

No role for ownership in insolvency of personal property lessees

New Commonwealth laws have been put in place which greatly diminish the role that ownership plays in disputes over what property of an insolvent person or business can be taken by creditors. If you rent out non-real estate related property you will almost certainly be affected.

Scope of the new Act

The new *Personal Property Securities Act 2009 (cth)* (“the Act”) is set to revolutionise the way securities over personal property are dealt with, and introduces new concepts about what constitutes a personal property security. Generally the Act applies to all personal property, meaning property other than land and fixtures thereon. However, the Act will also extend to property supplied on a **retention of title basis** and to **leases** over goods. The last two mentioned items have not previously been considered “security interests”.

Some examples of security interests which will be registrable include a:-

- fixed charge;
- floating charge;
- chattel mortgage;
- hire purchase agreement;
- pledge;
- consignment;
- conditional sale agreement (for example, an agreement to sell subject to a retention of title); and
- leases over personal property.

Retention of title arrangements and bailment

Personal property is often sold to someone else on the basis that the seller retains ownership of the goods until they are paid for in full. This is generally known as a retention of title arrangement.

Personal property may also be given to someone on a bailment arrangement. A notable example is where a new car dealer obtains stock from a manufacturer to hold in a showroom for general sale. Some types of bailment arrangements will be caught by the Act.

Whilst this article will focus on the issue of leasing personal property, most of the concepts will generally be applicable to retention of title and bailment arrangements, with some differences.

Author Peter Zdanowicz – Senior Associate – Short Punch & Greatorix Lawyers

9th November 2011

Liability limited by a scheme approved under professional standards legislation.

Implications of the new Act

The usual concern of creditors who lend money with security over personal property is to ensure that they do in fact have the priority they expected in the event of the insolvency of the owner or possessor of the secured item. The Act creates new rules about what constitutes a personal property security as well as new rules about which of one or more competing security holders has the right to take the property in the event of the insolvency of the person in possession of the property. The difficulty is that some of these rules may be somewhat counterintuitive. This may result in an unexpected result for a lender who was unaware of the application of the Act.

Effect on leasing of personal property

This article will focus on the difficulties that arise for businesses whose business it is to lease personal property if they do not take the required steps to protect themselves. Without delving into the matter closely, most lessors would not expect that a lease of personal property would constitute a personal property security. Unfortunately it is and this can have drastic consequences for the lessor under the Act. For example, if the lessor leases an item and that lease falls within certain criteria (many leases will be caught) to a business (or person) and that business or person becomes insolvent, another creditor who has “perfected” their security will be able to take that item and sell it to pay off their debt. The current state of the law is that such an item would not form part of the business’s estate to be available to creditors because the business does not own it. This is now not the case and the likelihood is that many lessors are not aware of how far reaching the Act will be.

What is a PPS Lease?

A lease of personal property will be subject to the Act where it is a PPS lease. A PPS lease arises where the lease gives a definite or possible right to a lessee to maintain possession of the property for more than one year. An example of a possible right might be where the lease has a term of less than one year but allows for a holding over period which could potentially take it over one year.

Where a personal property item is serial numbered the above rules still apply but the term only needs to be for 90 days.

Perfection of security interest

Perfection means making the security interest valid and enforceable against third parties by complying with the requirements of the Act. Perfection will occur when these three requirements have been satisfied:

- a) the property the subject of the lease has been delivered to the lessee;
- b) the lease is in writing and the property has been adequately described; and

Author Peter Zdanowicz – Senior Associate – Short Punch & Greatorix Lawyers

9th November 2011

- c) the lessor's interest in the property is registered on the PPS register.

Priority of perfected security interests

The general rule is that registered security interests have priority in the order that they are registered. For example a security interest registered second will have priority over one that is registered third.

Exception: Super priority is obtainable

An exception to the general priority rule is where a PPS lease is registered as a Purchase Money Security Interest ("PMSI"). A PMSI will have priority over any perfected (non PMSI) security interest even if that earlier interest was perfected earlier. It will be important for Lessors to have their documentation in order so as not to lose any possible PMSI super priority status.

What should you do?

If you are in a business that you may feel might be affected, it is important that you seek the appropriate legal advice to protect yourself. Although the implementation of the new regime has been postponed (again) until February, 2012, it is important that you prepare for it now. It is likely that there will be no transitional (grace) period for new security interests created after this date.

For further information about the new Act please contact:

Paul Jones – **Partner** – pdj@spglawyers.com.au

Peter Zdanowicz – **Senior Associate** – paz@spglawyers.com.au

Matthew Brook – **Associate** – mib@spglawyers.com.au

Author Peter Zdanowicz – Senior Associate – Short Punch & Greatorix Lawyers

9th November 2011