured assets, a secured party will therefore look to control an investment instrument by securing for themselves the right to deal with the investment instrument, and by taking possession of any certificates which evidence the instrument.

The right to deal with the instrument need not be exclusive. The PPSA provides that a debtor or a grantor of the security interest who retains the right to deal in the investment instrument does not alter the characterisation of the secured party having 'control' of the investment instrument.

(e) Protecting security interests with respect to 'controllable' collateral?

With respect to s 21(2) of the PPSA property, given the ability to 'control' such items of property, it is advisable that secured parties with respect to such property take unfettered control of it. As an example, in the event of a charge over a parent company which also secures its shares in a subsidiary, and where the shares are evidenced by a share certificate, it would be advisable to take possession of the share certificates from the company as well as obtaining a power of attorney or draft transfer document with respect to those shares. However, if the shares are not evidenced by certificates then obtaining an appropriately drafted power of attorney or draft transfer document with respect to shares allowing unconditional dealing in the shares may be sufficient.

In the context of a share in a proprietary company which does not have a certificate issued with respect to it, a secured party may run the risk that the issuing company may at some stage during the term of the security interests decide to issue share certificates. In such a situation, the secured party may no longer 'control' the shares if they did not take possession of the share certificates. In such a situation, if a third party secured lender then took possession of the share certificates (i.e., after the share certificates were issues which itself is after the first security interest holder obtained that interest) then the third party could have control of the shares within the meaning of the PPSA and the original secured party could lose priority of their security. Whilst such risks may be mitigated by requiring appropriate warranties and undertakings from both borrower and the insurer of the shares, the risk could only be removed by requiring the issuer to issue share certificates prior to money being lent on the strength of security.

It may also be prudent for any person considering taking security over investment instruments to include in their initial security view an enquiry as to whether investment instruments might be certificated or not and to require the issue and transfer of possession of any certificates where available.

(f) Vesting of unperfected security interest in a grantor

Under Part 8.2 of the PPSA, on the insolvency of a grantor an unperfected security interest will generally 'vest in' an insolvent grantor. This will apply when:

- a winding up order is made or a resolution passed winding up a company; or
- an administrator is appointed to a company, or a company executes a deed of company arrangement, or
- bankruptcy of an individual.

However, some kinds of security interests are not affected by this rule (section 268 of the PPSA). These include transfers of chattel paper and accounts, certain short-term PPS leases and commercial consignments.

The 'vesting in the grantor' rule in section 267 of the PPSA is important to note. It appears designed to 'vest in' insolvent grantors' interests held not only by as mortgagees or charges but also the ownership interest in the secured parties in retention of title sales, and those PPS leases and bailments not exempted by section 268 of the PPSA.

9. Purchase money security interest

A 'purchase money security interest' receives different priority rule treatment and, therefore, should be considered independently.

The special priority rules of a purchase money security interest reflects a traditional priority accorded to ownership interests and also to security taken to secure amounts used to purchase the subject of the security. The purchase money security interest rules attempt to reinstate its significance in priority terms to something approaching the pre-PPSA position.

Subsection 14(1) of the PPSA defines a purchase money security interest as any of the following:

- a security interest taken in collateral, to the extent that it secures all or part of its purchase price;
- a security interest taken in collateral by a person who gives value for the purpose of enabling the grantor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights;
- an interest of a lessor or bailor under a PPS lease;

- an interest of a consignor who delivers goods to a consignee under a commercial consignment.

It has been described by some as a 'super-priority', though see the discussion above a point 7(c). However, a purchase money security interest status is not itself a guarantee of 'super-priority' unless other steps are taken. When registering the security interest as a purchase money security interest, the financing statement must state that it is a purchase money security interest. Also a purchase money security interest only has super-priority for:

- inventory that comprise goods, if registered prior to the grantor obtaining possession and for other kinds of inventory if registered prior to attachment (subsection 62(2) of the PPSA); and
- for personal property that is not inventory, in the case of goods, if registered within 15 business days after the grantor obtains possession and for any other property within 15 days after the interest attaches (subsection 52(3) of the PPSA).

Section 10 of the PPSA relevantly states:

> ***inventory*** means personal property (whether goods or intangible property) that, in the course or furtherance, to any degree, of an enterprise to which an ABN has been allocated :
>
> (a) is held by the person for sale or lease, or has been leased by the person as lessor; or
>
> (b) is held by the person to be provided under a contract for services, or has been so provided; or
>
> (c) is held by the person as raw materials or as work in progress; or
>
> (d) is held, used or consumed by the person, as materials.

Security interests are susceptible to being defeated by 'silent' equipment purchase money security interests for a period of up to 15 business days. This risk arises because equipment purchase money security interests have 15 business days to register. Security interests may be defeated by 'latent' equipment purchase money security interests that do not show on the PPSR at the time of the search, but emerge on the PPSR within 15 business days.

Further, purchase money security interest super-priority also extends to proceeds (section 62 of the PPSA) and to processed or comingled goods (section 103 of the PPSA). These are discussed at point 15 below.

10. The Register

As the Registrar General's register for interests in land is the all-important records for real property, the PPSR (together with other perfection methods) is the all-important register for the PPSA and personal property regime. Under the PPSA, the security agreement itself is not registered, it is the 'financing statement'. A financing statement is a document that summarises the key points of a security agreement. Registration on the PPSR will be the most common method – and the most important method – of perfecting security interests under the PPSA.

The PPSA establishes an electronic register that is designed to provide a simple, quick and cheap process. It is intended to be a 'red flag' register – that is, it is intended to draw attention to a security interest, without disclosing too many details. Whilst registration is intended to be a simple process, there may be issues that arise with respect to how to describe particular collateral, and also deciding under which category the interest should be filed.

It should be noted that registration is effective from the 'registration time'. This is the moment when the description of the collateral is available for search on the PPSR with respect to that secured party. This time is important because it forms the basis for determining priority of a security interest perfected by registration. However, in order for a security interest to be effective, perfection must be continuous.

(a) 20 business day registration window

At the outset it is important to mention an amendment the PPSA regime has made to the Corporations Act. A new section 588FL has been inserted into the Corporations Act. The section provides that corporate secured parties who perfect by registration should register within 20 business days (and not the previous 45 calendar days as applied with respect to company charges pursuant to Chapter 2K of the Corporations Act). Section 588FL of the Corporation Act sets up a system under which a security interests vests in corporate grantors and is invalid if the grantor becomes insolvent (i.e. liquidation or voluntary administration) and the following conditions apply to the securing interest:

- it is perfected by registration only;
- it was granted in the six months leading up the grantor's administration or liquidation; and
- it was not registered within 20 business days of the grant.

Although s 588FL would have no application in the event that the 6-month period following the grant of a securing interest passed without the grantor entering into administration or liquidation, in order to reduce risks secured parties should always register their secured interest within 20 business days of the grant.

In *Re Cardinia Nominees Pty Ltd* [2013] NSWSC 32 Black J considered the failure to register the interest within time was due to 'inadvertence' (as that term is understood in relation to failing to register security interests) and exercised his discretion to fix the time of registration as requested. His Honour reached the same conclusion in and *Re Barclays Bank PLC* [2012] NSWSC 1095.

Section 588FL of the Corporations Act does not apply to transfers of account or chattel paper, commercial consignments, or PPS leases that relate to serial numbered goods for terms that exceed 90 days but are less than one year (see section 588FN of the Corporations Act).

(b) Financing statements

A registration on the PPSR is affected by completing a form called a "Financing Statement" (subsection 150(1) of the PPSA). It should be noted that a financing statement is intended to be a 'red flag' and is a short form registration, which discloses the main elements about a security interest. A financing statement is limited in information that it does disclose.

A financing statement (and therefore any information disclosed on the PPSR as a result of the information provided on a financing statement) provides limited details about security interest. They are:

- the details of the grantor;
- the secured parties;
- a broad description of the collateral – although parties may provide detailed particulars with respect to the collateral;
- the type of security interest granted.

As there is no 'title by registration' the process of registration itself does not create the security interest. It perfects an already existing security interest.

A secured party must have reasonable grounds for making an application to register a financing statement (section 151 of the PPSA). As financing statements may be lodged in anticipation of a security interest, if a security interest does not eventuate, the secured party has 5 business days to remove the registration (subsection 151(3) of the PPSA), failing which will subject the party to civil penalty provisions (subsection 151(2) of the PPSA).

A single registration may also perfect multiple security interests (subsection 21(4) of the PPSA). A sufficiently drafted financing statement may also cover multiple supplies of goods, especially in the context of purchase money security interests.

(c) Requesting copies of security agreements

As the PPSR is only a 'red flag', those interested still need to obtain the 'attachment document' (i.e. the security agreements) that purportedly create the security interest. Only interested parties may do so. Such parties include the grantor, other secured parties who hold a security interest over the same collateral, the auditor of the grantor and execution creditors with interest in the collateral (subsection 275(9) of the PPSA). This is a different situation as was the case with respect to the ASIC company charge register or the Department of Lands Register – under which anyone could have obtained details of such charges and instruments.

Subsection 277(1) of the PPSA provides that secured parties must provide a copy of their security agreement upon request from an interested party within 20 business days of receiving such a request. However, if the grantor and secured party have agreed in the security agreement that it shall be confidential, then a secured party is not obliged to respond to a request for a copy of the security agreement from the interested person unless either:

- the debtor authorises the disclosure (paragraph 275(7)(c) of the PPSA);
- the debtor, who may also be the grantor, is in default at the time that the request is received; or
- the request is made by the auditor of the grantor (paragraph 275(7)(e) of the PPSA).

Interested parties may request a written statement of the secured monies owing with respect to the security interest held by the other secured parties. However, there may also be confidentiality restrictions in security agreements, which would prohibit the provision of this information (paragraph 275(1)(b) of the PPSA). It should be noted that the secured party is prevented from denying that a security agreement is correct (section 283 of the PPSA). That is, a recipient of such information can rely on the information provided. Further, a secured party should ensure that the information provided is correct and the relevant version of it is provided otherwise the secured party is at that disadvantage as the recipient is entitled to rely upon it.

11. Taking free of a security interest

The PPSA provides for when personal property may be taken free of a security interest. Broadly, a party cannot acquire free title to goods that are subject to a security interest in the

event that they are involved in the creation of that security interest. By s 18(1) of the PPSA a security interest takes effect according to its terms. Because equitable and legal rules are mostly displaced, the PPSA provides for the circumstances in which a third party lessee or purchaser will take (by a lease) free of the security interest). Regard should be given to Chapter 2 as contained in Part 2.5 of the PPSA. Essentially these rules provide a code for when a third party may take free interest even including ownership.

The PPSA main rule of 'taking free' is that a buyer or lessee of personal property, for value, takes the personal property free of an unperfected interest in property (section 43 of the PPSA). The only exception is when a buyer or lessee was party to the transaction that created the interest. As a result, constructive or even actual notice on the part of the buyer or lessee does not preclude the taking free of a security interest of an item that was a security interest. This should be contrasted to the provisions in relation to notice for the real property register.

The general position is that good title will be acquired by a purchaser of collateral, notwithstanding that the collateral is subject to a security interest, where:

(a) The security interest is not perfected;
(b) Serial statements are misstated in the registration of prescribed property (e.g. motor vehicles, watercraft, aircraft and various intangible property rights. If they are 'consumer property', then they must be registered via serial number);
(c) Consumer property which is purchased and valued at less than $5,000; and
(d) Property is purchased in the ordinary course of a business

A buyer or lessee takes personal property free of a security interest given by the seller or lessor (including any proceeds) if it was acquired in the ordinary course of the seller's / lessor's business of selling or leasing property of that particular kind. However, the exception does not apply to serial-numbered property that the buyer themselves hold (or hold on another's behalf) as inventory. Further, the exception does not apply if the buyer / lessee has actual knowledge that the sale / lease is breaching a security agreement. Further, it should be noted that there is no duty on a third party to make reasonable inquiries.

12. Enforcement

Upon a debtor's default, the PPSA provides a range of statutory enforcement rights on secured parties. These rights are in addition to any rights conferred by the security agreement. A secured party is not required to obtain judgment against the debtor before taking enforcement action.

Given the nature of the PPSA regime it is significant, and interesting, that parties are free to contract out some enforcement provisions. However, in the case the property is predominantly for personal, domestic or household purposes (i.e., consumer property), this right is significantly limited to avoid duplication with *National Credit Code*.[11] Any secured party may initiate enforcement action but a higher-ranking secured party may obtain possession of collateral from a lower-ranking secured party.

Where collateral is liquid, such as debts owed by third parties to the grantor, the PPSA provides for statutory garnishee style remedy by notice to the third party debtor. In other cases, the PPSA provides the secured party with powers of seizure and disposal. A secured party may sell or lease collateral to third parties. Alternatively, in the event that effective notice is given and there are no objections, the secured party itself may purchase or retain the collateral. Written details of any dealings with the collateral should be kept by the secured party as both the grantor and other secured parties may request a statement of accounts.

All sales of collateral must be at market value or otherwise at best price reasonably obtainable in the circumstances. A secured party may only purchase collateral at a public sale and at market value. This brings into effect the principles and considerations that apply to trustees or others (such as mortgagees) effecting powers of sale.

An amount, proceeds or personal property derived from an enforcement process, must be allocated in order of:

1. obligations to persons holding interest other than security interest in the collateral that have the priority than the interest of the secured party;
2. reasonable expenses incurred in relation to the enforcement of a security interest against the collateral, to the extent that the expenses are secured by the security interest (reasonably enforceable expenses are taken to be secured);
3. obligations to persons holding security interests in the collateral that have a higher priority than the interests of the secured party;
4. obligations to the secured party that are secured by the security interest in collateral;
5. obligations to persons holding interests or security interests in the collateral that have a lower priority than the interests of the secured party;
6. to the grantor.

According to Meehan, *The PPS Guide,* Woof Creative, 2011 at [24.001], when enforcing security interest under the PPSA, the following should be borne in mind:

[11] See s 3 of and Schedule 1 to the *National Consumer Credit Protection Act* 2009 (Cth).

(a) **spot all security interests** – it should be ensured that all transactions that fall within the scope of the PPSA (i.e. those which establish security interest with respect of personal property) have been identified;

(b) **perfect all security interests** – it should be ensured that all security interests are properly perfected otherwise they may be extinguished upon the bankruptcy, administration or liquidation of the grantor;

(c) **seize opportunities to maximise or improve the priority position by** –

- one should perfect against all available collateral before the grantor enters bankruptcy, administration or liquidation;
- take security interest where others have either not taken a security interest, forgotten to perfect security interest or made a mistake with respect to their security interest;
- perfecting by control with respect to financial assets;
- identifying and perfecting as against proceeds;
- registering against serial numbers with respect to that type of collateral;

(d) **ascertaining priorities** – determine the priority of all relevant security interests over relevant collateral of the grantor. Priority will have formed how an enforcement or an insolvency is structured and controlled by determining the assets over which a receiver/controller, administrator or secure party has control and can still contribute to a restructuring plan; and

(e) structure and plan for enforcement and asset sales.

It is not convenient to consider some specific issues in relation to enforcement.

(a) Exclusions with respect to enforcement

The statutory enforcement rights do not apply to:

- transactions deemed to security interests (transfer of an account or chattel not as security, a PPS lease, commercial consignment);
- investment instruments perfected by possession or control;
- property subject to receiver or manager under the Corporations Act.

(b) Enforcement of security interest in liquid assets

Upon a debtor's default, the secured party may effectively issue a written garnishee notice (in an approved form) to the grantor's third party debtors. These apply to the debtor's liquid assets, accounts, chattel paper and negotiable interest. Upon receipt of the notice, the third

party debtor must pay the secured party any amount owed to the grantor within 5 business days, if the debt is not yet due, the third party debtor has 5 business days from the due date. Any amount received from a third party debtor must be applied by the secured party towards secured obligation. The distribution table applies to any monies received from the third party debtor.

(c) Notice to higher priority parties

If a lower ranking secured party intends to take garnishee action, it must give written notice to highest ranking secured parties. The notice must be given to the higher priority party at least 10 business days before the action is to be taken and must:

- contain the name of the secured party giving the notice; and
- contain the description for collateral; and
- state that the enforcement party proposes to take action against the liquid assets of the grantor (whether by garnishee notice or seizure of proceeds of collateral);
- state the address for notice of the lower ranking secured party.

Upon being notified, a higher priority party may elect to continue the enforcement process by giving notice to a lower priority party. A secured party must also give notice to the grantor of any action who intends to take over the liquid assets of the grantor at least 5 business days before the action is taken.

(d) Seizure of collateral

If a debtor is in default under a security agreement, the PPSA provides that the secured party may seize collateral by any methods permitted by law. A secured party may seize intangible property (predominantly intellectual property licences) by giving notice to the grantor and any licensor that the giving of notice can constitute seizure of the property. The parties to a security agreement may also agree upon another method of seizure. A secured party who has perfected their security interests by possession or control may seize collateral by provision of the same notice. Seizure of collateral does not perfect a security interest.

(e) Apparent possession

Where collateral cannot be readily moved from the grantor's premises, a secured party may seize the collateral by taking 'apparent possession'. A secured party which seizes collateral must either dispose of the collateral or retain the collateral (seemingly the only two options available). Subject to the security agreement, the secured party is entitled to a reasonable period in which to secure, store and value the collateral and determine how to deal with the collateral.

(f) Rights of higher priority party to seize collateral

A higher priority party may, by notice, request possession of collateral from a lower priority party. Upon receipt of notice, the lower priority party must give up possession of collateral within 5 business days or such further period as is reasonable. In return, a higher priority must pay an amount to a lower priority party reflecting its reasonable enforcement expenses. The lower priority party must provide evidence to support this amount. Generally, the higher priority party must pay the amount of enforcement expenses within 20 days of disposal of the collateral or from when the evidence is received.

(g) Obligations during enforcement: sale of collateral

Once a secured party has seized collateral, it may dispose of it by:

- private of public sale (including auction or closed tender);
- lease, of the security documents provides;
- if the collateral is intellectual property – by licence.

A secured party who disposes of collateral owes a duty to exercise all reasonable care:

- to obtain at least market value for the collateral; or
- otherwise to obtain the best price that is reasonably obtainable at the time of the disposal, having regard to the circumstances excising at the time.

On request by another secured party or grantor, the secured party must provide a written statement of account. The statement of account must be provided within 20 business days after the request. The statement of account must show:

- in the case of disposable lease – the total amount received, and expected to be received during the period from seizure to the end of the lease;
- in any other case – the total amount received from the disposal of the collateral;
- the total expenses relating to the disposal of the collateral;
- any amounts paid to the secured parties; and
- the balance owing by the secured parties to the grantor or by the debtor to the secured party, as the case may be.

If the secured party has not disposed of collateral within 6 months, it must give a written statement of account to any other person with a security interest or the grantor within 20 business days of their request. The 6-month notice must:

- state that the secured party has not disposed of the collateral; and

- show the total amount received in relation to the collateral during the six month period starting from the seizure date of the collateral; and
- show the amount of expenses relating to the retention of collateral.

Collateral disposed of by enforcement mechanisms is taken free of the interest of the grantor and all security interests in the collateral. A secured party may also dispose of collateral by purchasing it if the secured party gives the require notice *and* no notice of objection is given to the secured party. If a secured party receives a notice of objection, the collateral must either be sold or leased – the secured party cannot retain or purchase the collateral. The secured party is, however, entitled to request the objector to provide proof of their security interest.

Importantly, a secured party may only purchase collateral by public sale and by paying at least the market value at the time of the purchase.

A secured party who proposes to dispose of collateral (including by purchasing it) must give the notice to the grantor and any higher priority secured party. The notice must:

- contain the name of the secured party by giving them notice; and
- contain a description of the collateral; and
- state that the secured party proposes to dispose of the collateral, unless an obligation secured by the security interest is performed or an amount paid, within ten (10) business days after the notice is given; and
- state that the notice is given for the purposes of the PPSA; and
- the secured parties proposing to dispose of the collateral by purchase:
    - contain details of rights or objections; and
    - contain the address to which a notice of objection may be given under s.137 of the PPSA;
- any matters required by the PPS Regulations.

However, notice to the grantor or high priority parties is not required if:

- the secured party believes on reasonable grounds that the secured party was induced to enter in the relevant security agreement by fraud; or
- the secured party believes on reasonable grounds that the collateral might perish within 10 business days after the date the collateral is seized; or
- the secured party believes on reasonable grounds that there will be a material decline in the value of the collateral if it is not disposed of immediately after the day this collateral is seized; or

- the secured party believes on reasonable grounds that expenses of preserving the collateral disproportionately large in relation to its value; or
- the collateral is foreign currency; or
- the collateral is to be disposed of in accordance with the operation laws of a clearing and settlement facility.

Collateral disposed of by the secured party (including by purchasing it) is acquired free of all security interests and the interest of the grantor.

(h) Obligations during enforcement: retaining collateral

Alternatively, a secured party may elect to retain seized collateral if the secured party gives notice and no notice of objection is given to the secured party. The notice must be given to:

- the grantor; and
- another registered secured party; and
- if the retaining party is a purchased money securing interest holder – any other lower priority secured parties registered in the collateral.

The secured party must give notice at least 10 business days before the first steps are taken to retain the collateral. A notice must be given in the approved form and must:

- contain the name of the secured party giving the notice; and
- contain a description of the collateral; and
- state that the secured party proposes to retain the collateral, unless the obligation is performed or an amount is paid, secured by the security interest, within 10 business days after the notice is given; and
- state the obligation to be performed, or the amount of payment required, before the day is specified in accordance with the preceding point, to satisfy the obligations secured by the security interest in the collateral; and
- contain details of rights of objection; and
- contain the address to which a notice of objection may be given; and
- any matters required by the PPS Regulations.

If notice is given and no notice of objection is given to the secured party, 10 business days after the notice is given, the secured party may take steps to transfer the title to itself. When title does in fact pass, the secured party takes title free from the interests of the grantor.

(i) Obligations during enforcement: redemption of collateral

A secured party or grantor may redeem collateral by paying the amount secured by the obligation together with any enforcement expenses. A grantor has priority for this purpose. A debtor may also reinstate a security agreement by paying the amounts in arrears (not including an acceleration clause) together with any enforcement costs. A security agreement may only be reinstated once.

13. Practical Problems with the PPSA

As is to be expected, there are various practical issues with the PPSA regime. It is a far-reaching regime, affecting valuable interests in commerce and other activities that impose a detailed priority rules for recovery in circumstances of competition.

Over time case will address many of these practical problems, though is also likely to illuminate new problems not known before the particular judgment highlights it as such. There has been little judicial consideration of the regime thus far. As at the date of writing there are only 7 decisions in relation to the PPSA:

- In *Re Cancer Care Institute of Australia Pty Ltd (admin appointed)* [2013] NSWSC 37 Black J did not consider the PPSA in any detail;
- *Re Cardinia Nominees Pty Ltd* [2013] NSWSC 32 and *Re Barclays Bank PLC* [2012] NSWSC 1095, both discussed above, in which Black J exercised his discretion to confirm a date of register of an interest on the PPSR despite the failure to actually register on that date;
- In *Crossmark Asia v Retail Adventures* [2013] NSWSC 55 McDougall J, having concluded that the terms of contract a particular way, did not need to consider s 267 of the PPSA on which the parties had made submissions;
- In *Grant v YYH Holdings Pty Ltd* [2012] NSWCA 360 in which Basten JA sought comfort in the conceptual underpinning of the PPSA in considering livestock issues that did not arise under the PPSA;
- In *Prepaid Services v Atradius* [2012] NSWSC 608 at [111] where McDougall J notes that retention of title clauses may be affected by the PPSA on and from 31 January 2012; and
- In *Haruki Machinery Pte Ltd v RSM Crane Sales and Hire Pty Ltd* [2012] WASC 131 where Edelman J noted the registration of a crane on the PPSR but did not discuss the provisions in any detail.

There are, however, some issues or practical problems with the PPSA that can be considered up front, without reference to case law showing them to be an issue. They are considered separately below.

(a) Land vs Personal Property

The largest 'carve out' of the definition of 'personal property' is land. It is defined in s 10 of the PPSA as:

> ***"land"*** includes all estates and interest in land, whether freehold, leasehold or chattel, but does not include fixtures'

However, the extent of the application of the PPSA to land is unclear. Whilst the term 'personal property' seems to exclude real property (and fixtures, water rights, some statutory licences and some other miscellaneous interest), transactions involving security interest in the land may be impacted upon by the PPSA due to the way that those transactions are handled. For example, the PPSA expressly excludes from its application the '…*creation or transfer of any interest in land …'* (subparagraph 8(1)(f)(i) of the PPSA) including any interest in fixtures (subparagraph 8(1)(j) of the PPSA). However, some commercial property transactions that affect agricultural interest may be caught within the PPSA.

The PPSA may impact upon dealings in, and relates to real property in two broad areas:

- 'traditional' financing arrangements whereby interest in or connected to commercial real property are currently secured (or would be subject to similar security in the future) including fixed and floating charges, crop mortgages, goods mortgages, bills of sale; and
- capturing a broad ambit of dealings, which in substance, create a 'security interest' in, or rights in connection with, or related to, real property (including securing landlord ownership rights in premises fit-out, equipment leasing, protecting certain contractual 'step-in' rights etc.).

Another issue is when land is dealt with in conjunction with personal property. The PPSA recognises by acknowledging that land is often dealt with in conjunction with other assets that are covered by the PPSA, and offers an approach to enforcing security over this package of assets. The PPSA allows the security holder to elect to enforce the security interest by applying enforcement laws, which apply to land in the relevant State or Territory, to the whole security package including those assets would otherwise covered by the enforcement regime under the PPSA (see Part 4.2 of the PPSA, particularly ss 116 and 117).

As a result, a security holder could, for example, deal with land and other assets of a business operated on the land (and which would officially be subject to a fixed and floating charge) together, as a mortgagee in possession, under the relevant property law of the jurisdiction. However, the election can only be made if it is reasonable to do so in the circumstances, taking into account a number of matters, including:

- the respective values of the land and other assets;
- the degree of connection between the land and the other assets;
- whether it is an efficient method of enforcement to deal with them together;

- whether the land and the personal property are both located in the same State or Territory; and
- such other matters as are relevant.

Although these matters are only intended as a guide they evince the intention that this approach only apply where it is practical and efficient to do so given the circumstances.

(b) Commercial Actions on security interest

Three areas where the PPSA applies to specific commercial actions or situations are to be noted.

(i) Processed or comingled goods – whether the security interest subsists

The identity of goods that are manufactured, processed, assembled or comingled is lost in a product or mass if it is not commercially practical to restore the goods to their original state (subsection 99(2) of the PPSA). A security interest in goods that substantially becomes part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or comingled, that their identity is lost in the product or mass (subsection 99(1) of the PPSA).

With respect to such a situation, the priority rules provide that:

- a purchase money security interest has priority (section 103 of the PPSA);
- perfected security interests share in the product / mass according to the ratio of the obligation secured by the perfected security interest bears on the total sum secured by all perfected security interests (subsection 102(2) of the PPSA); and
- unperfected security interests share in the product / mass according to the ratio of the obligation secured by the unperfected security interest bears on the total sum secured by all unperfected security interests (subsection 102(3) of the PPSA).

(ii) Proceeds and security interests

If the collateral gives rise to proceeds (whether arising from a dealing with the collateral or otherwise), the security interest will attach to the proceeds of that collateral unless the security agreement provides otherwise (paragraph 32(1)(b) of the PPSA). It is therefore beneficial to the interest holder ensure the security agreement does not so provide.

Under the PPSA ‘proceeds’ means identifiable or traceable personal property of the types that include (see section 31 of the PPSA– and amongst other things):

- personal property derived directly or indirectly from dealing with a collateral;

- right to insurance payment or other payment as indemnity or compensation for loss or damage to collateral;
- if collateral is an investment instrument such as shares:
    - rights arising out of collateral;
    - property collected on collateral; and
    - property distributed on account of the collateral.

(iii) Accessions and security interests

Under the PPSA, an 'accession' to goods means goods that are installed in, or affixed to, other goods, unless both the accession and the other goods are required or permitted by the PPS Regulations to be described by a serial number (section 10 of the PPSA). An accession preserves its identity once installed in or affixed to the other goods. The PPSA provides detailed provisions relating to priority interest in accessions and obligations of the secured party as to their removal (see sections 90 to 97 of the PPSA).

The default rule and priority is that a security interest in goods that is attached at the time when the goods become an accession, has priority over a claim on the goods as an accession made by a person with an interest in the whole (see section 89 of the PPSA).

The issue of accession arose in *Grant v YYH Holdings Pty Ltd* [2012] NSWCA 360 in the context of 16 progeny born of a stolen sheep. The question of who owned the progeny was in issue. Although only passing reference is made to the PPSA it is an interesting read.

(c) Floating charges do not need to crystalise

A fixed and floating charge typically operates over all of the assets of a debtor. This includes both present and future assets. Under the PPSA, there is more flexibility to restrict the new security interests to specific assets.

Subsection 19(4) of the PPSA provides that a reference to a 'floating charge' does not cause the security interest to attach at a later time. A floating security interest may attach when the parties agree that the floating charge is agreed to (and not when, using the pre-PPSA terminology, the charge crystallises).

Under the old rules, a floating charge permits a chargor to deal with the charged assets in the ordinary course of its business and it only becomes a fixed charge on crystallisation. Under the PPSA there is no concept of deferral of time in relation to when a security interest attaches. That is, whilst the concept of fixed and floating charge does not remain under the PPSA, in its place parties enter into a general security agreement over a grantor's present and *"after acquired*" property. The security interest granted under a general security agreement

is identified as being attached to a specified class of collateral. There is no ongoing relevance for fixed and floating where a security interest are attached to fixed and fixed to collateral classes whichever themselves may capture circulating assets such as inventory.

The PPSA term is 'circulating asset' as considered in s 340 of the PPSA. A circulating asset, in effect, resembles a floating charge however preserves the commercial reality surrounding many historical issues with charges by avoiding the need to distinguish between fixed and floating charges. The PPSA thus removes the relevance of a fundamental issue under pre-PPSA law, that parties who encumbered their property through fixed charge would be unable to deal with such property in the ordinary course of business without the express consent form the secured party each and every time this was to occur.

As under the fixed and floating charge regime, the terms of the general security agreement should continue to specify the nature of restrictions on a grantor using the charged collateral. One way in which a person might have power to deal in an investment instrument is by way of a power of attorney granted by the debtor or grantor of the security interest in favour of the secured party authorising them to deal with the instrument.

Although power of attorney clauses in favour of the chargee are standard in fixed and floating charge documents, such powers are often conditional upon being exercised only in circumstances of an event of default. It is unclear from the PPSA whether such conditional power of attorney clauses would satisfy the requirement of the PPSA, that is, that the person controlling the instrument "is a able to" deal with the investment instrument. It may be argued that the PPSA requires an unfettered, present and existing right of control rather than the conditional one. However, there is no guidance on this issue.

(d) Failure to perfect will lose you your interest

A further note of great importance is perfection in the context of insolvency. Subject to certain limited exceptions, an unperfected security interest 'vests' in the grantor. As a result, a secured creditor will lose its security, and become unsecured. That is, even if an asset is owned by a particular party, if that party has a security interest in that asset which has not been perfected, that party may lose the asset on the insolvency of a counter-party, with the party becoming a mere unsecured creditor.

Section 267(1) of the PPSA sets out the winding up of a company, an administrator being appointed, a deed of company arrangement being executed, a sequestration order being made

or a person becoming bankrupt[12] are relevant events. If, at the time of one of them a security interest is unperfected s 267(2) applies. It provides:

> The security interest held by the secured party vests in the grantor immediately before the event mentioned in paragraph (1)(a) occurs.
>
> Note: This subsection does not apply to certain security interests (see section 268).

A person who acquires the collateral for new value from a secured party (or their agent) or a receiver is not affected by the vesting where they had no actual or constructive knowledge of the initiation of formal insolvency proceedings (s 267(3) of the PPSA).

In the Canadian case of *Central Refrigeration & Restaurant Services Inc (Trustee of) v Canadian Imperial Bank of Commerce* (1986) 5 PPSAC 262 it was held that temporary perfection at the commencement of bankruptcy was sufficient to maintain priority against the trustee in bankruptcy even where the security interest became unperfected after the end of the period of temporary perfection.

(e) Financing statement – information to be included

Care should be taken in the provision of information on a financing statement. A financing statement which contains a serious and misleading defect will be ineffective (subsection 164(1) of the PPSA). It should be noted that it is not necessary to establish that any particular person was misled (subsection 165(2) of the PPSA).

The table contained in section 153 of the PPSA sets out the data which must be included in a financing statement to be registered on the PPSR. A financing statement with respect to personal property prescribed by the Regulations (Regulation 5.3(1) of the PPS Regulations) must contain particular data (section 154 of the PPSA). At the moment, the following property is currently prescribed:

- a motor vehicle that has been impounded, immobilised or forfeited, or is subjected to an impoundment, immobilization or forfeiture application, under a law that provides for impoundment, immobilisation or forfeiture of a motor vehicle because it is used, or has been used, in the commission of certain offences;
- personal property that is subject to a notice or an order, or is confiscated or forfeited, under the provision of a proceeds of crime;
- personal property that is subject to an order of a court or tribunal (however described) that:
  - prevents or restricts the person dealing with the property; or

[12] By ss 55, 56E or 57 of the *Bankruptcy Act* 1966 (Cth)

- enforces another court order (however described); or
- orders the sale or other disposal of all or part of the property;

- personal property that:
  - is not mentioned in paragraph (a), (b) or (c); and
  - immediately before the registration commencement time, could have been registered on a transitional register maintained under a law of the Commonwealth, a State or a Territory.

Further, Schedule 1 of the PPS Regulations prescribes particular information, which must be included in the registration. Broadly speaking, a financing statement must contain details of:

- the secured party;
- the grantor;
- an address for the giving of notices to the secured party;
- the collateral and any proceeds;
- the end time of the registration;
- any subordination of the security interest;
- purchase money security interest; and
- any matters prescribed by the Regulations.

(f) Public Sale

Importantly, a secured party may only purchase collateral by public sale and by paying at least the market value at the time of the purchase. Further, as discussed at point 12(g) above, the secured party is obliged to sell any collateral at public sale for market value.

No guidance (other than the notice requirements etc discussed above) has been provided as to what obligations this imposes on the secured, and selling party. Considerations that apply to executors or mortgagee's in possession will be relevant on this point.

(g) Getting hold of the security documents

Although title is almost irrelevant under the PPSA, the need to control the security documents remains so. This was discussed in detail above at point 8(e) but it bears repeating that in relation to property for the purposes of s 21(2) of the PPSA the ability to 'control' such items of property, it is advisable that secured parties with respect to such property take unfettered control of it. E.g., obtain the share certificates.

(h) Perfect within 20 Business Days

It has been repeated a number of times in this paper – the need to register the interest within 20 Business Days of grant. Although s 588FL of the Corporations Act would have no application in the event that the 6 month period following the grant of a securing interest passed without the grantor entering into administration or liquidation, in order to reduce risks secured parties should always register their secured interest within 20 business days of the grant.

You do not wanting to be relying on the court's discretion to retrospectively order registration.

(i) Serial numbered property

The PPSA establishes 4 classes of serial numbered property, being motor vehicles, watercraft, aircraft and certain intellectual property rights (patents, trade marks, designs and plant breeder's rights). Security interests over consumer serial numbered property and commercial aircraft *must be* registered against the serial numbers. If not the general rule is that the registration will be defective, subject to certain 'grace periods' where the error in registration against the serial number is not the error or omission of the secured party (for example, the manufacturer subsequently changes the serial number (see s 165(a) of the PPSA)). The result is that the security interest will become unperfected.

Security interests over other commercial serial numbered property *may be* registered against it serial number.

Registration against serial numbers is advisable for all serial-numbered property because otherwise security interests are placed on serious risk of extinguishment (under s 44 of the PPSA) if the collateral is transferred (ss 44 and 45 of the PPSA).

14. Some important steps to ensure protection of security

The PPSA is structured and prescriptive with respect to the requirements for financing statements to be lodged on-line. If this is not followed, then there may be a loss of security or priority (though see the discretion exercised by Black J in both of *Re Cardinia Nominees Pty Ltd* [2013] NSWSC 32 and *Re Barclays Bank PLC* [2012] NSWSC 1095).

Because of the detailed requirements required (which vary according to the collateral, the security interest and the debtor / creditor), any entity registering security interests need to have detailed procedures in place to meet the requirements. Paragraph 34(1)(a) of the PPSA provides that perfection of a security interest may be lost (along with the priority interest) by

the effluxion of time. For example, perfection is lost 24 months after a debtor or grantor of the security interest transfers collateral to a third party, even where the third party has notice of the security interest and the secured party does not consent to the transfer.

Amendments to the Corporations Act made by the *Personal Property Securities (corporations and Other Amendments) Act 2010* (Cth) provide that perfection of registration of a security interest within 20 business days after a security interest is entered into is necessary to remove the risk of security being lost to a liquidator, administrator or to other creditors upon a company entering into a deed of company arrangement. As a result, financing statements should be registered o the PPSR as soon as possible (noting that they can be registered before the relevant security agreement is entered into).

Further (and overall):

- Group structures, and arrangements and agreements between entities, should be reviewed.
- A security interest should be registered in inventory prior to any stock passing. Retention of title causes will need to be agreed in writing and registered in order to be effective. Further, purchase money security interests may need to be registered to obtain 'super-priority'
- In the event that one takes 'security interests' in property and registers such interests, then proper records and systems should be in place to deal with any enquiries and other legislative requirements.
- If one has security interests registered against one's collateral, then continual regard should be given to the security interests registered. It should be ensured that any 'negative pledge' arrangements are not exceeded (particularly in the case of retention of title clauses which seek to gain a security interest over all the assets of an entity that grants a security interest).
- Secured parties need to ensure that they have the best form of security available. For example, whilst registration on the PPSR may be essential, there are some types of collateral that may have different forms of collateral that may be perfected better than by registration (e.g. control for ss 21(2) of the PPSA property);
- Charges should be renewed (and where relevant renegotiated) so as to deal with the new regime.
- The standard methodology of taking a mortgage over real property and a fixed and floating charge over the remainder may need to be reconsidered. Appropriate security interests should be taken in different forms of personal property.

- Despite the establishment of a PPSR, detailed security reviews both before and after the granting of the security interest will become more common – which will have an effect on the costs for borrowers.
- Secured parties need to closely monitor their secured assets (i.e. including on the PPSR).