

Personal Property Securities Reform

Rebecca Sadleir considers the impact of reform of securities regulation on the communications sector.

The *Personal Property Securities Act 2009* (Cth) (the **PPSA**) is due to come into force in October this year. It is complex and far-reaching, and businesses in most industry sectors will be affected by the sweeping changes this new legislation will bring to Australia's commercial law. The communications industry is no exception. The PPSA, is similar but not identical to equivalent legislation in New Zealand. It covers a wide range of transactions, not just security interests. It is not limited to consumer transactions, and it significantly alters aspects of commercial law and contracts. This article gives an overview of the PPSA and how it will affect the communications sector.

Background to the reforms

Current position

More than 70 Commonwealth, State and Territory pieces of legislation currently regulate personal property securities, with around 40 separate registers recording interests in different types of property. There are significant practical limitations on the use of personal property as security due to complexities and gaps in the arrangements for registering security interests.

Aim of the reforms

By introducing the Personal Property Securities (**PPS**) reforms, the Federal Government's stated intention is to streamline the law, increase certainty and consistency and reduce complexity and costs by introducing:

- a generic set of rules that apply to nearly all personal property;
- a single set of priority rules for competing security interests; and
- a single, definitive, online, national register on which all personal property securities will be registered and searchable by the public.

According to the Federal Attorney-General's website, the aim of PPS reform is to improve the ability of individuals and businesses, particularly small-to-medium-size businesses, to employ all of their property in raising capital.

Given the highly complex nature of the legislation, it remains to be seen whether the reforms will achieve the intended effect.

Legislation status and timing

The PPS legislation comprises:

- *Personal Property Securities Act 2009* (Cth) (received Royal Assent on 14 December 2009);
- *Personal Properties Securities (Consequential Amendments) Act 2009* (Cth) (received Royal Assent on 14 December 2009);
- *Personal Property Securities (Corporations and Other Amendments) Act 2010* (Cth) (received Royal Assent on 6 July 2010); and
- *Personal Property Securities Regulations 2010* (registered on the Federal Register of Legislative Instruments on 26 November 2010).

The bill for the third (and probably final) round of amendments to the PPSA, the Personal Property Securities (Corporations and Other Amendments) Bill 2010 (Cth), was released on 25 February 2011.

The original timetable for implementation of the PPS reforms was ambitious and implementation has been significantly delayed. In mid-February 2011, COAG agreed to defer the commencement date of the new legislation again, from May to October 2011.

Key terminology and concepts

Key to the reforms is the functional approach of the new regime, where generally (although not always) it is the commercial effect of a transaction, rather than its legal form which, determines how it is characterised by the legislation. *Under the 'form over function' approach*, the distinctions between different types of security interest and terminology such as 'charge' and 'mortgage' will become less significant. The new law signals the end of the floating charge, to be replaced by the concept of 'security interest over a circulating asset'.

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Key terminology introduced by the PPSA

Personal property is all property other than land and certain statutory licences. It includes tangibles such as goods and equipment as well as intangible property such as intellectual property (**IP**) and IP licences.

A **security interest** is an interest in relation to personal property that in substance secures payment or performance of an obligation.

The PPSA gives examples of arrangements that are security interests (provided they are interests in property that secure payment or performance of an obligation). These include:

- charges, mortgages and pledges;
- conditional sale agreements (including an agreement to sell, subject to retention of title);
- hire purchase agreements;
- consignments;
- leases of goods; and
- flawed asset arrangements.

In certain cases, the PPSA adopts a 'form over substance' approach, and deems some transactions to be security interests, even though they do not secure anything. Examples of this include:

- transfers of accounts (receivables for goods or services supplied) and 'chattel paper' (documentation governing certain financial interests in goods, such as a hire-purchase agreement);
- a consignor's interest in a commercial consignment; and
- most relevantly to the communications industry, a lessor or bailor's interest in goods under a 'PPS lease'.

A **PPS lease** is defined as a lease or bailment of goods for more than one year or an indefinite term, or 90 days for serial numbered goods. A PPS lease does not include arrangements where the lessor or bailor is not regularly engaged in the business of leasing or bailing goods and it only includes bailments where the bailee (the party that gets possession) provides value.

PPS leases will include operating leases as well as finance leases. This will be particularly relevant to the communications industry where there are numerous arrangements where equipment is provided as

part of a service. For example, where a content service provider provides customer premises equipment such as set top boxes or other reception equipment to customers on a lease basis, or when equipment is supplied as part of an outsourcing arrangement.

Key concepts under the PPSA

Attachment is the description of the successful creation of a security interest in personal property. A security interest attaches when:

- the secured party has given value (e.g. a loan) or done an act by which the security interest arises (e.g. execute a document); and
- the grantor has rights (or the power to transfer rights) in the personal property.

Enforceability of security interests. A security interest that has attached is enforceable against a third party when one of the following has occurred:

- the grantor has signed a written security agreement which adequately describes the personal property; or
- the secured party has possession or control of the property.

Perfection is the process that the security holder must undertake to ensure its security interest will take priority over other security interests created in the same personal property. Perfection of a security interest puts a potential secured party on notice of an existing security interest. A security interest is perfected when:

- it has attached to the collateral and the security interest is enforceable against a third party; and
- one of the following has occurred:
 - it has been registered on the PPS register; or
 - the secured party has taken possession or control of the property. For intangible property such as IP, registration is the relevant method to perfect.

Perfection is particularly important in the event of insolvency because, subject to only a few exceptions, on appointment of a liquidator, bankruptcy trustee or voluntary administrator, unperfected security interests 'vest' in the company. The secured creditor loses its security and becomes unsecured.

Priority Rules and Remedies. The PPSA establishes a complete set of rules for determining priority between security interests, and for determining under what circumstances a purchaser of collateral will take the collateral free of any security interests. *In relation to priority between security interests*, the general rule is that perfected security interests take priority over unperfected interests. *Another general rule is that* perfected interests take priority according to the order of perfection, *but there are many exceptions*. These rules replace the old principles-based approach of the common law and equity.

The PPS Register

The PPSA establishes an electronic register, which is designed to provide a simple, quick and cheap registration process. The register is a 'red flag' register, it draws attention to the security interest without giving too many details. While registration is generally simple, there will be some traps in deciding how to describe the collateral (for example with unregistered IP such as copyright), and also in deciding under which category to file the interest.

Because so many arrangements are security interests, hundreds, or even thousands, of security interests may need to be registered against a particular company, and so there is likely to be a lot of data or 'noise' on the register.

Security interests currently registered in certain registers, such as the charges register maintained by ASIC under the *Corporations Act 2001* (Cth), will be automatically migrated across. There will be no automatic migration for the IP registers for trade marks, designs and patents.

The Commonwealth has begun to deploy the IT resources needed to establish the PPS register. Fujitsu has been engaged to build the register and user acceptance testing is due to commence in June 2011.

Implications for the communication sector

The PPSA will have a significant impact on the communications industry, where relationships are highly contractual and equipment is often supplied without passing over full ownership. The PPSA will affect not only financing transactions, but also many transactions in which companies supply goods or services to customers, or have goods and services supplied to them. Interests that were not previously treated as security interests will become subject to the new regime.

Below is a list of scenarios that might be caught by the new legislation (it will ultimately depend on the circumstances of each case):

Equipment use: Any bailments or leases between parties concerning plant, equipment and other property may be registrable security interests. The supply of equipment in an agency, outsourcing or franchise arrangement might also be covered by the PPSA.

Transfers of receivables: Transfers of receivables (for example, the cash flows associated with consumer contracts for the provision of services) are caught by the PPSA.

Phone handsets, set-top boxes and other stock: If a business has acquired finance by offering security over its mobile handsets, set-top boxes or other retail stock, a registrable security interest may be created. This includes where goods are held on consignment. Also, consumer contracts governing, for example, any provision of services where the company retains ownership of an asset used by the consumer may be security interests.

Joint venture arrangements: Cross charges and default clauses in joint venture agreements may also fall within the regime and will need to be reviewed.

Intellectual property: The PPSA contains specific rules in relation to security interests in goods that have closely associated IP rights and, in some cases, the PPSA may deem IP rights to be covered by a security agreement. Security interests in relation to computer equipment, master recordings, copyright material (such as source code, music and photographs) and other assets with closely-related IP should be reviewed in this light.

Film financing: The structuring of financing transactions in the film and television industry may also be affected by the PPSA and will need to be reviewed.

Franchises: Transactions raising finance against projected franchise fees using franchised IP as the collateral will need to be reviewed.

What should companies in the communications sector (and their lawyers) be doing now?

The industry should begin preparing immediately for the new PPSA regime to protect their interests and minimise disruption to businesses once the PPSA takes effect. Preparations should include, where applicable:

- Scoping the task. This will involve checking in particular standard terms of supply, as well as financing arrangements and other potentially affected contracts.
- Identifying the assets affected.
- Compiling inventories of existing security interests (including interests that are currently registered on other registers) in order to register them and take any other steps necessary to protect them.
- Where necessary, developing new policies and procedures on the requirements for transactions and documentation and giving training and guidance to staff.
- Developing new systems to record and manage future security interests and deal with enquiries and other requirements of the legislation.
- For suppliers of goods or services, registering interests and redrafting supply terms.

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