



# Practicalities of PPS Act

Article supplied by the Legal Practitioners' Liability Committee of Victoria

## Introduction

In September 2011 the *Bulletin* published the article "Understanding the new personal property Securities Reform" provided by the Legal Practitioners' Liability Committee of Victoria. We now reproduce the second handout issued by the Committee, which focuses on some of the practicalities of the *Personal Property Securities Act 2009* (Cth). In the next *Bulletin* we will publish the third information sheet which deals with some specific issues for law firms concerning this legislation.

## What businesses are affected?

Every business that supplies goods (by sale or lease) or finance needs to consider the impact of the *PPS Act* upon its operations. Businesses that ignore the *PPS Act* face a real risk of suffering significant losses in the future in ways that have not occurred in the past. Conversely, businesses that make the necessary adjustments to their documentation and business processes will enjoy significant new protection from bad debts that simply has not existed in the past.

## What businesses need to do to prepare

To gain the full benefit of the *PPS Act*, a supplier of goods will ideally need to:

1. **Review their terms of trade.** This includes ensuring that their terms of trade contain a 'retention of title' or Romalpa clause, and considering whether to add additional clauses to contract out of some of the notification requirements (particularly in the enforcement area) where that is permitted by Section 115 of *PPS Act*.
2. **Obtain accurate details from customers** (ABN, ACN, name and date of birth) that can be then used to register an effective financing statement. It may be necessary to ask certain customers for identification (such as driver's licence) to verify the information provided.
3. **Obtain unequivocal acceptance (preferably in writing) from each and every customer** to their terms of trade, and establish the appropriate filing or document management system so that the business can prove such acceptance

as and when required to do so. This is important to ensure that the security interest is enforceable against third parties.<sup>1</sup>

4. **Obtain the super priority of a perfected purchase money security interest (PMSI)**, by registering a financing statement within the tight timeframes specified under the *PPS Act*.<sup>2</sup> If the customer is using the collateral:
  - as inventory (eg where the customer is on-selling or on-leasing the collateral, or consuming the collateral as raw materials), the security interest must be registered before the purchaser takes possession of goods;
  - as non-inventory, the security interest must be registered within 15 business days after the purchaser takes possession of the goods.
5. Put systems in place so that the business can **trace unpaid invoices** to the particular goods supplied. If a customer goes into liquidation and the supplier wants to either enforce a purchase money security interest (PMSI), or trace into proceeds of the sale of any unpaid goods, then the supplier must be able to identify

the precise goods that were supplied pursuant to any unpaid invoices.

6. Put systems and business processes in place to be able to **respond to any Requests for Information or Amendment Demands** in relation to their financing statements within the tight timeframes required by the *PPS Act*.

Businesses that lease goods or provide goods on bailment will need to review their terms of lease or bailment. If the terms do not limit the lease or bailment to less than 12 months, or the business does not ensure the goods are returned within 12 months, then it will be deemed to be a PPS Lease,<sup>3</sup> and the business should consider the costs/benefits of registering its security interest. Alternatively, the business might consider whether it is possible and desirable to alter **both** the terms of its leases or bailments (eg ensuring that the lease is less than 12 months) **and** its business processes (eg ensuring goods are in fact returned within 12 months) to take the arrangements outside the operation of the *PPS Act*.

Finally, it would be advisable for every single business to **monitor what financing**

*If a customer goes into liquidation and the supplier wants to either enforce a purchase money security interest (PMSI), or trace into proceeds of the sale of any unpaid goods, then the supplier must be able to identify the precise goods that were supplied pursuant to any unpaid invoices.*

statements are being registered against it, and seek discharge or amendment of such financing statements where appropriate. The failure of a business to do this might render it difficult, time consuming and costly for the business to raise finance in the future. This is because financing statements registered against the business may adversely affect its credit rating and may make any potential financier more wary.

## The information that a financing statement needs to contain

A 'secured party' perfects its security interest by registering one or more 'financing statement'. Sections 153 and 154 of the *PPS Act*, and clause 5.5 and Schedules 1 and 2 of the *Personal Property Security Regulations 2010* ("the PPS Regulations") provide that a financing statement will need to contain:

### • Details of the Secured Party.

This will require an address (including email or fax) for giving of notices to the secured party, and, if the secured party is:

- a. a company – its ACN ;
- b. a partner in a partnership – its ABN;
- c. an Individual or Sole Trader – the surname and given names as recorded on the individual's driver's licence( if the sole trader has an ABN, the secured party will nevertheless be described by name and not the ABN).

### • Details of the Grantor.

If the grantor is:

- a. a company – the ACN of the company;
- b. a partner in a partnership – the ABN of the partnership;
- c. an individual or a sole trader – the surname and given names, and date of birth as recorded on the individual's driver's licence (if the sole trader has an ABN, the security interest will still be registered against that person's name and date of birth, not against their ABN).

If the property is consumer property

which is required to be registered by serial number (ie motor vehicle, watercraft, aircraft or a specific IP right) then no grantor details are required.

### • Description of Collateral

a. **The class of collateral.** The collateral must belong to a single class of collateral prescribed by the regulations. Currently clause 2.3 of Schedule 1 of the PPS Regulations prescribe the following classes of collateral:

- i. agriculture;
- ii. aircraft;
- iii. all present and after-acquired property;
- iv. all present and after-acquired property, except [*such property as the parties have carved-out and have described in the free text field or an attachment*];
- v. financial property;
- vi. intangible property;
- vii. motor vehicles;
- viii. other goods;
- ix. watercraft.

b. **Free text field** giving further details about the collateral (see paras 5.39 and 5.41 of the Explanatory Memorandum). This is optional. One advantage of providing further information is that the secured party may thereby reduce the volume of Requests For Information that it receives because it will be more evident from the financing statement that it is limited to a specific type of property. A disadvantage is that the secured party may need to amend the financing statement or register a new financing statement if it later takes a security interest in property that does not fall in the description provided in the free text field.

- c. Whether the collateral is **consumer** property or **commercial** property;
- d. If the collateral is commercial property, whether the collateral:
  - i. **may include inventory**, and/or
  - ii. **may be subject to control**.
- e. Whether the collateral includes the **proceeds** arising from the sale of the property;

f. The **serial number** of the collateral in certain circumstances;

- i. If the collateral is a motor vehicle, watercraft or a specific IP right and **consumer property**, then it **MUST** be described by serial number.
- ii. If the collateral is a motor vehicle, watercraft or a specific IP right and **commercial property**, then it **MAY** be described by serial number.
- iii. If the collateral is an **aircraft**, then it **MUST** be described by serial number (regardless of whether it is consumer or commercial property).

### • Additional Information

- a. The **end time** of the registration (usually either 7 or 25 years after registration depending upon whether the collateral is described by serial number and is consumer or commercial property). If the security interest will continue after this end time, then the registration will need to be renewed or else the security interest will then become unperfected.
- b. Whether the security interest is
  - i. a **purchase money security interest (PMSI)**; and/or
  - ii. a **transitional security interest** (essentially one that arises prior to the commencement of the PPS Act); and/or
  - iii. a **migrated security interest** (and if so, the name of the register from which the security interest has migrated and the date the security interest was registered in that old register); and/or
  - iv. **subordinated** to any other security interest.

In many cases, a business will be able to perfect a wide range of securities over a particular customer (grantor) by registering a single financing statement. In most cases, that single financing statement will cover all future supplies or transactions with that customer. In other words, it **will not** be necessary to register a new financing statement every time a particular customer places an order.

# Practicalities of PPS Act (cont)

However, there will be situations where a secured party will need to register more than one financing statement over a particular customer (grantor). For example, if a business is supplying a range of commercial goods that fall into more than one class of property (eg both goods and intangible property) to a particular customer on a ROT basis, then it will be necessary for the business to register two financing statements: one over the goods and another over the intangible property. Another example is a supplier of goods that has an “all monies” type ROT clause. Such a supplier may need to register both a PMSI financing statement and a non-PMSI financing statement in order to fully perfect their security interest.

It is not necessary for the secured party to register a copy of the actual agreement or document that gives rise to the security interest. However, that document (and other evidence) needs to be available on short notice if a ‘Request for Information’ is received, or the security interest is questioned or challenged by, for example, a liquidator of the grantor.

## The consequences of errors in financing statements

An underlying policy of the *PPS Act* is that it is the secured party’s responsibility to ensure that the information registered on the PPS Register is correct and complete.<sup>4</sup> This has been adopted to promote the reliability of PPS Register data.

The registration of a security interest is ineffective if it contains either:

- a ‘seriously misleading defect’ or
- a defect specifically referred to in s.165 (‘a s.165 defect’).

It is **not necessary** to prove that any person was actually misled by the defect.<sup>5</sup>

The term ‘seriously misleading’ is not defined. In New Zealand, the courts have tended to the view that a defect is seriously misleading if it means that the security interest would not have been discovered at all by a person searching the register in the usual ways.

## Searching the register

A person can search the register to find all of the financing statements that have been registered against a particular grantor or a specific item of property where that property is described by serial number. To do so, the searcher must know either:

- the details of the grantor, such as:
- the ACN of the company;
- the ABN of the partnership;
- the full name and date of birth of an individual or sole trader; or
- the exact serial number of the property.

It will not be possible to search the register against the details of the secured party.

Given that it is not necessary for the secured party to attach a copy of the actual agreement or document that gives rise to the security interest, such information will not be available to someone who conducts a search. However, once an interested party discovers the existence of the security interest (by conducting a search) there

is the mechanism called a ‘**Request for Information**’ that allows certain parties to request and obtain further information and documents from a secured party.

Privacy concerns have been addressed in the *PPS Act* by specifying that a search of the Register against individuals (as opposed to companies or partnerships) is only permitted by certain persons and for certain purposes, as specified in the 19 items in the table in s.172 of the *PPS Act*. Someone who conducts an illegal search may incur civil penalties, be liable for penalties under the *Privacy Act* 1988 (Cth), or be liable for damages.

## Ongoing maintenance of financing statements

Businesses who register financing statements over their customers will need to have procedures for the ongoing maintenance of those financing statements, including:

- Renewing financing statements at the end of the 7 or 25 year registration;
- Amending financing statements when names or contact details of the parties have changed; and
- Amending a financing statement if the secured party takes security over collateral that is not covered by any description in the free text field.

Where the collateral is a consumer good or registered by serial number, and the security interest becomes ‘unperfected’ (eg by the customer paying all amounts outstanding), the secured party has a statutory obligation under s.167 to register a **Financing Change Statement** to discharge any associated registered financing statement, within five business days of the time the security interest becomes ‘unperfected’. Non-compliance exposes the secured party to liability for statutory damages.

Where the collateral is neither consumer goods nor registered by serial number, there is no statutory obligation on the secured party to end a registration when the security interest is discharged.<sup>6</sup> The rationale seems to be that in the commercial context, the amendment demand process affords sufficient protection to grantors to ensure that the register does not contain outdated financing statements.

*A person can search the register to find all of the financing statements that have been registered against a particular grantor or a specific item of property where that property is described by serial number.*

Notwithstanding the lack of an statutory obligation to do so, it would be good practice for secured parties to register financing change statements when the security interest underlying the financing statement no longer exists and is unlikely to arise again in the future (eg customer pays off all of their debts and terminates the relationship with the supplier).

Secured parties also need to monitor actual possession of any collateral that is the subject of their perfected security interest and in particular be alert to any transfer of possession of that collateral from the grantor to another party. If this occurs, the secured party will obtain a **'temporarily perfected'** security interest in the collateral as against the third party for a period of up to two years.<sup>7</sup> To fully protect itself, the secured party will need to register a new financing statement against the third party. Otherwise the security interest may become unperfected<sup>8</sup> or, even worse; the third party may on-sell the collateral to a fourth party who may take free of the secured party's temporarily perfected security interest.<sup>9</sup>

Any business that registers a financing statement will also need to have procedures to deal with the following two important mechanisms provided by the *PPS Act*.

The first mechanism is called a **'Request for Information'**.<sup>10</sup> This allows various interested parties (the grantor, other secured parties, an execution creditor etc<sup>11</sup>) to request certain information from the secured party including a copy of the security agreement, the amount owing as at the date of request, exactly what personal property is attached to the security interest (by way of approval or correction of an itemised list).<sup>12</sup> The secured party must respond within 10 business days,<sup>13</sup> and is estopped from later denying the accuracy of the information supplied.<sup>14</sup> If the secured party and the debtor have entered a **'confidentiality agreement'**, then secured party is only required to respond in certain limited situations.<sup>15</sup> Subject to various limitations and exclusions, the secured party can charge a reasonable amount for responding to the request.<sup>16</sup>

The second mechanism is called an **'Amendment Demand'**.<sup>17</sup> It allows a grantor

(and certain other parties) to require a secured party to amend or remove a registered financing statement.

The Amendment Demand can be made by:

- a direct request;
- via an administrative process; or
- via a judicial process.

## Transitional security interests and migrated security interests

The *PPS Act* will apply to security interests that already exist prior to the commencement time.<sup>18</sup> However, such interests, known as **'transitional security interests'**, will benefit from special transitional rules in Part 9.4 of the *PPS Act*. For example, transitional security interests:

- Are deemed to have attached immediately before the commencement time;<sup>19</sup>
- Are deemed to be perfected for up to two years from the commencement time;<sup>20</sup>
- Are deemed to be enforceable against a third party if they were enforceable under pre-*PPS Act* law;<sup>21</sup>
- Enjoy limited preservation of current priority.<sup>22</sup>

Furthermore, existing security interests that have been registered on certain existing registers (including the ASIC register of company charges, and the State based registers of security interests over motor vehicles) will be migrated onto the new PPS register. These are known as **'migrated security interests'** and form a subset of transitional security interests.

Whilst the intention of the *PPS Act* was to protect migrated security interests, the precise wording used in s.332 has raised some doubts as to the effectiveness of these protections in certain scenarios. For example, it seems that in the past many lenders have registered company charges over certain marketable securities out of an abundance of caution, even though they were technically not required to be registered under s.262 of the *Corporations Act 2001* (Cth). Depending upon how one interprets the specific wording of s.332 of the *PPS Act*, such security interests may not be 'migrated security interests'. If that is so, then whilst such interests will have the benefit of the transitional rules, they

will become unperfected if not otherwise registered within the two year transition period.

The process of data migration also raises other potential problems and difficulties. Obviously, if the data is incorrect or out of date on the old register, that data will continue to be incorrect or out of date on the PPS Register. Furthermore, because of limitations in the details of the secured party that are recorded in some old registers, the Attorney General has set up a **'Find and Claim'** process whereby:

- Migrated security interests are grouped together under a **'Secured Party Group'**. This might have simply been the address of a head office or regional office, or even the address of a third party agent;
- Secured parties are able to identify any 'Secured Party Group' that belongs to them and claim all of the migrated security interests that belong to that secured party group.

It would therefore be prudent for a business that has existing security interests to not simply assume that they have all been fully and effectively migrated. Rather a business should undertake some investigation to confirm that migration process will be or has been effective and the data is correct, and that any unclaimed security interests are properly claimed and allocated. **B**

## Endnotes:

- 1 See s.20 of the *PPS Act*.
- 2 See s.63 of the *PPS Act*.
- 3 See s.13 of the *PPS Act*.
- 4 See paragraph 5.72 of the Explanatory Memorandum.
- 5 See section 164(2) of the *PPS Act*.
- 6 See paragraph 5.82 of the Explanatory Memorandum to the PPS Bill 2009.
- 7 See s.34(1) of the *PPS Act*.
- 8 See s.34(2) of the *PPS Act*.
- 9 See s.52 of the *PPS Act*.
- 10 See Part 8.4 of the *PPS Act*.
- 11 See s.275(9) of the *PPS Act*.
- 12 See s.275(1) of the *PPS Act*.
- 13 See s.277 of the *PPS Act*.
- 14 See s.283 of the *PPS Act*.
- 15 See s.275(6) and s.275(7) of the *PPS Act*.
- 16 See s.279 of the *PPS Act*.
- 17 See Part 5.6 of the *PPS Act*.
- 18 At the time of writing, the commencement time will most likely be Monday 30 January 2012.
- 19 Section 321 of the *PPS Act*.
- 20 Section 322 of the *PPS Act*.
- 21 Section 311 of the *PPS Act*.
- 22 Section 320 of the *PPS Act*.