

LAWS4210

Commercial Law

Security Interests: using personal property to secure
payment

Personal property securities

- ▶ A security interest at general law can take one of two forms:
 - ▶ an interest in property (real or personal); or
 - ▶ a personal claim against a third party (in the case of a guarantee for example) or against a debtor (in the case of a collateral undertaking such as a bill of exchange).
- ▶ In both cases, security is sought and provided to protect a lender against the risk of non-payment of monies owed.

Personal property securities

- ▶ A security interest in property is called a ‘real security’, whether the property in which the interest is found is real or personal;
- ▶ A security interest that is a personal claim is called a ‘personal security’.
- ▶ This topic is concerned with the first type of security, also known as collateral.

Personal property securities

- ▶ “‘Real security’ is a right in another’s asset to secure performance of an obligation. The creditor acquires real rights over one or more of the debtor’s assets in order to secure payment of the debt. In principle, security in an asset carries through automatically to its products and proceeds except where the agreement indicates a contrary intention.”

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.583

Personal property securities

- ▶ A secured creditor is entitled to satisfy its claim out of the secured property ahead of other creditors.
- ▶ A secured creditor has a broader range of remedies.
- ▶ Traditionally 4 categories of security interests
 - ▶ Liens
 - ▶ Pledges
 - ▶ Mortgages
 - ▶ Charges

Personal property securities

- ▶ There are four forms of security referred to as 'consensual security':
 - ▶ Pledge;
 - ▶ Contractual lien;
 - ▶ Mortgage;
 - ▶ Equitable charge.

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.584

Personal property securities

- ▶ The earliest form of common law security was the pledge. A creditor took possession of the debtor's asset as security against payment of the debt.

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.584

An example of the operation of this type of security is the pawnbroker who lends money against the security of goods which can only be redeemed by the debtor on the repayment of an agreed amount.

Personal property securities

- ▶ The contractual lien ‘is a right given to a creditor by contract to detain goods of the debtor to secure payment or performance of some other obligation, the goods having been delivered to the creditor for some purpose other than security, such as storage or repair. It is this last element that distinguishes the contractual lien from the pledge.’

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.585

Personal property securities

- ▶ ‘The legal effect of a contractual lien differs from that of a pledge in that the latter carries with it an implied power of sale upon the debtor’s default, whereas a lien is in principle a right of retention only, so that a power of sale would have to be agreed.’

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.585

Personal property securities

- ▶ The mortgage of personal property (as distinct from real property) is a transfer of ownership to the creditor by way of security, upon the express or implied condition that the asset shall be reconveyed to the debtor when the sum secured has been paid. This is a 'legal' mortgage.

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.584

Personal property securities

- ▶ An equitable mortgage involves an equitable assignment to the secured creditor. An equitable mortgage may be created over both legal property - where the debtor holds legal title - and equitable property - where the debtor holds only equitable title or the property is only recognised in equity.
- ▶ In respect of both legal and equitable mortgages, the debtor holds an equity of redemption.

Pearson et al, *Commercial Law: Commentary and Materials*, 3rd Ed., Thomson Reuters, Sydney, 2010, p. 919.

Personal property securities

- ▶ An equitable charge does not involve the transfer either of possession or of ownership but constitutes the right of the creditor, created either by trust or by contract, to have a designated asset of the debtor appropriated to the discharge of the indebtedness. The right is satisfied out of the proceeds of the sale of the asset, whether that results from the debtor's voluntary act or as a result of a court order or the appointment of a receiver.

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.587

Personal property securities

- ▶ Since a charge is a mere encumbrance and does not involve any conveyance or assignment at law, it can exist only in equity or by statute.

Roy Goode, *Commercial Law*, 3rd ed, Penguin Books, London, 2004, p.587

Personal property securities

- ▶ Personal property security interests can also be categorised as “possessory” and “non-possessory”; or as “proprietary” and “non-proprietary”.
- ▶ Possessory security interests comprise possessory liens and pledges while non-possessory security interests comprise equitable liens, mortgages and charges.

Personal property securities

- ▶ The *Personal Property Securities Act 2009* (Cth) passed in December 2009 and entered fully into force on 30 January 2012.
- ▶ It establishes a single national law to govern security interests in personal property.
- ▶ The aim of the PPSA is to allow “*for more certain, consistent, simpler and cheaper arrangements for personal property securities for the benefit of all parties.*” (EM)

Personal property securities

- ▶ Previously, there were over 70 Commonwealth, State and Territory laws relating to company charges, bills of sale, ships mortgages, motor vehicle securities, crop liens, stock mortgages and most other securities affecting tangible and intangible personal property rights. The PPSA 2009 rationalised these.
- ▶ The *Personal Property and Securities (Corporations and Other Amendments) Act 2010* (Cth) received Royal Assent on 6 July, 2010. The bulk of the Act entered into force on 30 January, 2012. This Act amends the *Corporations Act 2001* (Cth) to ensure consistency with PPSA 2009.

Personal property securities

- ▶ Australian PPS law reform has been influenced by developments in Canada, The United Kingdom, New Zealand and the United States as well as the work of United Nations Commission on International Trade Law (UNCITRAL) and the International Institute for the Unification of Private Law (UNIDROIT).

Personal property securities

- ▶ Under the PPSA, security interests are no longer confined to those interests falling within the general common law understanding of security: ie those arising under pledges, mortgages or charges.
- ▶ Sales of goods with retention of title clauses, leases and other bailments of goods can also give rise to security interests *if the particular arrangement has a security function* (PPSA, s.12(1), (2)).

Pearson et al, *Commercial Law: Commentary and Materials*, 4th Ed., Thomson Reuters, Sydney, 2019, [5.10].

Personal property securities

- ▶ Under the PPSA, the notion of a security interest has been expanded by the PPSA to include some additional arrangements even though they lack this function (s.12(3)). E.g., interests of lessors under specified operating leases of goods (defined as “PPS leases”: s.13) and those transferees under transfers of certain types of debts (defined as “accounts”: s.10).

Personal property securities

- ▶ Personal property - subject to some limited exceptions in s 8 the PPSA will apply to all personal property defined in s 10
- ▶ "***personal property***" means property (including a licence) other than:
 - ▶ (a) land; or
 - ▶ (b) a right, entitlement or authority that is:
 - ▶ (i) granted by or under a law of the Commonwealth, a State or a Territory; and
 - ▶ (ii) declared by that law not to be personal property for the purposes of this Act.

Personal property securities

- ▶ S 10
- ▶ **"land"** includes all estates and interests in land, whether freehold, leasehold or chattel, but does not include fixtures
- ▶ **"goods"** means personal property that is tangible property, including the following:
 - (a) crops;
 - ▶ (b) livestock;
 - ▶ (c) wool;
 - ▶ (d) minerals that have been extracted (including hydrocarbons) in any form, whether solid, liquid or gaseous and whether organic or inorganic;
 - ▶ (e) satellites and other space objects;
- ▶ but does not include financial property or an investment entitlement.

Personal property securities

- ▶ PPSA will apply to personal property only if the grantor can transfer its rights in the property to the secured party - see s 19.
- ▶ Some licences which are readily transferable may be property while licences which depend on the discretion of the regulator may not qualify as personal property.

Personal property securities

- ▶ The PPSA adopts a functional approach to security interests - any right or interest in personal property that in substance secures performance of an obligation will be a security interest for the purposes of the legislation regardless of its form or who has title to the secured property.
- ▶ **Meaning of security interest**
- ▶ S 12(1) A ***security interest*** means an interest in relation to 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).

Personal property securities

- ▶ S 12 (2)
- ▶ For example, a *security interest* includes an interest in relation to 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 agreement;
 - ▶ (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.

Personal property securities

- ▶ Deemed security interests - s 12 (3)
- ▶ The interest of a transferee under a transfer of accounts receivable or chattel paper - a new concept in Australian law.
- ▶ The interest of a consignor who delivers goods to a consignee under a commercial consignment
- ▶ The interest of a lessor or bailee under a PPS lease.

Personal property securities

- ▶ Chattel paper is writing (including in electronic form) that evidences both a monetary obligation and either or both a security interest or lease of specific tangible property or specific intellectual property - eg equipment leases, hire purchase agreements, chattel mortgages.

Personal property securities

- ▶ Form of security agreements
- ▶ Parties are generally free to negotiate the terms of their agreements without the need to satisfy prescriptive form requirements; however other Commonwealth and State and Territory law may still need to be satisfied if that law can operate concurrently with the PPSA.

Personal property securities

- ▶ The Personal Property Securities Register
- ▶ Electronic registry accessible 24 hours a day.
- ▶ Security agreements are not lodged but the security is registered by way of lodgement of a one page financing statement. This may be lodged before the security interest arises.
- ▶ One registration can cover multiple security interests if completed appropriately.
- ▶ Not mandatory to register and no time limit for registering but failure to perfect has consequences for the secured party.
- ▶ The PPS Register began operation on 30 January, 2012.

Personal property securities

- ▶ When does the security interest attach?
- ▶ S 19 provides that the security interest attaches when the grantor has rights in the collateral or the power to transfer rights in the collateral to the secured party and either value is given for the security interest or the grantor does an act by which the security interest arises.

Personal property securities

- ▶ Perfection of security interests - see s 21
- ▶ A security interest will generally be perfected if it is attached and
 - ▶ In respect of any type of collateral, it is effectively registered or the secured party has possession of the collateral (other than as a result of seizure of repossession) or
 - ▶ For certain kinds of collateral the secured party has control of the collateral.

Personal property securities

- ▶ Priorities
- ▶ PPSA 2009 makes major changes to the existing priority rules under the *Corporations Act 2001* (Cth) and general law. Most of the rules are set out in Part 2.6 of the Act. The priority rules apply where two or more security interests attach to the same collateral.

Personal property securities

- ▶ Default priority rules s55
- ▶ (a) where two unperfected security interests attach to the same collateral, priority is accorded by the chronological order of attachment
- ▶ (b) a perfected security interest in collateral has priority over an unperfected security interest in the same collateral
- ▶ (c) priority between two or more security interests that are perfected (but not by control) is determined by order of their “priority time” (i.e. for a particular security interest, the earliest of when the security interest was registered, or the security holder took possession of the collateral, or when the security interest was perfected by force of the Act). Security interests perfected by control will take priority over security interests perfected by other means, such as registration.

Personal property securities

- ▶ A security interest will have the same priority in respect of all advances (including future advances), and the performance of all obligations, secured by the security agreement - see s 58 - changes the common law rule about tacking under which future advances would lose priority if made after the mortgagee became aware of another interest in the mortgaged property.

Personal property securities

- ▶ Secured parties can continue to agree the order of priorities amongst themselves by use of priority or subordination agreements. - see s 61.

Personal property securities

- ▶ Special priority rules s 62
- ▶ Purchase money security interests have a super priority
- ▶ s 14 defines a PMSI as a
 - ▶ Security interest taken in collateral to the extent that it secures all or part of its purchase price
 - ▶ A security interest taken in collateral to the extent the value is applied to acquire those rights
 - ▶ The interest of a lessor or bailor of goods under a PPS lease
 - ▶ The interest of a consignor who delivers goods to a consignee under a commercial consignment

Personal property securities

- ▶ To obtain the super priority the financing statement must indicate that it is a PMSI and the registration must be made within a prescribed timeframe. - see s 62 (3)
- ▶ Other special priority rules apply for:
 - ▶ Certain agricultural security interests s 65
 - ▶ Certain interests in goods that become an accession to other goods part 3.3
 - ▶ Commingled goods part 3.4
 - ▶ Intellectual property part 3.5
 - ▶ Accounts receivable, accounts with ADIs chattel paper etc see eg ss 71, 75

Personal property securities

- ▶ Taking property free of security interests Part 2.5 of PPSA 2009 addresses circumstances in which a person may acquire an interest in personal property free of security interests. Often this will require that the person provide “new value” for the collateral and have no actual or constructive knowledge of the pre-existing security agreement. For example:

Personal property securities

- ▶ (a) (**ordinary course of business**) where a person acquires an interest in personal property in the ordinary course of the vendor's business of dealing with property of that kind, it would be free of any security interest granted by the vendor, whether perfected or unperfected (eg retail sales) s 46

Personal property securities

- ▶ (b) (**low value consumer property**) where a buyer or lessee of personal property intends to use the property predominantly for personal, domestic or household purposes, s/he takes the property free of a security interest in it, if its market value is not more than \$5,000 (or other amount as prescribed by regulations) s 47

Personal property securities

- ▶ (c) **(unperfected security interests)** a buyer or lessee of personal property takes the personal property free of an unperfected security interest in the property s 43

Personal property securities

- ▶ **(d) serial numbered personal property)** a buyer or lessee of personal property takes the personal property free of a security interest in the property if:
- ▶ (i) the regulations provide that personal property of that kind may, or must, be described by serial number in a registration; and
- ▶ (ii) searching the register, immediately before the time of the sale or lease, by reference only to the serial number of the property, would not disclose a registration that perfected the security interest.

Personal property securities

- ▶ Enforceability against third parties - see s 20
- ▶ A security interest will generally be enforceable where the security interest is attached and
- ▶ The secured party possesses the collateral or
- ▶ The secured party has perfected the security interest by control or

Personal property securities

- ▶ A security agreement is evidenced by writing that is
 - ▶ Signed by the grantor or
 - ▶ Adopted or accepted by the grantor
- ▶ And contains
 - ▶ A description of the particular collateral or
 - ▶ A statement that a security interest is taken in all of the grantor's present and after-acquired property.
 - ▶ See s 20(2)

Personal property securities

- ▶ Fixed and floating charges - the distinction is irrelevant for priority purposes
- ▶ New terminology see ss 339 (4) and (5) security interest that has attached to an asset that is not a circulating asset (fixed) and security interest that has attached to a circulating asset (floating).
- ▶ Crystallisation no longer relevant unless the parties agree otherwise.