

NEWSLETTER

INSOLVENCY, TURNAROUND & FORENSIC SPECIALISTS

Merger with Paladin Partners

On 1 July 2009 the business of Paladin Partners merged with Jirsch Sutherland. The merger has seen John Kukulovski, Sam Henderson, Andrew Ngo (partners of Paladin Partners) and their staff join the Jirsch Sutherland team. As a result of the merger, Jirsch Sutherland becomes one of the leading service providers in the following industry sectors:

Insolvency – Corporate & Personal;
Turnaround Management and Business Recovery;
Forensic Accounting; and
Intellectual Property

Jirsch Sutherland has a team in excess of 50 people and is well placed to service its clients' needs for the above services.

NEW PARTNER APPOINTMENTS

Congratulations to our newly appointed partners:

John Kukulovski - Insolvency & Turnaround Management, Sydney

Sam Henderson - Insolvency & Turnaround Management, Sydney

Andrew Ngo - Insolvency & Turnaround Management, Sydney

Blair Beven - Intellectual Property, Sydney

Brett Goodyer - Forensic Accounting, Sydney





Personal property securities reform

INTRODUCTION

The Commonwealth Government has finally put together some much needed personal property security reform with a single harmonized national act and register for security interests in personal property. For years there have been too many pieces of legislation at State and

Federal levels and numerous security registers presenting a maze of red tape with no clear Australia wide approach.

It is important to understand the changes that will take place with the new Personal Property Security (PPS) and be aware of the practical implications of the reform for your business and clients.

WHEN ARE THE CHANGES EXPECTED TO TAKE PLACE?

The Personal Property Securities Bill 2009 was passed on 16 September 2009 and should become an Act in early 2010. New South Wales has been the first State to pass the necessary referral legislation.

The proposed commencement date for the new legislation was initially May 2010. However, the Senate Standing Committee in its report of 19 March 2009 made the recommendation that the implementation date be extended by at least 12 months to 2011. The Attorney General has since advised that while the IT framework for the register is to be in place by 2010 the reform should not be implemented until May 2011 to allow adequate

transition time for businesses and consumers. So with the legislative process nearly complete businesses need to come to grips with the fundamental and inevitable shifts in the PPS landscape and take the time to prepare as best as possible to prevent any potentially costly mistakes.

WHY REFORM PERSONAL PROPERTY SECURITIES LAW?

It is fair to say that the existing regime is in real need of an overhaul. The proposed regime aims to replace the current inefficient and duplicating legislation with a comprehensive set of rules with greater coverage.

The Attorney General has emphasised in a recent media release the expected positive outcomes from the reform

through a single framework, including:

The harmonisation of laws

Assisting the process of businesses, especially small to medium size in using personal property to raise capital by reducing red tape and legal disputes.


Improving the capacity of businesses to borrow which is important in the current economic climate.

Reducing the costs and increasing the availability of credit to more businesses.

Providing consumers with greater certainty in acquiring unencumbered goods.

It has been estimated that PPS reform will reduce interest rates for loans secured on personal





property by 3-4%. While the aim of providing certainty, consistency, and simplicity, are likely to be achieved, whether any cost savings will be passed on is debatable. However, based on the experiences of other countries that have undergone reform, we can expect the positive outcomes to outweigh the negatives.

The changes will impact individuals and companies, especially financiers, suppliers, borrowers and professional services. It's fair to say that nearly everyone in business will be affected to some degree by the changes.

THE PROPOSED REGIME

Personal property is broadly defined as any form of property, other than land, including licenses, both tangible and intangible. (There are some limited exclusions such as water rights.) For example, the

definition includes goods such as cars, machinery, crops and livestock, financial property, letters of credit, and intangibles such as intellectual property rights. Personal property is known as collateral if it is (or is expected to be) the subject of a security interest.

The new regime will apply to all transactions that create an interest in personal property that secures a loan or other obligation. A **security** interest is defined in the Bill as:

“An interest in relation to personal property provided for by a transaction that, in substance, secures payment or performance of an obligation.”

It is essential to understand that there will be a change in the fundamental concepts as we know it for PPS. At the moment we have a system that looks to the form of a transaction.

Under the proposed reform it will be the substance of a transaction that will be important. This approach will mean that transactions which previously would not have been classified as a security interest will now be included for PPS legislation. For example, deemed security interests will include:

- Leases for terms longer than one year
- Commercial consignments
- Interests from an assignment of accounts receivable
- Retention of Title (“ROT”) interests (in the past a security interest by stealth which will now have to be registered)

These deemed security interests are all potentially deceptive. The regime will treat a debtor as having some attributes of ownership.


In order for a security interest relating to personal property to be enforced against the grantor the interest must be attached to the personal property. Put simply, **attachment** occurs when the secured party has given value for the security or the debtor grants an interest in the collateral.

A security agreement must then be evidenced in writing, signed or accepted by the debtor and contain a precise description of the collateral.

Perfection of a security interest is essential. If left unperfected your priority will be lost. Essentially perfection of a security interest is achieved when a security interest has attached to the collateral through the following:

- Registration of the financing statement
- Possession/control
- Temporary perfection





Temporary perfection can be automatic but only lasts for a limited time. This is designed for instances including where collateral is moved from off shore, or transferred by the grantor without notice to the holder of a perfected security interest. The idea of temporary perfection is to allow the holder of the security interest time to perfect their interest by registration, possession or control.

In situations where there are competing security interests in the same collateral, there are rules to establish who has priority. The priority rules allow for perfected security interests to take priority over unperfected security interests, and for the first in time to have priority, when comparing competing perfected interests, and also when comparing

competing unperfected interests.

The Bill provides for other general rules to be applied when there are competing security interests. Perfection through control will take priority over other means of perfection, such as registration. Perfection through control is limited to certain types of collateral where possession and registration are impractical such as frequently traded assets like investment entitlements and instruments. If there are rival interests in collateral perfected through control, it is the first that takes priority.

If perfection was not achieved through control, it is the first that was perfected through registration, possession or temporary perfection that has priority. Priority is placed with the security interest that has

been constantly perfected for the longest time.

There will be special priority rules relating to “purchase money security interests” or “PMSI” (these are security interests that finance all or part of the purchase price of the collateral). So even if a PMSI is registered after a non PMSI interest for the same collateral the PMSI will take priority (unless perfected through control). This will protect the rights of suppliers, lessors and financiers that have helped the grantor to purchase the property. The current law does not require a PMSI to be registered, but soon it will be.

Any secured party is allowed to seize collateral if a debtor is in default under their security agreement. Collateral, which has been seized, can be sold or kept in keeping with the

provisions set out in the Bill. These enforcement provisions will require all parties to act with honesty and in a commercially reasonable manner. This applies to secured parties. There has been some comment on the need for this term to be included in the Bill. A similar term was included in the Canadian legislation and case law there has established that this is a standard of what a reasonable prudent business person in similar circumstances would be expected to do. The **enforcement** provisions, including the obligation to act honestly and commercially, do not apply to property in hands of Receivers and Managers or Controllers. As defined in the Corporations Act separate obligations are imposed on such persons under the Corporations Act.





REGISTERING A SECURITY INTEREST

Practically, there will be obvious improvements to the current PPS situation. There will be an online national register that can be accessed 24 hours a day, 7 days a week for registration and searching (for a small fee). Prospective security interests will also be able to be lodged in advance.

Personal property securities currently registered on other registers such as the Register of Company Charges maintained by the Australian Securities and Investments Commission will be transferred to the new register, preventing the need to re-register these interests. Also note that these transferred interests will retain their original priority.

To register an interest, specific information will be required,

such as an address for service, information about the secured party and grantor, a description of the collateral and the period of registration. Commercial property will be registrable for an unlimited period of time and consumer property or property identified by a serial number will be able to be registered for 7 years, which is extendable by periods of up to 7 years.

A word of caution: precision when registering information is imperative as a mistake in recording a serial number for example, can result in the security interest being unregistered and therefore unperfected. So when the time comes - take care, details must be exact.

There will be a transitional period for registering security interests. The Bill proposes to

allow for two years to perfect a security interest otherwise priority will be lost and will be ineffective in an insolvency situation, which is a persuasive inducement for registration.

The reform has looked to countries that have recently implemented a national register, specifically New Zealand and Canada. On the whole the introduction of PPS reform in these countries has seen improvements, but there are lessons that we can take from these jurisdictions when Australia's Bill is enacted.

LESSONS LEARNT FROM NEW ZEALAND

In New Zealand it could be said that people were slow to adapt to the regime, but in New Zealand unregistered security interests were not affected as they may be in Australia. This will provide more incentive to

register and may lead to a quicker uptake compared to New Zealand where an unregistered security interest can still be enforced, though priority is affected.


The Costly Mistake - Failure to Register

One of the first major cases in NZ regarding personal property was the Portacom case (Graham & Gibson v Portacom New Zealand Limited), which well and truly tested the traditional concepts in existence.

The case concerned the rights of a Receiver (appointed by a first charge holder) to sell as part of the assets of NDG Pine Limited, some portable buildings leased to NDG by Portacom.

Before the reform to the PPS, The Receivers could not have sold the portable buildings, as





they were owned by Portacom. However, the buildings were leased to NDG for a term of more than one year and subsequently fell within the definition of a “security interest” under the New Zealand Act. Consequently, Portacom was a secured party of NDG. Portacom should have registered its security interest on the Personal Property Securities Register, but failed to. The High Court also held that by reason of the PPS legislation NDG acquired a proprietary interest in the portable buildings, which was subject to the security in favour of the first charge holder. The first charge holder had perfected its security interest by registration. Portacom’s failure to register meant that it lost priority to the first charge holder and the Court held that the Receiver was entitled to sell the

buildings ahead of Portacom as owner.

The lesson to learn from these types of cases is to be careful to recognise when a transaction constitutes a security interest and if you are a secured creditor, to protect your position through registration, possession or control.

There have also been cases in New Zealand where suppliers of products to companies have failed to register their interest and have suffered, as their priority has been lost to other creditors.

HOW TO PREPARE

Identify any existing security interests or charges over personal property.

Prepare to register all security interests in the transitional period to protect priority position.

Standard documentation will need to be reviewed and updated to ensure that assets affected by the PPS legislation will be protected.

Put processes in place to ensure that your security register is kept up to date, e.g. for renewals or changes in the security position and discharges.

Prepare and train staff to maintain up to date information on registers and identify security interests that require registering.

The register will need to be searched when acquiring personal property to ensure there are no prior registered security interests.

Ensure policies and procedures are compliant with legislation (security documentation, terms of trade and other contracts affected) .

Identify any situations in which possession or control can be exercised over secured collateral.

Managers/Receivers will need to check priority before the distribution of assets. The register is effectively a notice board and will not have actual full documents attached to same, these will need to be requested, as financing statements will be brief.

CONCLUSION

So while choosing to register will be voluntary, and there will be no statutory requirement to register a security interest, failure to register may cause significant loss, as a security interest not perfected through registration will fall behind all those who have registered their interest in the property.

The proposed regime will provide us with new concepts





and comprehensive rules to digest and understand, such as attachment, perfection and complicated priority rules. There are also new forms and procedures which will require a

level of precision not previously needed and documentation, including security agreements will need to be redrawn with this in mind. Hopefully we can expect greater efficiency, and

while the costs for secured parties to bring records up to date may initially be high, the cost of not doing so and losing priority could be much higher.

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Readers should feel free, with no obligation, to contact the writer to discuss any matter raised herein.

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