GRAIN TRADE AUSTRALIA

Grain Trade Australia Limited Level 11, 56 Pitt Street Sydney NSW 2000
PO Box R1829 Royal Exchange NSW 1225
Phone: +61 2 9247 6408 Fax: +61 2 9247 9153
Email: admin@graintrade.org.au Web: www.graintrade.org.au

Member Update

Title: **Personal Property Securities Law Reform**

Update No.: **24 of 11**

Date of Issue: **22 August 2011**

Prepared by Geoff Farnsworth Principal, Macpherson and Kelley Lawyers

Issue

The new Personal Property Securities ("PPS") scheme is due to begin on 31 October 2011. It is likely to have a significant impact on many areas of business including the grains industry. The new scheme is complex and it is hard to predict with clarity how it will operate in practice. This note is intended to provide an overview only.

What are the reforms?

The reforms will change the way people give and take securities over personal property (that is, everything other than real estate and land). It will affect the way personal property is dealt with in the event of insolvency.

In summary, a security interest in property (for example a fixed or floating charge) allows a lender (for example) to secure an obligation (such as repayment of a loan; or payment of the purchase price) over some identified personal property.

Central to the new scheme is a new on-line register for security interests. In the grains industry in particular, they will affect the way;

- grain is sold under a contract containing a retention of title clause;
- finance is provided against inventory In general, the PPS scheme applies to "security interests" in "personal property".

The reforms will affect the way;

- security interests are created;
- security interests are enforced;
- priority between competing security interests.

New Language

The reforms are modelled on schemes in North America and as introduced into New Zealand. They have a new language, or terminology.

- The person who gives the security interest is the **Grantor**.
- The person who benefits from the security interest is the **Secured Party**.
- The property over which the interest is secured is the **Collateral**.
- A retention of title clause is a **Purchase Money Security Interest**, or **PMSI**.
- Before a security interest can be enforced, it must **Attach** to the Collateral.
- A security interest can also be enforced against the **Proceeds** of the Collateral, that is personal property that is derived directly or indirectly from a dealing with the Collateral (e.g. flour will be proceeds of wheat).
- An entry on the PPS Register is a **Financing Statement**.
- In order for a security interest to have priority over other security interests, it must be **Perfected**.
- By way of example, if a Grower sells grain to a Merchant, and the contract contains a retention of title clause;
- The Grower is the **Secured Party**;
- The Merchant is the **Grantor**;
- The grain is the **Collateral**;
- The contract/retention of title clause is a **PMSI.**

The Reforms in Practice

The reforms are contained in the Commonwealth **Personal Property Securities Act 2009** and the regulations to that Act. The new laws are due to take effect from 31 October 2011 (however they have already been deferred twice). There is a two year "moratorium" on the operation of the law, meaning that priority of security interests existing at the time of commencement will be preserved for two years.

PPS and Grain
The new laws contain specific provisions relating to agricultural and bulk commodities.

Part 3.2 of the Act deals with Agricultural Interests, principally crop liens. The new Act provides that a security interest may attach to crops while they are growing.[1]

A crop lien will have particular priority so long as it was necessary to grow the crop (for the purchase of seed, or fertilizer, for example), and was created while the crops were growing, or within 6 months prior to planting.[2]

The Act also makes express provision for the enforcement of securities over crops, including granting the secured party the right to enter the land on which the crops are, or were, growing.[3]

PPS and Bulk Commodities
Part 3.4 of the Act deals with "Processed or commingled goods".

Section 99 makes clear that a security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so commingled that their identity is lost in the product or mass.

Under section 123, the Secured Party is authorised to seize collateral if the debtor is in default under a security arrangement.

The Power of the PMSI
One of the most important reforms under the new scheme is the elevation of the retention of title clause as a PMSI. While retention of title clauses are common forms of security and their operation and efficacy has been recognised by the courts, the PMSI now takes its place alongside other more recognised (and indeed, formalised) forms of security interest.

That said, while the new Act recognises and gives priority to PMSIs, there are no formal requirements under the Act as to what may amount to a PMSI. The Act defines a PMSI as a "security interest created in collateral, to the extent that it secures all or part of its purchase price."

It is common for retention of title clauses to do much more than that. For example, the clause may purport to create a trust in relation to the proceeds of sale of the collateral, or provide rights of entry to property to secure control of the collateral.

The PPS Lease
One of the new "creatures" of the scheme is the "PPS Lease".

The PPS lease is a form of deemed security interest created by section 13 of the Act. Central to the concept of the PPS Lease is a bailment of goods for an extended period of time (usually in excess of 12-months). It will apply to equipment leased or hired to 3rd parties. It is possible that a failure to register an otherwise registrable PPS Lease may affect the owner's rights in the property in the event of an insolvency of the Lessor/bailee.

Protection for Purchasers
Section 46 of the Act provides protection for purchasers. A purchaser who buys goods in the ordinary course of business will acquire those goods free of any security interest.

In the previous example, where a Grower sells grain to a Merchant subject to a PMSI, if the Merchant sells that grain to a Miller, the Miller takes the grain free of the security interest. In other words, if the Merchant does not pay the Grower, the Grower is not able to seize the grain from the Miller (even if the actual retention of title clause purported to give the Grower that power). The exception to the rule is when the purchaser buys the grain with actual knowledge that it is buying the grain in breach of the terms of the PMSI.

Registration
An important aspect of the new scheme is an on-line searchable register of security interests. A security interest will become perfected when it is either registered, or in the case of some collateral, when the secured party has possession and control of the collateral. It is anticipated that the cost of registering a financing statement on-line will be around $7.40 for 7 years or less, or $37 for 7-25 years. It will be important that details are entered accurately as inaccuracies could affect registration and priority. Failure to register will not mean that a security interest cannot be enforced. It may however affect the priority of the security interest.

Conclusion
The new scheme is almost upon us and businesses will all need to learn how to live with PPS. The new scheme is intended to improve the availability of capital to businesses by improving the rights of secured lenders. It is also intended to stream-line registration processes by replacing multiple State-based registers with one centrally administered on-line register. Clearly these benefits need to be weighed against the significant administrative burdens created by the new system.

For a more information on the new Personal Property Securities ("PPS") scheme, GTA has produced an Industry Briefing Document which can be found on the GTA website www.graintrade.org.au

1 Section 84A(1)
2 Section 85
3 Section 138B(3)