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Précis Paper

The *Personal Property Securities Act 2009* (Cth)

Discussion of the *Personal Property Securities Act 2009* (Cth), with particular focus upon extension of time to register securities

Discussion Includes

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Précis Paper

The *Personal Property Securities Act 2009* (Cth)

1. In this edition of BenchTV, Nicholas Mirzai (Barrister, Level 22 Chambers, Sydney) and Christopher Athanassios (Principal, Miller & Prince Lawyers, Sydney) discuss the *Personal Property Securities Act 2009* (Cth) (PPS Act), with a particular focus upon extension of time to register securities, and provide very useful advice not only to practitioners, but more broadly to all those involved in the personal property securities space.

Overview of the *PPS Act*

2. Registering securities means here to register financing statements in respect of security interests to ensure that encumbered parties have the highest-ranking priority, which has a number of important ramifications upon insolvency.

3. Put simply, the *PPS Act* is about personal property (i.e. anything that is not real property), and an interest that relates to personal property. Practitioners usually have to work through the Act to find out whether or not a transaction requires compliance with the *PPS Act*, and whether or an interest needs to be 'perfected'.

4. It is common for people to associate taking security or encumbrances with real property. The *PPS Act* concerns the taking of the very same securities and encumbrances - but in respect of anything but land.

5. Anything that is not land, or a fixture attached to land, generally falls within the first threshold of the *PPS Act*. To take security is to lend money, or to perform a particular obligation, instead of, or in support of, collecting money, repayment of a loan, or performing some obligation. A party contractually reserves the right to enforce that interest against property for non-compliance.

6. So the reason why a person needs to 'perfect' (or let the world at large know that it has taken an interest) is that other parties who might engage with the person granting the interest will want to know whether or not that asset is encumbered, to what extent it is encumbered, how much equity is left in the asset, and how many other assets the grantor may have.

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'Perfecting' a security interest

7. Some of the ways in which a secured party can 'perfect' include by:
    - possession
    - control
    - registration

8. The Act recognises a number of interests that create security, interests which traditionally were not recognised as creating security. Traditionally, security interests were mortgage, pledge, lien, charge. Now the Act recognises others.

9. The Act provides for a number of ways in which a security interest can be perfected, and secured parties should ensure that they are perfected. This is because under the legislation, priority is conferred not by reference to notions of title, or who holds the asset, but by the prescribed approach under the Act.

10. Priority rules are contained in Part 2.6. The most commonly cited section is s 55. S 55 states in effect that a perfected security, irrespective of whether it arises earlier or later, will trump an unperfected security. A priority contest is a contest between two secured parties who both have taken an interest in the same asset.

11. There are some complexities concerning how to go about tracing a security interest, but reality is, it can be done. Because a supplier or secured party has very limited recourse outside of pursuing their security (noting that the grantor is not paying), retaining a position of priority is critical.

12. Retaining a position of priority is also critical when dealing with third-party purchasers, and critical in the insolvency context, particularly when an external administrator/liquidator/receiver is appointed to the grantor. Only perfected security interests survive that appointment.

What is the benefit of 'perfecting' in the insolvency context?

13. A secured party needs to perfect, otherwise it faces a security interest vesting in the grantor. If a secured party is unperfected, it faces a s 267 issue, which effectively vests in the grantor the security interest.

14. By perfecting, even if the registration is not yet complete, a secured party:
    - may be able to argue that the registration is still effective
    - will avoid being faced with a s 588FL *Corporations Act 2001* (Cth) (*Corps Act*) issue

15. S 588FL of the *Corps Act* states that if registration does not occur within 20 business days from the date of the security agreement, the security interest effectively vests in the grantor.

16. S 588FM of the *Corps Act* is extension of time for registration of a security interest. This section is relied upon when a party:
    - has not registered within the 20 business day rule under s 588FL
    - or in circumstances whereby a party provides equipment under a hire purchase agreement, and does not adhere to the 15 business day rule for purchase money security interests (PMSIs) under s 62 of the *PPS Act*

17. S 293 of the *PPS Act* refers to applications for extension of time in relation to PMSIs.

18. S 267 of the *PPS Act* provides that where there is a secured party who is unperfected, their security interest vests in the grantor. The earlier cases on the Act, when it was in its infancy, discussed exactly what this meant. It does not mean that the interest that the grantor held, vests in the grantor again. For example, if the grantor had a mere possessory interest, only a possessory right would arise. It means that the very ownership of the underlying asset vests in the grantor.

19. S 588FM is important not only because it provides a sort of remedial recourse to parties by giving them a chance to perfect, but also because s 588FM applications can be brought not only prior to the vesting event, but even, in accordance with Australian jurisprudence, after the vesting event.

20. If a grantor has gone into external administration and concern arises over their registration (assuming that there is a registration), and a practitioner is acting for a secured party that wants to rely on its security interests, one of the very first questions to be asked is: is there a registration before the external administration? This is because if the registration is registered on the Personal Properties Securities Register (PPSR) before the grantor goes into external administration, then an application under s 588FM can be made.

21. These extension of time applications are not limited to whether something is registered or unregistered. They go further to apply to PMSIs, which is a very discrete type of security interest under the Act.

22. The definition of a PMSI is contained in s 14 of the *PPS Act*. S 62 of the *PPS Act* states that a PMSI has priority over a non-PMSI.

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23. The next question to ask is: *but for* the supply, would the grantor have any rights in the collateral? If the answer to that question is no, then it is likely that the supplier has a PMSI.

24. A PMSI holder must perfect their security interest within 15 business days of the grantor coming into possession of the asset if they have supplied equipment. So in the context of leasing, entities that lease large pieces of equipment (bobcats, cranes etc.) need to ensure when they are creating these leases that they have diligent processes in place to:
    - not only perfect the security interest on the PPSR
    - but also to indicate that the interest that they are taking is a PMSI

25. This allows the secured party to then preserve, as a matter of priority, not only priority against any subsequent holder of a security in the same asset, but also against any earlier holder. The reality is, as a matter of commerce, that by the time the supplier comes along to supply the equipment, it is highly likely that the underlying grantor has already granted an all assets charge/all assets security interest/AllPAAP (all present and after-acquired property) in favour of someone else.

<u>Need for extension of time arising as a result of accident or inadvertence</u>

26. The first step is to demonstrate that the error arose due to accident or inadvertence. Those terms have been interpreted quite broadly by the Courts. The Courts have recognised that the provisions are remedial in nature.

27. The Courts have said that inadvertence is not only satisfied if a party does not know about the requirement to register. Inadvertence may also be satisfied if a party does not know the *effect* of not registering. Evidence from the primary source is required. It is insufficient for a solicitor to depose an affidavit which says that 'I am instructed by my client that he/she was unaware of this'.

Key facts of Duke Contracting Australia Pty Ltd *[2017] NSWSC 767*

28. The supplier supplied equipment to the grantor. It came to the supplier's attention that it had not registered its security against the ABN of the trust. So it did so in 2014. Some time after that, the grantor went into external administration, and it relied on its master registration against the ACN of the corporate trustee, and its registration against the ABN of the trust.

29. The external administrator argued that the supplier was out of time, and that it had already vested. The supplier went to Court to apply for an extension of time under s 293 (1)(a) of the *PPS Act*. The Court in this case granted an extension of time in respect of the registration (by finding some sort of inadvertence or error, in accordance with s 293 (1)(a)).

30. More often than not, when practitioners are approached with these sorts of conundrums, the reality is that the problem is merely an example of a far greater problem.

31. That something was due to inadvertence can only be argued once. When an order like this is made, there is no longer inadvertence or error on the part of the party against whom the order is made, because they have now been made aware of the incorrect registrations.

32. These orders are discretionary.

33. The reason it is useful to couple s 588FM (extension of time applications) with s 293 (extension of PMSI registrations) into the same topic is because the criteria in respect of each of those types of applications is quite similar.

Joining parties, and the types of prejudice that they might suffer

1. Practitioners and secured parties needs to be quite careful about how evidence is structured, and quite careful about who is a party to the proceedings. In relation to these types of applications, if there is only one registration that a party is seeking to perfect, the grantor must be joined to the proceedings. Ordinarily, the grantor is utterly disinterested in the application.

2. Any AllPAAP holders also have to be joined to the proceedings. This is because they too have taken a security in respect of the asset. Anyone else who has taken a discrete interest in an asset must also been joined.

3. The reality is, as was made out in *Accolade Wines Australia Limited and others* [2016], that once there is an AllPAAP holder, or several AllPAAP holders, and somebody takes a PMSI over the asset, there will not be all that much equity left over for anyone else. So it is unlikely that there will be other secured parties - but, of course, there might be - and if they are known, they ought to be joined to the proceedings.

4. An efficient way of doing this is to have:
- A list of first defendants (for grantors)
- A list of second defendants (for all other secured parties - which can be further subdivided into earlier AllPAAP holders, and later AllPAAP holders)
- A list of third defendants (for peculiar cases that do not fall into the style of error into which the vast majority do)

5. Before an application is commenced, practitioners are advised to write to the grantors (i.e. their customers) to alert them to the fact that such an application is being made, that they will be served with relevant documents, and that they are not being sued.

6. The next step is to prepare all the evidence, i.e. who is going to be giving evidence on behalf of the secured party. Once the orders are granted, there is a six-month leeway.

7. Where there are multiple grantors and multiple registrations, logistically, things can get extremely complicated and difficult. The normal process for serving an originating process is personal service. Normally what occurs is that the secured party applicant prepares two forms of letter:
    - a covering letter to all grantors (explaining the nature of the application)
    - a separate form for the secured parties (with more detail about the application)

8. Prejudice is a loaded term. It is a term that carries some legal meaning, but which is not otherwise described by the *Corps Act* or the *PPS Act* in a sufficient amount of detail.

9. The prejudice is in respect of the AllPAAP holders. Their conundrum is whether they would have relied upon the registration at the time that they performed their registration prior to doing something (e.g. lending money, using encumbered equipment).

10. The prejudice is not necessarily prejudice that would arise from a making of the order. In the context of a s 293 application, once an order is made, the applicant is highly likely to have a first-ranking priority, which means, in an enforcement context, the applicant will likely exhaust the value of the asset, to the detriment of all other secured parties.

11. In a situation in which an AllPAAP holder would not have relied on the register when granting their AllPAAP (for example, in the case of an earlier AllPAAP holder), the PMSI would never have existed. So the earlier AllPAAP holder arguably has no (relevant) prejudice.

12. Prejudice is not something that is taken into account when it is inevitable. Prejudice, by the very making of the order, will occur in every case. The AllPAAP holder must lose priority in order for the PMSI holder to win priority. It is prejudice as a result of what appeared on the PPSR if the AllPAAP holder (particularly a later AllPAAP holder) can demonstrate to the Court that they did do a PPSR search, and proceeded to do whatever they did on the basis of their search. The burden is on the AllPAAP holder to demonstrate this.

13. If they can demonstrate this, then it would be difficult to see why a Court, exercising its discretion, would allow the PMSI holder applicant to trump the AllPAAP holder. The PMSI holder may trump other secured parties who cannot demonstrate prejudice. But they should not be able to trump parties who are genuinely prejudiced.

14. The same thing occurs in the s 588FM context. The prejudice that is being considered in this context is prejudice that is suffered by unsecured creditors, because if the asset vests

in the company, and is not the subject of any other security, it will be there for the benefit of unsecured creditors generally.

15. The prejudice is not denying these creditors the windfall gain that they might otherwise have received had this asset vested - it is any prejudice that might arise from these unsecured creditors performing a search, relying on what appeared, and acting accordingly. For an unsecured creditor, this is an incredibly difficult thing to prove.

16. Whenever the Courts or Registrars are asked to exercise discretion, more often than not, they are required to consider what other parties might be prejudiced. The onus is on the applicant to make clear that no one else is prejudiced, as a prima facie proposition. Once evidence has been produced to this effect, the onus is on any other party to contradict that evidence.

Registering against the ABN and ACN of a trust in circumstances where an entity trades in its capacity as trustee of the trust

17. The *PPS Act* and its strictures exemplify a more important problem, which is that the regulation of trusts as trading vehicles is fairly poor. Every state has its own *Trusts Act* regulating trusts, and the origins of those acts are equitable - they are testamentary trusts, and trusts in the conventional sense.

18. The increase in the use of trusts as trading mechanisms (for taxation and other reasons) has meant that the problem is becoming more common, as opposed to less. There is no obligation on a trust to disclose that it is trading as a trustee for anything. That shifts the burden back onto the secured party and their due diligence.

19. The *PPS Act* (and legislation like the *PPS Act*, including the *Corps Act*) was designed for the very purpose of increasing transparency. If a person has taken an interest, that person is obliged to register it, so that the world at large can be put on notice of it.

20. But the fact that a person is able to hide behind a trust structure, in circumstances where it may be fatal not to refer to the trust, undermines the very transparency that the whole regime purports to be founded upon in the first instance.

21. In promoting the legislation and its efficiency, PPS lawyers always throw up the example of ROT (retention of title) suppliers. Under the old system (pre-*PPS Act*) someone who supplies an asset on retention of title terms did not have to register anything (because it was not a mortgage, charge, lien, or pledge). So there was no way of any external party knowing that the ROT supplier had first-ranking entitlement to the asset.

22. The same problem is occurring in relation to trusts. It is essentially a different example of the very same problem. The lack of transparency allows, in particular contexts, entities

acting in that capacity to benefit arbitrarily. This is not an academic or hypothetical problem. It is a problem which permeates a number of very high-profile corporate entities and corporate groups.

23. In some instances, it is near impossible for the secured party to know with certainty which company in a corporate group actually holds the asset. So when they all go into external administration, and the secured party has lodged a financing statement registering an interest in respect of Company A, but Company B holds the asset, and there is no contract between the two companies, there is no way that the secured party could have ever known this. The administrator of Company B, in some instances, can say to the secured party: 'your interest is unperfected, and we hold the asset'.

24. These sorts of problems and difficulties have brought into relief some of the teething aspects of the *PPS Act*. There is no short or clear-cut solution to these problems, but these issues are starting to make their way through the Courts, and there will be some judicial guidance in this space because the problem is not unique to a specific circumstance.

Conclusion & takeaways

25. In a nutshell, for all secured parties, practitioners should ask:
    - Is the *PPS Act* applicable? (s 8, *PPS Act*)
    - If the *PPS Act* does apply, what security interest is being taken? (an AllPAAP or PMSI?)
    - How can the interest be perfected?
    - (Once the interest is registered) Is the registration correctly registered on the PPSR?

26. If the registration has been done correctly, the person is not faced with any further issues. If the registration has not been done correctly, the person is faced with the issue of rushing off to Court for an extension of time for registration.

27. Perfecting by registration sounds like a fancy term. But, in fact, it only involves going to www.ppsr.gov.au, and filling out a form called a financing statement.

28. A key takeaway for all solicitors and compliance officers is that perfection by registration must be treated with the degree of seriousness that it deserves.

29. It is critical to read the *Regulations* when registering on the PPSR in respect of a financing statement.

30. It is useful to look closely at s 153 as a starting point. S 153 contains the prescribed details that must be included.

31. In order to work out how to include them, or what identifier to include, the *Regulations* (particularly Schedule 2 of the *Regulations*) must be looked at. It is important to make sure that the right identifiers are included. It is also very important to make sure that nothing has been incorrectly included or ticked.

32. Given the number of ways an error can be made, and the risk that follows error, one person should perform the registration, and another person (preferably more senior) should check the registration.

33. So the lesson for anyone who participates in this space of personal properties securities is to:
    - spend some time acquainting themselves with the correct approach
    - get advice
    - if there are things that should be registered, to register them straightaway, and not to wait for a grantor to go into administration

34. At the end of the day, the secured party who benefits from priority bears the burden of making sure that what appears on the PPSR is accurate, and this is how the PPS legislation has been designed, and interpreted.

35. It is important to bear in mind that there is no room for equity to intervene where the Act speaks specifically to an outcome, and that most conflicts are resolved by the priority rule.

36. In sum, it is quite an unforgiving regime. The benefit of this is that if you get it right, it improves consistency and predictability, and assets can be taken out of an insolvent company without too much difficulty.

37. Basically, the two basic steps are:
    - to identify whether or not the Act applies
    - to perfect the security interest in time

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BIOGRAPHY

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Nicholas was called to the Bar in 2013 after serving as an Associate at the High Court of Australia and as Tipstaff at the Supreme Court of NSW. Nicholas' practice focuses primarily on resolving commercial, corporate and insolvency disputes. As co-author of the Annotated Personal Property Securities Act and part-time Lecturer in Commercial Law and Finance Law at the University of Technology, Sydney, Nicholas has been briefed to advise and appear in a number of matters of varying complexity before the Local, District and Supreme Court of New South Wales and the Federal Court of Australia.

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Christopher was admitted as a solicitor in 2015 and has substantial experience in corporate finance, alternative dispute resolution and insolvency law. Christopher is a casual academic at the University of Technology, Sydney from where he also holds a Bachelor of Laws and a Master's Degree, majoring in Corporate and Commercial Law.

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Legislation

Personal Property Securities Act 2009 (Cth)

Personal Property Securities Regulations 2010 (Cth)

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