



Personal Property Securities

Denis Barlin

Barrister

13 Wentworth Selborne Chambers

dbarlin@wentworthchambers.com.au

(02) 9231 6646

July 2012

Contents

1. Overview of the personal property securities regime	4
2. The scope of the PPS Act – determining whether there is ‘personal property’	6
(a) <i>Express exclusion of ‘land’ from the definition of ‘personal property’</i>	6
3. What is a security interest?	7
(a) <i>Charge-backs are permitted</i>	9
(b) <i>What is not a security interest</i>	10
(c) <i>What ‘interests’ does the PPS Act not apply to?</i>	10
(d) <i>Processed or comingled goods – whether the security interest subsists</i>	11
(e) <i>Proceeds and security interests</i>	12
(f) <i>Accessions and security interests</i>	12
4. Attachment – section 19 of the PPS Act	12
5. Enforceability of security interests against third parties – section 20 of the PPS Act	14
6. Perfection of a security interest – section 21 of the PPS Act	14
7. General priority rules	17
(a) <i>Subsection 21(2) Property – perfection by control</i>	19
(b) <i>Security interests perfected by control as against purchase money security interests</i>	20
(c) <i>How is section 21(2) property controlled?</i>	20
(d) <i>How does one protect a security interest with respect to security interests with respect to ‘controllable’ collateral?</i>	22
8. Purchase money security interest – section 14 of the PPS Act	23
9. Registration on the personal property security registry	24
(a) <i>The twenty business day registration window (section 588FL of the Corporations Act 2001 (Cth))</i>	24
(b) <i>Financing statements</i>	25
(d) <i>Requesting copies of security agreements</i>	27
10. Taking free of a security interest	28
11. Priority interests – the list of priorities	29
(a) <i>First - Payments to creditors (section 69 of the PPS Act)</i>	29
(b) <i>Second - General law liens and statutory liens and charges arising in the ordinary course of business – section 73 of the PPS Act</i>	30
(c) <i>Third – Takers of interest in negotiable instruments chattel paper and negotiable documents of title (section 70, 71 and 72 of the PPS Act)</i>	30
(d) <i>Fourth – control (section 57 of the PPS Act)</i>	30

(e)	<i>Fifth – Accounts – Secured interest over (future) accounts generated from sales and inventory, as original collateral and further for new value (section 64 of the PPS Act)</i>	31
(f)	<i>Sixth – “Strong” purchase money security interest (section 63 of the PPS Act)</i>	31
(g)	<i>Seventh – “Normal” purchase money security interest (section 62 of the PPS Act)</i>	32
(h)	<i>Eighth – Perfected security interests – earliest priority time wins (subsection 55(4) of the PPS Act)</i>	32
(i)	<i>Ninth – Execution creditors may defeat unperfected security interests (section 74 of the PPS Act)</i>	33
(k)	<i>Eleventh – Priority as between unperfected security interests – The first to attach has priority provided that the grantor is not bankrupt, in administration or liquidation (subsection 55(2) of the PPS Act)</i>	33
12.	<i>Enforcement of “mixed securities” including land</i>	34
13.	<i>The enforcement of a security interest</i>	34
(a)	<i>Exclusions with respect to enforcement</i>	36
(b)	<i>Personal property and land used to secure the same obligation</i>	36
(c)	<i>Enforcement of security interest in liquid assets</i>	36
(d)	<i>Notice to higher priority parties</i>	37
(e)	<i>Seizure of collateral</i>	37
(f)	<i>Apparent possession</i>	37
(g)	<i>Rights of higher priority party to seize collateral</i>	38
(h)	<i>Disposal of collateral</i>	38
(i)	<i>Duty to obtain market value</i>	38
(j)	<i>Statement of account</i>	38
(k)	<i>Six month rule – disposal of collateral</i>	39
(l)	<i>Retaining Collateral</i>	40
(m)	<i>Redemption of collateral</i>	41
14.	<i>Fixed and floating charges and the PPS Act</i>	41
15.	<i>Some important steps to ensure protection of security</i>	42

Personal Property Securities

1. Overview of the personal property securities regime

- 1.1 The *Personal Property Securities Act 2009* (Cth) (**‘the PPS Act’**) fundamentally changes the process of creation, registration and enforcement of securities in personal property. The PPS Act replaced a series of general law property and priority rules. In their place the PPS Act places primacy on the concept of ‘perfection’ (e.g. registration) of a security interest. Before the introduction of the PPS Act, it was often difficult, in the course of realising assets for the benefit of creditors to determine which items of (in particular personal) property of an insolvent entity, but which title was held by another entity, were assets available for the creditors.
- 1.2 The provisions deal with security interests provided by consent, and interests created by the operation of the law (such as certain liens) are excluded from the reach of the PPS Act.
- 1.3 The PPS Act also takes a substantive approach to security. Under the PPS Act, the concept of ‘title’ is irrelevant. The PPS Act looks at ‘security interest’ as opposed to title. Broadly speaking, a ‘security interest’ is a transaction which ‘... *in substance secures the payment or performance of an obligation ...*’ (see section 12 of the PPS Act).
- 1.4 Generally speaking, the PPS Act assumes that assets are generally available for realisation (and reimbursement of creditors) unless a ‘security interest’ with respect to them are ‘perfected’ by the person who has such an interest – thus giving them priority to other creditors. As a result, title does not give one right over assets if there is a registered security interest. Broadly speaking:
 - 1.4.1 the PPS Act changes the law of ‘security interests’ in personal property. It also alters some commercial law considerations – such as the assignability of contracts and negotiability.
 - 1.4.2 there is a ‘substance over form’ approach taken in determining whether there is a ‘security interest’. Further, certain arrangements (such as leases, bailments and assignments of some accounts receivable) are deemed to be security interests, notwithstanding that they do not secure any obligation.
 - 1.4.3 generally speaking, who holds title is not relevant;
 - 1.4.4 perfection is essential in order to ensure priority with respect to competing security interests, and is effective in a wind-up. Perfection can be effected via registration, possession or (with respect to some financial assets) control.

- 1.4.5 There are rules with respect to 'priority', and when an asset can be assigned free of security interests.
 - 1.4.6 whilst one may still obtain an 'all asset' security, an entity with such a security interest may in certain circumstances have a security interest which does not have first priority (notwithstanding that the person buying or taking security over the asset has knowledge with respect to the earlier security interest).
 - 1.4.7 although there are prescriptive rules which relate to enforcement, and except for certain consumer property, they may be contracted out.
- 1.5 The taking of good security under the PPS Act require a three step process to be satisfied, being that a 'security interest':
- 1.5.1 must **attach** to collateral – this makes the security interest enforceable against the entity which granted it;
 - 1.5.2 are **enforceable against third parties** - which usually will require an agreement in writing; and
 - 1.5.3 are **perfected** – perfection is the essential element of the PPS Act. For most security interests, perfection is effected by registration on the PPSR. However, in certain circumstances, possession or control may perfect a security interest.
- 1.6 Perfection is required to:
- 1.6.1 ensure priority;
 - 1.6.2 provide protection against wrongful sale by the grantor; and
 - 1.6.3 ensure the security interest will survive the grantor's insolvency.
- 1.7 That is, pursuant to the regime, a security interest cannot be enforced:
- 1.7.1 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;
 - 1.7.2 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).
- 1.8 The PPS Act also provides for the establishment of a national on-line register, known as the personal properties security registry ('PPSR').

2. The scope of the PPS Act – determining whether there is ‘personal property’

- 2.1 The PPS Act is concerned with ‘personal property’.
- 2.2 The definition of ‘personal property’ as contained in section 10 of the PPS Act, 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. Land includes freehold and leasehold estates and other interests in land but excludes fixtures as defined in section 10 of the PPS Act.
- 2.3 The PPS Act does not apply to interest in fixtures (paragraph 8(1)(j) of the PPS Act). It should be noted that differences between the PPS Act definition of ‘fixtures’ and the general law concept of a ‘fixture’ may raise issues in determining the scope of the PPS Act.
- 2.4 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. There are specific exclusions with respect to interests in land and fixtures, water rights, and other matters prescribed by regulations.
- 2.5 Broadly speaking, personal property may be grouped into four major categories for the purposes of the PPS Act:
- 2.5.1 goods;
 - 2.5.2 financial property;
 - 2.5.3 intermediated security; and
 - 2.5.4 intangible property.
- 2.6 The category of personal property that is subject to security interest may be essential to determine. This is because there may be different rules (such as mode of perfection and taking free - i.e. extinguishment) which may apply depending on the type of personal property.
- (a) Express exclusion of ‘land’ from the definition of ‘personal property’
- 2.7 The PPS Act does not affect the laws with respect to the registration of security interests in a property interest - such as mortgages and caveats. However, the extent of the application of the PPS Act to land is unclear.
- 2.8 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 PPS Act due to the way that those transactions are handled.

- 2.9 For example, the PPS Act expressly excludes from its application the ‘...*creation or transfer of any interest in land ...*’ (subparagraph 8(1)(f)(i) of the PPS Act) including any interest in fixtures (subparagraph 8(1)(j) of the PPS Act). However, some commercial property transaction which affect agricultural interest may be caught within the PPS Act. The PPS Act may impact upon dealings in, and relates to real property in two broad areas:
- 2.9.1 ‘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
- 2.9.2 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.).

3. What is a security interest?

- 3.1 Ascertaining a ‘security interest’ is essential for the purposes of the engagement of the PPS Act. Specifically, the PPS Act is enlivened when there is a ‘security interest’ which relates to personal property. A security interest can be classified as either an ‘in substance’ security interests (see subsection 12(1) of the PPS Act and the examples contained in subsection 12(2) of the PPS Act) or ‘deemed’ security interests (subsection 12(3) of the PPS Act).
- 3.2 Broadly speaking, the term ‘security interest’ is defined as an interest in personal property provided for by a transaction that secures payment or performance of an obligation. However, the PPS Act expands the concept of security interest beyond traditional interests. Specifically, the regime affects any financier or other business that 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 PPS Act).
- 3.3 In order to determine whether there is a security interest, the following elements will need to be established, bearing in mind the exclusions from the PPS Act pursuant to section 8 of the PPS Act:
- 3.3.1 personal property;
- 3.3.2 transaction, this will usually if not always be a consensual transaction;
- 3.3.3 an interest in personal property – a sufficient interest includes a legal or equitable interest and seemingly captures proprietary rights; and

- 3.3.4 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.
- 3.4 The central provision with respect to identifying a ‘security interest’ is contained in subsection 12(1) of the PPS Act, which provides that:
- 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).*
- 3.5 That is, and subject to subsection 12(3) of the PPS Act, 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.
- 3.6 There are essentially two elements to the definition of ‘security interest’ pursuant to the PPS Act, being that:
- 2.9.3 **firstly** – there must be secured property (i.e. collateral); and
- 2.9.4 **secondly** - there is secured moneys (i.e. the obligation).
- 3.7 That is, a transaction that both grants an interest in personal property (i.e. the collateral) and in substance secure the payment or performance of an obligation , will most likely satisfy the definition of ‘security interest’ (see section 12 of the PPS Act).
- 3.8 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 PPS Act) 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.
- 3.9 Subsection 12(2) of the PPS Act provides for examples of ‘security interests’, by providing that:

For example, a security interest includes an interest in personal property provided by any of the following transactions, if the transaction, in substance secures payment or performance of an obligation:

- (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 arrangement;
- (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.

3.10 Subsection 12(3) of the PPS Act deems certain interests to be security interests, by providing that:

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.

3.11 It should be noted that the enforcement provisions contained in Part 4 of the PPS Act does not apply to deemed security interests contained in subsection 12(3) of the PPS Act, unless the deemed security interest secures the payment or performance of an obligation – see section 109 of the PPS Act.

(a) Charge-backs are permitted

3.12 Subsections 12(3A) and (4) of the PPS Act allow for charge-backs. For example, a deposit taking institution may take security over an account held by one of its customers. Subsection 12(3A) of the PPS Act provides that: ‘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.’ Further subsection 12(4) of the PPS Act provides that:

Without limiting subsection (3A):

- (a) an account debtor, in relation to an account debtor, in relation to an account or chattel paper, may take a security interest in the account or chattel paper;

(b) an ADI may take a security interest in an ADI account that is kept with the ADI.

(b) What is not a security interest

3.13 Subsection 12(5) of the PPS Act 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.*

3.14 It should be noted that whilst a licence is not of itself a security interest, to the extent that it can be transferrable, then it can be collateral, to which a security interest may attach. It should also be noted that an intellectual property right is also a 'licence' (see the definition of that term in section 10 of the PPS Act). Further, Part 3.5 of the PPS Act deals with intellectual property.

3.15 The only interest prescribed in the PPS Regulations as something which is not a security interest, as provided by paragraph 12(5)(b) of the SIS Act is Regulation 1.8 of the PPS Regulations provides that the extinguishment of a beneficial interest in an account or chattel paper is not a security interest.

3.16 Subsection 12(6) of the PPS Act expressly excludes subordination agreements from the PPS Act, 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.*

3.18 However, it should be noted that subordination agreements, in the context of altering priority interests, is provided for in section 61 of the PPS Act.

(c) What 'interests' does the PPS Act not apply to?

3.19 Section 8 of the PPS Act provides an extensive list of interest to which the PPS Act does not apply. For example, the regime does not apply with respect to:

- 3.19.1 any right of set-off or right of combination of account (paragraph 8(1)(d) of the PPS Act);
 - 3.19.2 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) of the PPS Act);
 - 3.19.3 a lien, charge or any other interest in personal property that arises under the relevant State or Federal statutes (other than the PPS Act), unless the person who owns the property in which the interest is granted agrees to the interest (paragraph 8(1)(b) of the PPS Act);
 - 3.19.4 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) of the PPS Act);
 - 3.19.5 certain interests in property created under the *Bankruptcy Act 1966* (Cth) (paragraph 8(1)(g) of the PPS Act);
 - 3.19.6 an interest in a fixture (paragraph 8(1)(j) of the PPS Act);
 - 3.19.7 particular statutory rights granted by a relevant State or Federal statute which are declared not to be personal property for the purposes of the PPS Act (paragraph 8(1)(k) of the PPS Act).
- 3.20 In-substance security interests include the usual mortgages and charges. However, the PPS Act also contemplates an in-substance security will extend to a transaction which in-substance secure payments or performance and obligation (subsection 12 (2) of the PPS Act) and includes:
- 3.20.1 conditional sale agreement (including an agreement to sell subject to retention of title);
 - 3.20.2 leases of goods; and
 - 3.20.3 flawed asset arrangements
- 3.21 It should be noted that a retention of title sale transaction clearly gives rise to a security interest, and indeed is an example contained in subsection 12(2) of the PPS Act.
- (d) *Processed or comingled goods – whether the security interest subsists*
- 3.22 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 PPS Act).
- 3.23 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 PPS Act).
- 3.24 With respect to such a situation, the priority rules provide that:

- 3.24.1 a purchase money security interest has priority (section 103 of the PPS Act);
- 3.24.2 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 PPS Act); and
- 3.24.3 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 PPS Act)

(e) Proceeds and security interests

- 3.25 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 PPS Act).
- 3.26 Under the PPS Act 'proceeds' means identifiable or traceable personal property of the types that include (see section 31 of the PPS Act – and amongst other things):
 - 3.26.1 personal property derived directly or indirectly from dealing with a collateral;
 - 3.26.2 right to insurance payment or other payment as indemnity or compensation for loss or damage to collateral;
 - 3.26.3 if collateral is an investment instrument such as shares:
 - (a) rights arising out of collateral;
 - (b) property collected on collateral; and
 - (c) property distributed on account of the collateral.

(f) Accessions and security interests

- 3.27 Under the PPS Act, 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 Regulations to be described by a serial number (section 10 of the PPS Act).
- 3.28 An accession preserves its identity once installed in or affixed to the other goods.
- 3.29 The PPS Act 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 PPS Act).
- 3.30 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 PPS Act).

4. Attachment – section 19 of the PPS Act

- 4.1 Subsection 19(1) of the PPS Act provides that:

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

4.2 Broadly speaking, 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.

4.3 Subsection 19(2) of the PPS Act 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.*

4.4 By way of examples which may (together) enliven subsection 19(2) of the PPS Act:

4.4.1 a grantor will have 'rights' in collateral by owning or possessing it;

4.4.2 a secured party could 'give value' by lending money on the value of the security; and

4.4.3 a grantor may do '*... an act by which the security interest arises ...*' by executing a security agreement with the secured party.

4.5 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.

4.6 Subsections 19(3) and (4) of the PPS Act deals with the time at which a security interest attaches to collateral. Subsection 19(3) of the PPS Act provides that subsection 19(2) of the PPS Act 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*'. 4.7 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).

4.8 Subsection 19(4) of the PPS Act 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-PPS Act terminology, the charge crystallises).

5. Enforceability of security interests against third parties – section 20 of the PPS Act

5.1 A security agreement is 'enforceable against third parties' where:

5.1.1 attachment has occurred; and

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

5.2 Subsection 20(1) of the PPS Act 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).*

6. Perfection of a security interest – section 21 of the PPS Act

6.1 Perfection of a security interest occurs when a secured party effectively provides notice to their parties of its security. 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.

6.2 The consequences of unperfected securities include that it is:

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

6.3 The main reasons for perfection are to ensure that:

- 6.3.1 the intended priority of competing security interests is preserved;
- 6.3.2 the secured party is protected if the grantor becomes insolvent; and
- 6.3.3 it protects against taking free or extinguishment provisions under the PPS Act.

6.4 Further, an unperfected security interest vests in a debtor upon insolvency.

6.5 Subsection 21(1) of the PPS Act provides that:

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 collateral;*
 - (ii) the security interest is enforceable against a third party;*
 - (iii) subsection (2) applies.*

6.6 That is (and 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:

6.6.1 the security interest is ‘attached’ to collateral and is ‘enforceable against third parties’; and

6.6.2 the secured party has either:

- (a) registered its interest on the PPSR;
- (b) taken possession of the collateral; or
- (c) with respect to certain collateral, taken control of collateral (i.e. if it is subsection 21(2) Property).

6.7 Subsection 21(2) of the PPS Act provides that:

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 intermediary 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 payments or requiring the performance of an obligation;*
 - (vi) satellites and other space objects.*

6.8 That is, depending on the type of collateral, perfection may occur by:

- 6.8.1 registration of a 'financing statement' in a PPSR;
 - 6.8.2 the secured party takes possession of collateral – other than by seizure or repossession;
 - 6.8.3 the secured party has control of the collateral; and
 - 6.8.4 situations where the PPS Act provides for temporary perfection (where there is a change or transfer of collateral).
- 6.9 A security interest is only effective if it attaches to collateral.
- 6.10 Perfection is important 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.
- 6.11 That is, 'perfection' is essential so as to:
- 6.11.1 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 PPS Act). 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.
 - 6.11.2 avoid a security interest vesting in a grantor, upon the grantor entering into bankruptcy, administration or liquidation (see section 267 of the PPS Act).
 - 6.11.3 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);
 - 6.11.4 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 PPS Act). However, a security interest must be perfected against proceeds (paragraph 33(1)(b) of the PPS Act).
 - 6.11.5 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 PPS Act).

7. General priority rules

- 7.1 The PPS Act gives priority to those who perfect their securities. Generally speaking, the PPS Act adopts a 'first-in-time' rule in the context of priority disputes. As a result:
- 7.1.1 priority between two unperfected security interests is determined by the order of attachment;
 - 7.1.2 priority between two perfected security interests is determined by order of the 'priority time'.
- 7.2 The priority as between security interests with respect to the same collateral includes:
- 7.2.1 **determining the type of security** - for example, is the collateral a purchase money security interest or an ordinary security interest;
 - 7.2.2 **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
 - 7.2.3 **method of perfection** - for example, is the collateral of a type that permits perfection by control.
- 7.3 Perfected security interests have priority over unperfected securities. Perfection by control (only available with respect to some forms of collateral) has priority over perfection by any other method. Section 55 of the PPS Act sets out the default priority rules applicable to other types of secured personal property. Broadly speaking, the rules provide that:
- 7.3.1 a 'perfected' security interest in collateral has priority over an unperfected security interest; and
 - 7.3.2 priority between perfected interests amongst themselves, and unperfected interests amongst themselves, is determined on a first-in-time basis.
- 7.4.1 Key priority rules under the PPS Act are as follows:
- 7.4.2 unperfected security interest rank in order of attachment (subsection 55(2) PPS Act);
 - 7.4.3 a perfected security interest defeats an unperfected security interest (subsection 55(3) of the PPS Act);
 - 7.4.4 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) of the PPS Act);
 - 7.4.5 a security interest perfected by control defeats a security interest perfected in another way (section 57 of the PPS Act);
 - 7.4.6 a purchase money security interest has priority over non-purchase money security interest (subsection 62(1) of the PPS Act).

- 7.5 With respect to perfected security interests, the 'priority time' is the 'registration time'. Registration is effective from when it becomes available for search in the PPSR (it should be noted that a security interest may be registered before attachment and before the existence of security agreement) .
- 7.6 Once the requirement for perfection is met, the 'priority time' goes back to the 'registration time' – but only if the perfection is continuous.
- 7.7 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.

7.7.1 **first** – creditors receiving payment of a debt. Section 69 of the PPS Act 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 of, 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.*

7.7.2 **second** – general law liens, and statutory liens and charges . Subsection 73(1) of the PPS Act 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.*

- 7.7.3 **third** – acquisitions of interests in chattel paper, negotiable instruments and negotiable documents of title – sections 70, 71 and 72 of the PPS Act;
- 7.7.4 **four** – control – section 57 of the PPS Act.
- 7.7.5 **five** – accounts – section 64 of the PPS Act;
- 7.7.6 **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);
- 7.7.7 **seven** – other purchase money security interest rules – section 62 of the PPS Act;
- 7.7.8 **eight** – perfected securities interests – earliest in time has priority – subsections 55(4) and 55(5) of the PPS Act;
- 7.7.9 **nine** – perfected and unperfected securities – perfected securities interest has priority (subsection 55(3) of the PPS Act);
- 7.7.10 **ten** – execution creditors defeat unperfected security interests – section 72 of the PPS Act; and
- 7.7.11 **eleven** – unperfected securities interest – that which attaches first has priority – subsection 55(2) of the PPS Act.

(a) Subsection 21(2) Property – perfection by control

- 7.8 Pursuant to the PPS Act, 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.
- 7.9 The security interests that can be perfected by control relate to assets provided for in subsection 21(2) of the PPS Act. Importantly, such assets include an ‘investment instrument’, which is defined in section 10 of the PPS Act to include almost any type of financial product, including shares, options, units and interests in managed investment

schemes. Subsection 21(2) of the PPS Act property includes shares, debentures, certain loans, derivatives, options foreign exchange contracts and negotiable instruments.

7.10 Subsection 57(1) of the PPS Act 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.

7.11 For competing security interests that are both perfected by control, subsection 57(2) of the PPS Act provides that the first-in-time prevails. Further, knowledge of a competing security interest is almost irrelevant in resolving priority disputes under the PPS Act and notice is irrelevant for the principal priority rules in the PPS Act regime.

(b) Security interests perfected by control as against purchase money security interests

7.12 An issue to consider is what the real ‘super –priority’ under the PPS Act.

7.13 Subsection 57(3) of the PPS Act provides that the above priority rules prevail over any of the other priority rules in the PPS Act. As a result, security interests over s 21(2) Property perfected by control have priority over any other type of security interest, including over purchase money security interests, and collateral perfected by any other means (such as registration on the PPSR).

7.14 Although purchase money security interests are said to have ‘super priority’ under the PPS Act because they defeat all other types of security, they do not trump security interests perfected by control.

7.15 It should be noted that the reason for the ‘super-priority’ afforded by purchase money security interests is that they include ‘deemed’ security interests under the PPS Act, which (traditionally) have not been recognised as security interests (see subsection 12(3) of the PPS Act) – but rather preserve a lender’s title to and ownership of, an asset – and include retention of title arrangements, certain leases, hire purchase agreements and commercial consignments.

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

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

7.17 The concept of ‘control’ for subsection 21(2) property is set out in sections 25 to 29 of the PPS Act, which prescribes rules with respect to control of ADI accounts, intermediated

securities, investment instruments, letters of credit and uncertified negotiable instruments.

- 7.18 Importantly, section 27 of the PPS Act deals with control of investment instruments (e.g. shares). That is, section 27 of the PPS Act provides that a person has control of an investment instrument if (and only if) one of the following occurs:
- 7.18.1 the person (other than a debtor or a grantor of the security interests themselves) become the registered owner of the investment instrument; or
 - 7.18.2 if the investment instrument is evidenced by a certificate – the person takes possession of the certificate and has the power to either:
 - (a) transfer the instrument to themselves or to another person; or
 - (b) otherwise deal with the instrument; or
 - 7.18.3 if the investment instrument is not evidenced by a certificate, the secured party an 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
 - 7.18.4 if the investment instrument is not evidenced by an instrument, a person may also control it where:
 - (a) 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
 - (b) there is an agreement by which the person has the power to direct the transfer of or otherwise deal with the investment instrument.
- 7.19 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.
- 7.20 It should be noted that the right to deal with the instrument need not be exclusive. The PPS Act 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.
- 7.21 If an investment instrument is negotiable paper, then taking possession of it will also give the possessor the right to deal with it. It is unclear whether this is also the case for non-negotiable paper and other investment instruments which are (by their nature) non-possessory securities.

(d) How does one protect a security interest with respect to security interests with respect to 'controllable' collateral?

- 7.22 With respect to subsection 21(2) 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.
- 7.23 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.
- 7.24 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.
- 7.25 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 third party secured lender then took possession of the share certificates (i.e., after the share certificates were issued 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 PPS Act and the original secured party could lose priority of their security.
- 7.26 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.
- 7.27 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.

(e) Vesting of unperfected security interest in a grantor

- 7.12 Under Part 8.2 of the PPS Act, on the insolvency of a grantor an unperfected security interest will generally ‘vest in’ an insolvent grantor. This will apply when:
- 7.12.1 a winding up order is made or a resolution passed winding up a company; or

- 7.12.2 an administrator is appointed to a company, or a company executes a deed of company arrangement, or
 - 7.12.3 bankruptcy of an individual.
- 7.13 However, some kinds of security interests are not affected by this rule (section 268 of the PPS Act). These include transfers of chattel paper and accounts, certain short-term PPS leases and commercial consignments.
- 7.14 The 'vesting in the grantor' rule in section 267 of the PPS Act 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 PPS Act.

8. Purchase money security interest – section 14 of the PPS Act

- 8.1 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-PPS Act position.
- 8.2 A purchase money security interest is defined as any of the following (subsection 14(1) of the PPS Act):
- 8.2.1 a security interest taken in collateral, to the extent that it secures all or part of its purchase price;
 - 8.2.2 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;
 - 8.2.3 an interest of a lessor or bailor under a PPS lease;
 - 8.2.4 an interest of a consignor who delivers goods to a consignee under a commercial consignment.
- 8.3 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.
- 8.4 Also a purchase money security interest only has super-priority for:

- 8.4.1 inventory that is 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 PPS Act);
- 8.4.2 for personal property that is not inventory, in the case of goods, if registered within fifteen (15) business days after the grantor obtains possession and for any other property within fifteen (15) days after the interest attaches (subsection 52(3) of the PPS Act).
- 8.5 It should be noted that the term 'inventory' has a wide definition contained in section 10 of the PPS Act.
- 8.6 Further, purchase money security interest super-priority also extends to proceeds (section 62 of the PPS Act) and to processed or comingled goods (section 103 of the PPS Act).

9. Registration on the personal property security registry

- 9.1 Under the PPS Act, 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 important method of perfecting security interests under the PPS Act.
- 9.2 The PPS Act 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.
- 9.3 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.
- 9.4 The registration 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) *The twenty business day registration window (section 588FL of the Corporations Act 2001 (Cth))*
- 9.5 It should be noted that a new section 588FL of the *Corporations Act 2001* (Cth) (**'the Corporations Act'**) has been inserted. The section provides that corporate secured parties who perfect by registration should register within twenty (20) business days (and not the

previous forty-five (45) calendar days as applied with respect to company charges pursuant to Chapter 2K of the *Corporations Act*.

9.6 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:

9.6.1 it is perfected by registration only;

9.6.2 it was granted in the six months leading up the grantor's administration or liquidation; and

9.6.3 it was not registered within twenty (20) business days of the grant.

9.7 In the event that the six month period following the grant of a securing interest passed without the grantor entering into administration or liquidation then section 588FL of the *Corporations Act* would have not application however, in order to reduce risks, secured parties should always register their secured interest within twenty (20) business days of the grant.

9.8 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 ninety (90) days but are less than one (1) year (section 588FN of the *Corporations Act*).

(b) Financing statements

9.9 A registration on the PPSR is effected by completing a form called a "Financing Statement" (subsection 150(1) of the PRS Act). 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.

9.10 Broadly speaking, a financing statement (and therefore any information disclosed on the PPSR as a result of the information provided on a financing statement) only provides the following details about security interest, being (see also below):

9.10.1 the details of the grantor;

9.10.2 the secured parties;

9.10.3 a broad description of the collateral – although parties may provide detailed particulars with respect to the collateral;

9.10.4 the type of security interest granted.

9.11 It should be noted that registration is an important element because it will perfect security interests, but registration of itself will not create a security interest which does not otherwise exist. It is the attachment process that creates a security interest. Further,

registration does not mean that the secured party actually has the interest recorded on the registry. There is no 'title by registration'.

- 9.12 A secured party must have reasonable grounds for making an application to register a financing statement (section 151 of the PPS Act). Because financing statements may be lodged in anticipation of a security interest, if a security interest does not eventuate, the secured party has five (5) business days to remove the registration (subsection 151(3) of the PPS Act). A secured party that breaches these requirements will be subject to civil penalty provisions (subsection 151(2) of the PPS Act).
- 9.13 A single registration may also perfect multiple security interests (subsection 21(4) of the PPS Act). A sufficiently drafted financing statement may also cover multiple supplies of goods, especially in the context of purchase money security interests.

(c) Financing statement – information to be included

- 9.14 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 PPS Act). It should be noted that it is not necessary to establish that any particular person was misled (subsection 165(2) of the PPS Act).
- 9.15 The table contained in section 153 of the PPS Act sets out the data which must be included in a financing statement to be registered on the PPS. 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 PPS Act). At the moment, the following property is currently prescribed:
- 9.15.1 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;
- 9.15.2 personal property that is subject to a notice or an order, or is confiscated or forfeited, under the provision of a proceeds of crime;
- 9.15.3 personal property that is subject to an order of a court or tribunal (however described) that:
- (a) prevents or restricts the person dealing with the property; or
 - (b) enforces another court order (however described); or
 - (c) orders the sale or other disposal of all or part of the property;
 - (d) personal property that:
 - i. is not mentioned in paragraph (a), (b) or (c); and

- ii. 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.

9.16 Further, Schedule 1 of the PPS Regulations prescribes particular information which must be included in the registration.

9.17 Broadly speaking, a financing statement must contain details of:

- 9.17.1 the secured party;
- 9.17.2 the grantor;
- 9.17.3 an address for the giving of notices to the secured party;
- 9.17.4 the collateral and any proceeds;
- 9.17.5 the end time of the registration;
- 9.17.6 any subordination of the security interest;
- 9.17.7 purchase money security interest; and
- 9.17.8 any matters prescribed by the Regulations.

(d) Requesting copies of security agreements

9.18 Because the PPSR is only a “red flag” those interested still need to obtain the “*attachment documentation*” (i.e. the security agreements) that purportedly create the security interest. It should be noted that only interested parties may obtain details of, and copies of security arrangements from the secured party. 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 PPS Act). This is a different situation as was the case with respect to the ASIC company charge register – under which anyone could have obtained details of such charges.

9.19 Subsection 277(1) of the PPS Act provides that secured parties must provide a copy of their security agreement upon request from an interested party within twenty (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:

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

- 9.20 Further, 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 PPS Act).
- 9.21 It should be noted that the secured party is prevented from denying that a security agreement is correct (section 283 of the PPS Act). 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.

10. Taking free of a security interest

- 10.1 The PPS Act provides for when personal property may be taken free of a security interest. Broadly, a party cannot acquire free title to goods which are subject to a security interest in the event that they are involved in the creation of that security interest. Under the PPS Act a security interest takes effect according to its terms (subsection 18(1) of the PPS Act). Because equitable and legal rules are mostly displaced, the PPS Act 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 PPS Act. Essentially these rules provide a code for when a third party may take free interest even including ownership.
- 10.2 The PPS Act 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 PPS Act). 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.
- 10.3 Broadly speaking, good title will be acquired by a purchaser of collateral, notwithstanding that the collateral is subject to a security interest, where:
- 10.3.1 The security interest is not perfected;
 - 10.3.2 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);
 - 10.3.3 Consumer property which is purchased and valued at less than \$5,000; and
 - 10.3.4 Property is purchased in the ordinary course of a business

- 10.4 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.
- 10.5 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.

11. Priority interests – the list of priorities

(a) First - Payments to creditors (section 69 of the PPS Act)

- 11.1 The most common of these types of arrangements are transfers from ADI accounts where the ADI account is subject to an all assets security interest. The purpose of the priority rule contained in section 69 of the PPS Act is to ensure certainty of payments and minimise interruption of the payment system in Australia. It should be noted that even an account bank (i.e., the authorized deposit taking institution at which the ADI account is held) which holds the security interest over the ADI account and which is perfected of the ADI account, defeated if they allow payments out of the ADI account to pay a creditor of the grantor and that creditor has no actual knowledge that the payment may breach the terms of a relevant security agreement.
- 11.2 This priority rule is designed to maintain the certainty of payments through payment and clearing systems, and ensure a debtor can continue to trade. If a secured party wishes to lock up an ADI account over which it has security, it should do so by requiring the debtor to restrict the operation of the signatories on the account.
- 11.3 The priority rule contained in section 69 of the PPS Act which relates to creditors receiving payments of debts, is the first priority rule, ahead of general law liens and statutory liens or charges arising after the commencement of the PPS Act to secure amounts owing for the provision of goods and services in the ordinary course of business (being the second-priority discussed below). The PPS Act provides in section 69 that payments from ADI accounts or by negotiable instruments made on the conditions outline in section 69 of the PPS Act have priority to PPS Act security interests. It should be noted that general law liens, and statutory liens or charges, are not security interests as defined in the PPS Act. That is, creditors receiving payments and debts by transfers from ADI accounts or by negotiable instruments, should prevail over statutory liens or statutory charges over the funds used to pay the payment in most circumstances.

(b) Second - General law liens and statutory liens and charges arising in the ordinary course of business – section 73 of the PPS Act

11.4 General law liens and statutory liens and charges arising after the commencement of the PPS Act to secure amounts owing for the provision of goods or services in the ordinary course of business, have priority over perfected PPS Act security interest in the same collateral. However the lien holder needs to have no actual knowledge that the lien arising breaches the terms of a security agreement that governs the security interest of the same collateral (section 73 of the PPS Act). That is, under such a situation general law liens and statutory liens and charges have priority over any other security interest in the PPS Act.

(c) Third – Takers of interest in negotiable instruments chattel paper and negotiable documents of title (section 70, 71 and 72 of the PPS Act)

11.5 It should be noted that in order to fall within this priority rule, each of the chattel paper, negotiable instruments and negotiable documents of title can be “negotiated” (that is, transferred for value to others).

11.6 The PPS Act within sections 70, 71 and 72 provide the negotiation of negotiable instruments, and chattel paper in priority to any other “security interest” which may be attached to them, provided (in broad terms) the buyer investments in them:

11.6.1 provide value;

11.6.2 take possession or control of the instrument, document or chattel paper;

11.6.3 in most cases, acquire the instrument, document or chattel paper in the ordinary course of a business of acquiring instruments, documents or chattel paper of that kind; and

11.6.4 in many cases, acquire the instrument, document or chattel paper without actual constructive knowledge of either the existence of a security interest over the instrument, document or chattel paper or that the terms of such security agreement would be breached by the acquisition.

11.7 The concept of “chattel paper” is first introduced in the PPS Act (see definition contained in section 10 of the PPS Act). It seems that the most common form of chattel paper will be agreements under leases of goods (bearing in mind that chattels means goods) and conditional sales by retention of title in respect of specific goods.

(d) Fourth – control (section 57 of the PPS Act)

11.8 Security interest perfected by control defeat all other security interest with respect to the same collateral except those described immediately above, and perfected transitional security agreements (section 322A of the PPS Act).

11.9 It should be noted that perfection by control has “super-priority” in a similar way as purchase money security interests, although perfection by control defeats such interests. Perfection by control can defeat secured interest perfected in the same collateral but that are prior in time, and can even defeat purchase money secured interests regardless of whether the secured party has knowledge of prior perfected secured interest.

11.10 However, it should be noted that perfection by control is only available for a limited class of collateral.

(e) Fifth – Accounts – Secured interest over (future) accounts generated from sales and inventory, as original collateral and further for new value (section 64 of the PPS Act)

1.11 Security interests over accounts generated from sales of inventory as original collateral and granted for new value defeat inventory personal money security interests that may attach to the same accounts as proceeds of sale of inventory. This is provided that the secured party either:

1.11.1 registered over the accounts (probably as future property) before the purchase money security interest is registered over the inventory which then sold will generate the accounts (paragraph 64(1)(a) of the PPS Act);

1.11.2 otherwise, the secured party looking to take security over the account gives fifteen (15) business days’ notice to the holder of the purchase money security interest before the attachment of the security interest over the accounts or registration to perfect the security interest over the accounts (whichever is earlier), nominating the inventory and when sold will generate accounts over with the incoming secured party over accounts will take priority (paragraph 64(1)(b) and subsection 64(2) of the PPS Act). (This rule seems to create priority for financiers who provide finance over invoices so as to allow them to take security interest over future accounts generated from inventory sales, which have priority to purchase money security interests over the underlying inventory sold that would otherwise attach to the accounts proceeds with purchase money security interest of “super-priority”.)

(f) Sixth – “Strong” purchase money security interest (section 63 of the PPS Act)

11.12 Purchase money security interest have “super-priority” over many other security interests in the same collateral even where the other security interest are perfected and have a priority time before the purchase money security interest. “Strong” purchase money security interest are title based purchase money security interests being purchase money security interests of lessors, sellers and commercial consignors provided that they comply with the purchase money security interest rules. Such purchase money security interest defeat other purchase money security interest granted by the same grantor in the same

collateral however, the holders of “strong” purchase money security interests may be defeated by those that hold security interests as outlined above.

- 11.13 “Strong” purchase money security interests are title based purchase money security interests of sellers (for example retention of title sales), lessors and commercial consignors. The policy is to protect suppliers against the insolvency of their buyer customers, and to promote the supply of goods and other stock to retailers and the like, to keep the economy ticking over and facilitate commerce. As a result, suppliers may be better off by supplying property via a lease or conditional sale by retention of title (which will meet the condition of “strong” purchase money security interests), rather than outright sales and taking security interests back – which will be normal purchase money security interests.

(g) Seventh – “Normal” purchase money security interest (section 62 of the PPS Act)

- 11.14 All other perfected purchase money security interests (i.e., those which are not held by sellers, lessors or commercial consignors) are “normal” purchase money security interests. Normal purchase money security interests have limited super-priority over other perfected security interests pursuant to the PPS Act (but not strong purchase money security interests and not security interests which are perfected by control). This is regardless of priority time or knowledge of prior security interest, provided that they comply with the purchase money security interest rules.

(h) Eighth – Perfected security interests – earliest priority time wins (subsection 55(4) of the PPS Act)

- 11.15 With respect to priority arguments as between two or more perfected security interests which are not themselves purchase money security interest and not perfected by control, this security interest with the earliest priority time prevails (subsection 55(4) of the PPS Act).
- 11.16 The priority time arises from the time of perfection of a security interest. Perfection can be affected either by:
- 11.16.1 registration;
 - 11.16.2 temporary perfection by force of the PPS Act which applies to pre-PPS Act transitional security interest; or
 - 11.16.3 the secured party taking possession or control of the collateral.
- 11.17 Generally speaking, knowledge is not relevant with respect to priority disputes between two perfected PPS Act security interests. It is generally speaking irrelevant that once secured interests may have attached prior to another and the other security interest is perfected with the knowledge of the first attached (but unperfected secured interest).

11.18 Secured interest perfected by control and purchase money secured interests will generally defeat other perfected security interests regardless of priority time. As a result, priority time is not absolute or indefeasible but is a general rule.

(i) Ninth – Execution creditors may defeat unperfected security interests (section 74 of the PPS Act)

11.19 Execution creditors who obtain orders to enforce judgments debts against collateral defeats security interest that remain unperfected over that collateral. This is provided the execution creditor, who has already obtained judgment for a debt, seeks a garnishee order or other court order against the collateral or takes possession of collateral before any other perfected security interest over the collateral is perfected (section 74 of the PPS Act).

(j) Tenth – Perfected and unperfected security interests – The perfected security interest wins (subsection 55(3) of the PPS Act)

11.20 With respect to priority claims as between a perfected and unperfected security interest, the perfected security interest will take priority (subsection 55(3) of the PPS Act).

11.21 This will be the case even if the secured party who perfects has knowledge of an existing unperfected security interest and registered with the intention of defeating the unperfected security interest. That is, perfection is not affected by knowledge of prior unperfected security interest. The first to perfect will generally defeat other security interests that exist but are not perfected with limited exceptions.

11.22 It should be noted that perfection must be continuous. Continuous perfection means that there has been no gaps in the perfection and any windows of temporary perfection have been complied with and security interest was duly perfected before the expiration of any temporary perfection windows.

(k) Eleventh – Priority as between unperfected security interests – The first to attach has priority provided that the grantor is not bankrupt, in administration or liquidation (subsection 55(2) of the PPS Act)

11.23 With respect to priority as between two unperfected security interests, the first to attach takes priority (subsection 55(2) of the PPS Act).

11.24 However, upon a grantor entering into bankruptcy, administration or liquidation most unperfected security interests vest in the grantor which means that they become invalid.

11.25 There are exceptions – any of the “deemed” security interests (transfers of accounts, commercial consignments and PPS leases) do not vest even if unperfected, provided that they do not secure obligations.

12. Enforcement of “mixed securities” including land

- 12.1 The PPS Act recognises that land is often dealt with in conjunction with other assets that are covered by the PPS Act, and offers an approach to enforcing security over this package of assets. The PPS Act allows the security holder to elect to enforce the security interest by applying enforcement laws that 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 PPS Act (see Part 4.2 of the PPS Act).
- 12.2 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.
- 12.3 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:
- 12.3.1 the respective values of the land and other assets;
 - 12.3.2 the degree of connection between the land and the other assets; and
 - 12.3.3 whether it is an efficient method of enforcement to deal with them together.
- 12.4 That is, it is intended that this approach only apply where it is practical and efficient to do so given the circumstances.

13. The enforcement of a security interest

- 13.1 Upon a debtor’s default, the PPS Act 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.
- 13.2 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*. Any secured party may initiate enforcement action but a higher ranking secured party may obtain possession of collateral from a lower ranking secured party.
- 13.3 Where collateral is liquid, such as debts owed by third parties to the grantor, the Act provides for statutory garnishee style remedy by notice to the third party debtor.
- 13.4 In other cases, the Act 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.
- 13.5 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.
- 13.6 An amount, proceeds or personal property derived from an enforcement process, must be allocated in order of:
- 13.6.1 obligations to persons holding interest other than security interest in the collateral that have the priority than the interest of the secured party;
 - 13.6.2 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);
 - 13.6.3 obligations to persons holding security interests in the collateral that have a higher priority than the interests of the secured party;
 - 13.6.4 obligations to the secured party that are secured by the security interest in collateral;
 - 13.6.5 obligations to persons holding interests or security interests in the collateral that have a lower priority than the interests of the secured party;
 - 13.6.6 to the grantor.
- 13.7 When enforcing security interest under the PPS Act, the following should be borne in mind:
- 13.7.1 ascertaining all security interests – it should be ensured that all transactions that fall within the scope of the PPS Act (i.e. those which establish security interest with respect of personal property) have been identified;
 - 13.7.2 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;
 - 13.7.3 any opportunity to maximise or improve a priority position should be taken –
 - (a) one should perfect against all available collateral before the grantor enters bankruptcy, administration or liquidation;
 - (b) 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;
 - (c) perfecting by control with respect to financial assets;
 - (d) identifying and perfecting as against proceeds;
 - (e) registering against serial numbers with respect to that type of collateral;

- (f) 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
- (g) structure and plan for enforcement and asset sales.

(a) Exclusions with respect to enforcement

13.8 The statutory enforcement rights do not apply to:

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

(b) Personal property and land used to secure the same obligation

13.9 The PPS Act enables a secured party who is a security interest in both land and personal property to take enforcement steps as if the personal property were land. When making the decision, the secured party must act reasonably and consider:

- 13.9.1 the respective values of the personal property and the land;
- 13.9.2 whether there is any connection between, and the nature of any connection between, the personal property and the land;
- 13.9.3 whether the land and the personal property are both located in the same State or Territory;
- 13.9.4 such other matters as are relevant to the efficient enforcement of the security interests and the interest in land.

13.10 It should be noted that these matter are only intended to be a guide.

13.11 A secured party intending to so act must give notice in the prescribed form to the grantor, a secured party perfecting immediately before the decision is made and any other secured party who has notified the secured party of its interest.

13.12 A secured party adopting this course must apply the distributions proceeds hierarchy.

(c) Enforcement of security interest in liquid assets

13.13 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.

- 13.14 Upon receipt of the notice, the third party debtor must pay the secured party any amount owed to the grantor within five (5) business days, if the debt is not yet due, the third party debtor has five (5) business days from the due date.
- 13.15 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.

(d) Notice to higher priority parties

- 13.16 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 ten (10) business days before the action is to be taken and must:
- 13.16.1 contain the name of the secured party giving the notice; and
 - 13.16.2 contain the description for collateral; and
 - 13.16.3 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);
 - 13.16.4 state the address for notice of the lower ranking secured party.
- 13.17 Upon being notified, a higher priority party may elect to continue the enforcement process by giving notice to a lower priority party.
- 13.18 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 five (5) business days before the action is taken.

(e) Seizure of collateral

- 13.19 If a debtor is in default under a security agreement, the Act provides that the secured party may seize collateral by any methods permitted by law.
- 13.20 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.
- 13.21 A secured party who has perfected their security interests by possession or control may seize collateral by provision of the same notice.
- 13.22 Seizure of collateral does not perfect a security interest.

(f) Apparent possession

- 13.23 Where collateral cannot be readily moved from the grantor's premises, a secured party may seize the collateral by taking "apparent possession".

13.24 A secured party which seizes collateral must either dispose of the collateral or retain the collateral. 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.

(g) Rights of higher priority party to seize collateral

13.25 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 five (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 twenty (20) days of disposal of the collateral or from when the evidence is received.

(h) Disposal of collateral

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

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

(i) Duty to obtain market value

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

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

(j) Statement of account

13.28 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 twenty (20) business days after the request. The statement of account must show:

- 13.28.1 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;
- 13.28.2 in any other case – the total amount received from the disposal of the collateral;
- 13.28.3 the total expenses relating to the disposal of the collateral;
- 13.28.4 any amounts paid to the secured parties; and
- 13.28.5 the balance owing by the secured parties to the grantor or by the debtor to the secured party, as the case may be.

(k) Six month rule – disposal of collateral

- 13.29 If the secured party has not disposed of collateral within six (6) months, it must give a written statement of account to any other person with a security interest or the grantor within twenty (20) business days of their request. The six month notice must:
- 13.29.1 state that the secured party has not disposed of the collateral; and
 - 13.29.2 show the total amount received in relation to the collateral during the six month period starting from the seizure date of the collateral; and
 - 13.29.3 show the amount of expenses relating to the retention of collateral.
- 13.30 Collateral disposed of by enforcement mechanisms is taken free of the interest of the grantor and all security interests in the collateral.
- 13.30 A secured party may also dispose of collateral by purchasing it if:
- 13.31.1 the secured party gives the require notice; and
 - 13.31.2 no notice of objection is given to the secured party.
- 13.31 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.
- 13.32 Importantly, a secured party may only purchase collateral:
- 13.32.1 by public sale; and
 - 13.32.2 by paying at least the market value at the time of the purchase.
- 13.33 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.
- 13.34 The notice must:
- 13.34.1 contain the name of the secured party by giving them notice; and
 - 13.34.2 contain a description of the collateral; and
 - 13.34.3 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
 - 13.34.4 state that the notice is given for the purposes of the PPS Act; and
 - 13.34.5 the secured parties proposing to dispose of the collateral by purchase:
 - (a) contain details of rights or objections; and
 - (b) contain the address to which a notice of objection may be given under s.137 of the PPS Act;
 - 13.34.6 any matters required by the PPS Regulations.
- 13.35 Notice to the grantor or high priority parties is not required if:

- 13.35.1 the secured party believes on reasonable grounds that the secured party was induced to enter in the relevant security agreement by fraud; or
 - 13.35.2 the secured party believes on reasonable grounds that the collateral might perish within ten (10) business days after the date the collateral is seized; or
 - 13.35.3 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
 - 13.35.4 the secured party believes on reasonable grounds that expenses of preserving the collateral disproportionately large in relation to its value; or
 - 13.35.5 the collateral is foreign currency; or
 - 13.35.6 the collateral is to be disposed of in accordance with the operation laws of a clearing and settlement facility.
- 13.36 Collateral disposed of by the secured party (including by purchasing it) is acquired free of all security interests and the interest of the grantor.

(l) Retaining Collateral

- 13.37 Alternatively, a secured party may elect to retain seized collateral if:
- 13.37.1 the secured party gives notice; and
 - 13.37.2 no notice of objection is given to the secured party.
- 13.38 The notice must be given to:
- 13.38.1 the grantor; and
 - 13.38.2 another registered secured party; and
 - 13.38.3 if the retaining party is a purchased money securing interest holder – any other lower priority secured parties registered in the collateral.
- 13.39 The secured party must give notice at least ten (10) business days before the first steps are taken to retain the collateral.
- 13.40 A notice must be given in the approved form and must:
- 13.40.1 contain the name of the secured party giving the notice; and
 - 13.40.2 contain a description of the collateral; and
 - 13.40.3 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 ten (10) business days after the notice is given; and
 - 13.40.4 state the obligation to be performed, or the amount of payment required, before the day is specified in accordance with paragraph (c), to satisfy the obligations secured by the security interest in the collateral; and
 - 13.40.5 contain details of rights of objection; and
 - 13.40.6 contain the address to which a notice of objection may be given;

13.40.7 any matters required by the Regulations.

13.41 If notice is given and no notice of objection is given to the secured party, ten (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.

(m) Redemption of collateral

13.42 A secured party or grantor pay redeem collateral by paying the amount secured by the obligation together with any enforcement expenses. A grantor has priority for this purpose.

13.43 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.

14. Fixed and floating charges and the PPS Act

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

14.2 The PPS Act defines a security interest as “*an interest in personal property provided for by a transaction and secures payment or performance of an obligation*”. In order to secure a loan, financiers (i.e., a secured party) will need to perfect their security interest in the property provided to the grantor on the PPSR. It should be noted that the PPS Act does not provide for a distinction between fixed and floating charges nor does the concept of crystallisation exist under the PPS Act.

14.3 Under the old rules, a floating charge permits a chargeor to deal with the charged assets in the ordinary course of its business and it only becomes a fixed charge on crystallisation. Under the PPS Act 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 PPS Act, 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.

- 14.4 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.
- 14.5 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.
- 14.6 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 PPS Act whether such conditional power of attorney clauses would satisfy the requirement of the PPS Act, that is, that the person controlling the instrument “*is a able to*” deal with the investment instrument.
- 14.7 It may be argued that the PPS Act requires an unfettered, present and existing right of control rather than the conditional one. However, there is no guidance on this issue.

15. Some important steps to ensure protection of security

- 15.1 The PPS Act 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.
- 15.2 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.
- 15.3 Paragraph 34(1)(a) of the PPS Act 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 [bona fide purchaser for value with notice?]
- 15.4 Amendments to the Corporations Act made by the *Personal Property Securities (corporations and Other Amendments) Act 2010* (Cth) provide that perfection t 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).
- 15.5 Further (and overall):

- 15.5.1 Group structures, and arrangements and agreements between entities, should be reviewed.
- 15.5.2 A security interest should be registered in inventory prior to any stock passing. Retention of title clauses 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'
- 15.5.3 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.
- 15.5.4 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).
- 15.5.5 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 PPS Act property);
- 15.5.6 Charges should be renewed (and where relevant renegotiated) so as to deal with the new regime.
- 15.5.7 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.
- 15.5.8 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.
- 15.5.9 Secured parties need to closely monitor their secured assets (i.e. including on the PPSR).

Denis Barlin

13 Wentworth Selborne Chambers