



Commercial notes

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PERSONAL PROPERTY SECURITIES BILL 2008: AN OVERVIEW OF THE NEW REGIME

The consultation draft of the *Personal Property Securities Bill 2008* (the PPS Bill), released by the Commonwealth Attorney-General on 16 May 2008, contains important reforms to laws concerning security interests taken over personal property in Australia. The PPS Bill, if introduced and enacted, will establish a new national system of registration and priorities for personal property with effect from 2010.

This note provides an outline of the personal property securities scheme (the PPS scheme) proposed by the PPS Bill and suggests some actions for Commonwealth agencies involved in giving or receiving securities over personal property in anticipation of the new scheme.

What are personal property securities?

Personal property is any form of property other than land or buildings. Personal property can include tangible property (for example, cars, boats, machinery, artworks, crops and livestock) and intangible property (for example, shares, intellectual property, receivables and contract rights). Under the PPS Bill, a licence (for example, a taxi licence or broadcasting licence) is also classified as personal property.

A 'personal property security' is an interest in personal property which in substance secures the repayment of a loan or performance of an obligation. Historically, securities took the form of legal mortgages. The range of securities now includes transactions such as hire-purchase and leasing arrangements, conditional sale agreements, commercial consignments, the factoring of book debts and retention of title arrangements.

Why is reform necessary?

There are significant limits to using personal property as security under the current system due to the complexity and uncertainty in registering security interests. The Commonwealth, states and territories each have their own schemes and among these various jurisdictions there are more than 70 pieces of legislation, administered by 30 agencies, which regulate personal property securities. This fragmented system leads to delays and higher transaction costs, and may dissuade lenders from entering into transactions involving personal property as security.

Key reforms of the proposed legislation include:

- the establishment of a single, national register for security interests over personal property



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- a 'functional' approach to what constitutes a security interest
- a new set of priority rules governing competing interests.

These changes will improve the ability of borrowers to use personal property to raise capital, reduce risk for lenders and bring Australia into line with New Zealand and other countries such as the US and Canada.

Who will be affected by the new regime?

The new regime will have an impact on a broad range of transactions and will affect, for example, banks and finance companies, equipment lessors, suppliers of goods, businesses wanting to borrow money secured against personal property and consumers considering major purchases of items of personal property. Providers of financial advice, including business advisors and solicitors, brokers, accountants and insolvency practitioners, will also need to be familiar with the new laws.

The changes will affect various Commonwealth government departments and governmental agencies which give or receive security over personal property, or which otherwise need to consider whether particular property is the subject of any security interest.

Some circumstances in which agencies may need to be aware of the new PPS scheme

- **where assets are purchased using grants and a charge or other security is taken over those assets** to ensure compliance with the grant conditions
- **where a loan is given and security is taken** to secure repayment of the loan
- **where a debt to the Commonwealth is secured** over assets of an individual, company or other entity
- **where the Commonwealth is contracting with a party** and needs to establish whether or not assets related to the contract are encumbered.

Major changes and key concepts introduced by the Personal Property Securities Bill

Functional approach

At present, the legal principles relevant to a particular transaction are determined by the *form* of that transaction (for example, what type of personal property is involved, the location of the property and whether the grantor¹ of the security interest is an individual or corporation). The new scheme focuses on the *substance* of a transaction, taking a 'functional' approach to security interests.

The functional approach should provide more certainty, as the law will apply to all security interests. Under the new approach, 'security interests' include not only traditional securities such as charges, mortgages and pledges but also some transactions that are currently not viewed as securities; for example, a lease of more than one year, the transfer of an account receivable and a commercial consignment.

As a result of the functional approach, the terms 'fixed charge' and 'floating charge' will fall away. Under the new system, a 'floating charge' will become a security over a 'circulating' asset.

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'Attachment' and 'perfection' of security interests

The PPS Bill establishes rules for determining when a security interest has been created over personal property and when it can be enforced against that property.

Attachment

The term 'attachment' is used to describe the successful creation of a security interest in personal property.

Under the PPS scheme, when does a security interest attach to personal property?

- **when the secured party has given value** (for example, a loan)
- **when the grantor has rights in the personal property** that are transferable to another person
- **if the security interest is to be enforced against a third party**, when one of the following has occurred:
 - **the grantor has signed a security agreement** which is in writing and has an adequate description of the property
 - **the secured party has possession or control** of the property.

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Perfection

'Perfection' is the term used to describe what a security holder must do to ensure the security interest will have priority over other security interests created in the same property.

Under the PPS scheme, when is a security interest 'perfected'?

- **if it has attached**
- **if one of the following has occurred:**
 - **it has been *registered on the PPS Register*** (it is expected that the PPS Register, which is explained below, will be the most common way to perfect a security interest)
 - **the secured party has taken *possession of the property***
 - **the secured party has taken *control of the property*** (this applies only to certain kinds of personal property, including bank accounts, letters of credit and investment instruments such as shares).
An example of this is where the secured party becomes a customer of the bank in relation to the grantor's bank account, enabling the secured party to deal with the funds in the account.

Perfection of a security interest by registration, possession or control should put a potential secured party on notice of a prior, higher ranking security interest. A security interest may also be 'temporarily perfected' in a limited range of circumstances.

When a third party will acquire personal property free of a security interest

In most cases, perfection of a security interest will be sufficient to enable a security holder to enforce its security interest against a third party (such as a person who has purchased the secured item of personal property from the grantor). However, the PPS Bill provides for circumstances in which a third

party may take that property free of the security interest, whether perfected or unperfected, namely:

- serial numbered property² (for example, trade marks and large aircraft) where a search of the serial number on the PPS Register immediately before the purchase would not have disclosed the registered interest
- certain consumer goods with a market value below \$5,000
- personal property that is purchased in the ordinary course of the seller's business of dealing with property of that kind
- currency
- investment instruments.³

A third party will take a motor vehicle⁴ free of a security interest if the motor vehicle was purchased from a motor vehicle dealer, or if a search of the vehicle's serial number on the PPS Register on the day of the purchase or on the previous day would not have disclosed the registered security interest.

Prerequisites to taking personal property free of a security interest

Generally, the above rules will only apply when a third party provides value for the personal property and has no knowledge of the security interest, or no knowledge that the transaction was a breach of the security agreement. The term 'knowledge' will extend to 'recklessness' as to whether a circumstance exists.

The PPS Register

Purpose of the PPS Register

A central reform is the establishment of a single, national register (the PPS Register), which will replace the more than 40 registers currently operated by, or on behalf of, the Commonwealth, states and territories. Examples of existing registers include the ASIC register of company charges and the various registers of encumbered vehicles (REVS) of the states and territories.

The PPS Register will act as an online noticeboard of personal property which is, or may be, subject to a security interest. A lender will be able to search the PPS Register to establish whether to provide credit to, or obtain a guarantee or indemnity from, a person or corporation with an interest in the personal property. Additionally, purchasers will be able to search the PPS Register to establish whether or not an item of personal property is subject to a registered interest.

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Using the PPS Register

The PPS Register will be electronic, publicly accessible 24 hours a day, updatable in real time and primarily accessed through the internet. Business users with a significant number of transactions, such as banks and finance companies, will be able to use the B2G (business-to-government) channel. Registration will be voluntary, allowing secured parties to weigh up the costs and benefits of registering their security interests.

Any person will be able to register personal property on the PPS Register, but it will usually be the secured party who does this. A registration will include information such as the secured party's details, the grantor's details, a description of the personal property (so that it can be readily identified by any other person searching the PPS Register) and the period of registration.

Period of registration

Registrants will have the choice of nominating a period of registration, failing which, the PPS Register system will assign default periods of registration: seven years for consumer property and serial numbered goods, and 25 years for other

types of personal property. Registration periods can be extended simply by amending the registration.

Advance registration

An important change will be the ability to register a proposed security interest in advance, before a security agreement has even been entered into. For example, if a borrower applies to a lender for a loan, the lender may register the relevant assets before approving the loan. The rationale behind advance registration is to provide notice of the proposed security interest to other parties, and to allow the lender to know its position in relation to other registrants while still negotiating the transaction.

Priorities

The PPS Bill establishes a priorities regime in relation to competing security interests. Disputes about priorities usually arise when a grantor is unable to meet obligations to multiple secured parties. In such a case, the priority rules will determine the order of distribution of money received on the seizure and sale of the personal property.

Generally speaking, priority will be on a first-to-register basis, which will provide certainty for security holders. However, for personal property that is frequently traded (such as investment property, including shares and quoted securities) registration may not be practicable. In such a case, priority will be determined on the basis of possession or control of that personal property.

In determining priority under the new regime, the following will be relevant:

- whether or not perfection of the security interest has occurred
- how perfection occurred
- the nature of the security interest itself.

The PPS Bill establishes a priorities regime in relation to competing security interests.

Default priority rules under the PPS scheme

Under the PPS scheme, the following default rules will apply in relation to priorities:

- A **perfected** security interest has priority over an unperfected security interest.
- A security interest **perfected by control** has priority over a security interest perfected by other means.
- If there are **two security interests perfected by control**, priority is determined by the **order of perfection**.
- If there are **two security interests perfected by means other than control**, priority is determined by which security interest is **first in time**.
- If there are **two unperfected security interests**, then priority is determined by the **order of attachment**.

Exceptions to the default priority rules

There are some exceptions to the default priority rules. For example, the PPS Bill introduces a special category of security interest called a 'purchase money security interest' (PMSI) in relation to a secured party who provides value to enable the grantor to acquire the property. A PMSI will have 'super-priority' over all other security interests in the same property perfected by either registration or possession (but will still rank behind an interest perfected by control).

The PPS Bill also provides for special priority rules that affect the following types of personal property:

- crops and livestock
- fixtures (personal property that is affixed to land)
- ‘accessions’ (personal property that is installed in, or affixed to, other personal property; for example, new tyres for a car)
- ‘commingled goods’ (goods that have become a part of a product and, in the process, have been so manufactured or processed that their identity is lost in the product; for example, the flour and yeast used to make bread).

These types of personal property also raise particular extinguishment and enforcement issues which are outside the scope of this note.

Enforcement and remedies

The PPS Bill includes a regime for enforcing security agreements in the event of a default by the grantor. The remedies provided for are similar to existing rights to seize and sell property in satisfaction of an outstanding debt. However, the regime is not intended to be exhaustive; other laws such as the Uniform Consumer Credit Code will continue to apply, along with the rights provided by the security agreement itself. It will also be possible to contract out of sections of the enforcement regime in certain circumstances; for example, where the security relates to property that is not used predominately for personal, domestic or household purposes.

The PPS Bill includes a regime for enforcing security agreements in the event of a default by the grantor.

Transitional provisions: the effect of the new regime on existing security interests

Existing security interests will continue to have effect under the new regime. The draft provisions of the *Personal Property Securities (Transitional Provisions and Consequential Amendments) Bill 2008* provide that, before the PPS Register becomes accessible to the public, security interests which are recorded under various Commonwealth and state registers will be ‘migrated’ to the PPS Register.

Migrated security interests: no need to re-register

Security interests that are recorded on a register that is migrated will simply appear on the PPS Register, which will avoid the need to re-register those interests. A verification statement will be sent to secured parties whose interests have been successfully migrated. The existing interests will be available for searching at the ‘registration commencement time’, at which point new security interests will be able to be registered. Existing interests will maintain their priority against any interests subsequently registered on the PPS Register.

Non-migrated security interests: temporarily perfected

Some currently registered security interests, however, will not be suitable for migration (for example, where the existing database does not contain sufficient identifying information). If the information on a register cannot be migrated before the registration commencement date, the affected interests will be deemed to be temporarily perfected and the rights of secured parties will be protected for a period of two years. Accordingly, the PPS Register will not be comprehensive during this two-year transitional period.

However, there is an incentive for such parties to register their existing security interest on the PPS Register (or otherwise perfect it under the future PPS Act) because, if their interest has not been perfected by the end of the two-year transitional period, that interest will lose priority to interests in the same property which have been perfected under the PPS Act.

Preparing for the new system

While the scheme is only at the consultation stage, it is nonetheless important for agencies to ensure that they keep up to date with developments in relation to the scheme.

It is anticipated that the new system will take effect in May 2010.

Tips for agencies dealing with personal property securities

Agencies should start to consider the impact of the PPS scheme on their operations, including:

- **identifying who in their organisation will take responsibility** for ensuring that the agency is ready for the introduction of the scheme
- **reviewing their credit policies**
- **looking at their information collection procedures**—for example, ensuring that, for transactions that are likely to be afoot for some years, information is collected that would facilitate registration of any security interests (such as serial numbers)
- **looking at standard legal documents**, particularly those used for transactions that will remain afoot for some years. For example, it would be appropriate to ensure that such documents are sufficiently broadly drafted to allow for the introduction of the new scheme, including providing for registration at the appropriate time and collection of any additional information that may be required for registration
- **looking at IT procedures.**

Once the PPS Register comes into effect, the ultimate tip for security holders will be to **register early and register often.**

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Conclusion

As mentioned above, the PPS Bill is still in draft form. AGS will provide updates in future months as more information becomes available. In the meantime, for more details or to discuss the implications for your business, please contact one of the authors of this article or one of our specialist lawyers listed on the back cover of this issue.

Lee-Sai Choo heads our Perth Commercial team. He has a specialist property and commercial law practice and has assisted Australian Government departments and agencies with probity advice, commercial arbitration, real property acquisitions and disposals, leasing, tenders, auctions and major asset disposals.

Rebecca Eldred has worked on various property and commercial matters, including developing documents and procedures for loan programs, and guidance sheets on the purchase of businesses and real property. Prior to joining AGS Perth she was the Associate to the Hon. Justice Wheeler in the Court of Appeal of Western Australia for two years.

Notes

- 1 For the purposes of this article, the 'grantor' is the person, corporation or other legal entity which grants the security interest to the secured party.
- 2 'Serial numbered property' is property which the regulations provide may, or must, be described by serial number.
- 3 Where the third party has taken possession or control of the investment instrument.
- 4 'Motor vehicle' in this context means a motor vehicle of a kind prescribed by the regulations.

AGS contacts

AGS has a national team of lawyers specialising in advising agencies on commercial transactions including those involving taking security over real or personal property. We also have a network of lawyers specialising in debt recovery and enforcement of securities. For assistance with any security matters, please contact one of our specialist lawyers listed below.

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