

# Heading towards a more secure Australia

Michael Ryan discusses some implications for insolvency practitioners of Australia's proposed Personal Property Securities Act.

In less than six months, new legislation dealing with taking and enforcing security in Australia is expected to be enacted. The new legislation will be called the Personal Property Securities Act 2009 (Cth) (PPSA or Act). The legislation is based on similar legislation in New Zealand and Canada, and draws on concepts found in article 9 of the US Commercial Code. Even though a two-year transition period will apply, certain aspects of the legislation will apply from day one. Some have described the legislation as the most fundamental change in commercial law in Australia since the voluntary administration regime was introduced in 1993.<sup>1</sup>

This article focuses on four elements of the PPSA that are of particular relevance to insolvency practitioners (IP):

- 1) the effect on retention of title suppliers;
- 2) application to receivables financing arrangements;
- 3) risks for equipment lessors and hirers; and
- 4) additional enforcement duties and powers.

## The new legislation in 100 words

Under the Act, a security interest is widely defined and captures traditional securities (such as charges and mortgages) as well as leases, retention of title and consignment arrangements. Personal property is also widely defined to include all property other than land and certain statutory licences<sup>2</sup>. Central to the legislation is an online register. Failure to register a security interest could result in a loss of priority vis-à-vis other security holders or a subsequent purchaser of the secured property<sup>3</sup>. New enforcement procedures will provide some additional flexibility to security holders. The Act will replace numerous federal and state laws and online and manual registers.

## Retention of title

### Supplier arrangements under the current law

Currently, suppliers of inventory who want to ensure payment for their goods will insert what are commonly known as 'retention of title' clauses into credit application forms, terms of trade and supply invoices. These clauses have the effect of securing the payment of the goods as the supplier retains title to the inventory until payment is made by the customer.



These arrangements are not currently recognised as registrable securities and therefore are not revealed on a search of the companies register or any other register. It is therefore difficult, if not impossible, for an outsider to ascertain what goods are subject to retention of title arrangements and on what terms.

### Supplier arrangements under the PPSA

The PPSA aims to create a far simpler and more transparent method of dealing with these arrangements.

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Under the Act, suppliers will be required to register a security interest on the register to notify the world of their ongoing interest in the relevant assets. It will be possible to register one security interest at the beginning of a trading relationship in respect of all present and future assets that will be traded on retention of title terms.

The proceeds from the sale of such goods will also be protected by the registration provided that they can be identified.

It will also be simpler for suppliers to retain a security interest over goods that

become included in, or become part of, other property. For both goods that remain identifiable (such as tyres on a car) and goods that are no longer identifiable (such as yeast in beer) the supplier's security interest will continue in the goods. This is likely to result in lower realisations for secured creditors holding charges over substantially all the assets and undertakings of manufacturing or assembly businesses than is currently the case. There will be different rules in relation to enforcement of those security interests. Where the supplier's interest in these goods has not been registered, then title will be lost if the property in which the goods have been included is sold or given as security.

### Practical considerations

From a practical point of view, the ability to search one, all-encompassing register that records traditional securities (equivalent to charges and mortgages) and also title-based securities (such as title retention arrangements) will ensure a more accurate understanding of a company's assets and liabilities. It should also assist with the resolution of disputes as between various 'secured' parties. However, until the new legislation is understood by the wider business community, and subject to the transitional provisions, there may be some 'windfall' outcomes for secured creditors holding charges over substantially all the

assets and undertakings, as retention of title suppliers discover their existing securities are ineffective unless registered.

Retention of title suppliers will no longer be able to rely on their ownership of the goods as under current law. They may still be able to seize the supplied goods on a default, but they will no longer be entitled to simply retain and sell the goods unless they follow the retention and sale procedures in the new legislation. To some extent these provisions can be contracted out of but again, until the wider community becomes familiar with the legislation, there may be some unexpected outcomes.

### Receivables financing

The legislation applies to most types of receivables financing. Receivables financing secured by a fixed and floating charge<sup>4</sup> should be registered in order to ‘perfect’<sup>5</sup> the security interest.

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Where receivables are transferred on a non-disclosed basis and therefore do not achieve a transfer of the legal interest in the receivable, a security interest should also be registered. An arrangement for the transfer of receivables on a disclosed basis will generally also create a registrable security interest.

The only type of receivables financing that does not give rise to a registrable security interest is where the receivables are transferred on a disclosed and non-recourse basis.

### Lessors and hirers

The legislation contains two concepts relevant to lessors and hirers: a PPS Lease and a Purchase Money Security Interest (PMSI).

The PPS Lease is an agreement to lease goods for more than a year or for an indefinite period or renewable annually. Further, the period is reduced to 90 days where the goods subject to the lease are identifiable by a serial number. A PPS Lease is deemed to be a security interest under the legislation. One potentially very significant consequence is that if a PPS Lease is not perfected by registration, it is possible the owner of the goods will not be entitled to enforce its rights as against the holder of a general security interest over all the assets and undertakings of the lessee.

A PMSI is a security interest taken over secured property that is purchased in part or in full with the funds provided by the secured party. A PPS Lease and a sale of inventory that includes a retention of title clause in the sale agreement would be a PMSI under the new Act.

A PMSI, if perfected, will enjoy priority over a prior general security interest over all of a company’s assets and undertakings, which will give PMSIs a so called ‘super priority’.

### Enforcement

The legislation introduces a new regime for enforcement of a security interest. Many of the concepts are similar to current procedures; however, there are some relevant new rights and obligations.

### Application to receiverships

Section 116 states that the chapter dealing with enforcement: ‘...does not apply in

*relation to property while a person is a receiver, a receiver and manager, or a controller of the property.’*

This means that receivers will not be bound by the additional obligations imposed under the PPSA and will not be

able to take advantage of the additional rights and remedies provided by the PPSA. Rather, they will be subject to the statutory and common law rights and obligations that currently apply. The exclusion of receivers may change secured creditors’ approach to the enforcement of their securities. Although presumably, if a secured party wished, they could appoint a receiver and manager who could then be

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retired (and replaced by an agent for the mortgagee or the mortgagee itself) immediately before the secured party wished to avail itself of the right.

### Exercising rights

Section 111 states that: *All rights, duties and obligations that arise under this chapter must be exercised or discharged:*

- a. *honestly; and*
- b. *in a commercially reasonable manner.’*

Section 131 requires the secured creditor to take all reasonable care when disposing of the secured property and:

- a. *if the collateral has a market value at the time of disposal – to obtain at least market value; or*
- b. *otherwise – to obtain the best price that is reasonably obtainable at the time of disposal, having regard to the circumstances existing at the time.’*

It will be interesting how these sections are interpreted by the courts in comparison to the obligations that currently exist under the Corporations Act 2001 (Cwth)<sup>6</sup> and the common law and whether these sections will influence secured parties’ decisions as to whether to:

- contract out of the legislation to the extent allowed; and
- appoint a receiver or enforce via a mortgagee in possession or agent for the mortgagee.

### A simpler method of foreclosure

The legislation provides two ways for a secured creditor to effectively foreclose on the secured property. The first way is the

provision of a statutory right to dispose of the collateral by the secured party purchasing it. The second way is by providing a secured creditor the right to retain the collateral in exchange for extinguishment of its debt.

Both methods require ten days’ notice<sup>7</sup> to be given to the grantor (usually this will be the debtor) and other secured creditors. These parties may object, in which case the secured property must be disposed of by private or public sale.

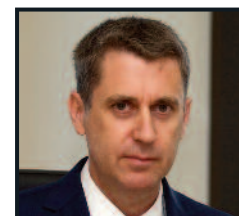
### Conclusion

From an IP’s point of view, the proposed PPSA legislation should eventually make life easier when conducting investigating accountant’s assignments. The availability of a central register should make determination of the financial position of a company clearer from an asset and liability perspective. However, additional complexity will be added to the IP’s role given secured creditors may contract out of certain provisions of the legislation from time to time. It will be important to

understand the effect of such action in providing strategic restructuring advice. Finally, dealing with retention of title arrangements will need a fresh approach given the fundamental nature of the changes involved. □

### References

- <sup>1</sup> Note the new laws also apply to household property; however, this article is written from a commercial property perspective
- <sup>2</sup> And other limited exceptions such as mining leases
- <sup>3</sup> Except where the secured property is subject to the possession or control of the secured party
- <sup>4</sup> The terms ‘fixed and floating’ will be replaced by the terms ‘non circulating’ and ‘circulating’. Fixed and floating charges will be replaced by general security agreements having a similar effect
- <sup>5</sup> Perfection is a key concept in the new legislation and is achieved when certain steps necessary to render the security interest enforceable against third parties are taken. Those steps may be registration of the security interest on the PPS register or the secured party taking possession or control of the secured property
- <sup>6</sup> Section 420A and sections 180–184
- <sup>7</sup> This notice period can be extended by application to the court



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