

U.C.C. Article 9 and the PPSA: Vesting of Assets in Australia



Mr. Peter Mills

Special Counsel with Thomson Geer
Lawyers www.tglaw.com.au

Summary

Many creditors (often being sellers or consignors of goods) register a UCC-1 Financing Statement under U.C.C. Article 9 (**called "Article 9"**) against their debtors. A UCC is typically filed, so that in the event the debtor files for bankruptcy protection, the creditor can recover their property and fixtures from the trustee controlling the bankruptcy.

This paper looks at how these principals apply in Australia¹ under the *Personal Property Securities Act 2009 (Commonwealth of Australia)* (**called "PPSA"**) and the laws related to bankrupt companies, as to the rights of creditors who must perfect by registration, with case examples.

U.S. and other foreign companies who were unaware of the PPSA have already suffered loss². Creditors who deal with Australian businesses should obtain advice from Australian lawyers on their contracts involving Australian businesses, or assets located in Australia, and how to comply with the PPSA.

One National Law

One national law and register for security interests in assets "located in Australia", but does not apply to "fixtures".

In January 2012, Australia consolidated some 40+ registers and 70+ laws, to create one national register and a single national PPSA³ law, based on Article 9. The register is a 24/7 online electronic national register, which can be accessed by anybody in the world with internet access (**called the "PPSR"**). The PPSA and PPSR do not apply to fixtures and generally applies to any personal property "located" in Australia, including certain intellectual property registered on an Australia IP register.

The PPSR is a Means For:

1. Secured creditors to "perfect" their security interest in "collateral" by lodging "financing statements" on the PPSR, in relation to "deemed" and "in substance" "security interests" granted to the creditor's "secured party group" (SPG).

Whilst the PPSA uses similar terminology to Article 9, the technical meaning can often be quite different. Some common PPSA "security interests" include:

- a. Purchase Money Security Interests (also **called "PMSI's", pronounced "pim-zee's"**), which includes:
 - i. A financier's rights under a financing lease;
 - ii. Creditor's' rights under a conditional contract of sale or hire purchase;
 - iii. Certain lessors' and bailors' interests under an operating lease or bailment of goods for various specified periods (**called a "PPS lease"**);
 - iv. Consignor's interest under a commercial consignment; and
- b. A transferee's rights as to an account receivable or chattel paper.
- c. A general security interest over all present and after acquired property (with or without exceptions)

Such security interests are registered by the SPG lodging data via the PPSR's internet portal. No documents (faxed, emailed or mailed) are lodged.

2. "Prescribed interests" to be registered. These include:
 - a. Confiscation or forfeiture orders made under proceeds of crime law, and
 - b. Certain other court orders⁴

and each of which will normally have priority ahead of an unregistered creditor⁵.

3. Initial lodgment and continued registration of a financing statement, provided that the SPG has (and continues to hold) a reasonable belief that they do hold, or will become entitled to hold, a security interest in the relevant collateral. PPSR registrations can be (and more often than not are) lodged before a security agreement is "signed" or "adopted". This avoids the potential loss of priority due to late lodgement of an AIIPAAP, or super priority under a PMSI.

The PPSA adopts definitions used in other Australian laws, and the PPSR actively and continuously "talks to" and "verifies" data from other government data bases created under such laws. This assists in generally ensuring that perfection is obtained and maintained.

Effect of Debtor's Bankruptcy in Australia

In Australia, the bankruptcy of an individual or a partnership is dealt with under the national *Bankruptcy Act 1966*, that of corporations under the *Corporations Act 2001*, and the insolvency of Trusts under various Trust Act laws in each state.

This white paper discusses only corporate debtors incorporated in Australia under the *Corporations Act 2001*. The effect on unperfected security interests by the bankruptcy of other legal entity types will generally be similar; however specific advice should be sought in each case.

Generally, the effect of the debtor becoming bankrupt is that an unperfected creditor's security interest "vests" in the debtor, which is different to the Article 9 position. In practice, this normally means that the unperfected creditor loses its collateral, and receives very little by way of a dividend (if anything) as an unsecured creditor and cannot repossess its assets. In some cases, the unperfected creditor may even have to hand back the collateral it did repossess.

The rules in Australia are very strict on when a creditor must register. In certain cases registration might not assist if it was made within 6 months of the deemed "commencement date" of the debtor becoming bankrupt.

Scenario One

Retrospective Loss of Rights by the "Vesting" of Your Interest in Collateral

- A creditor's rights in the collateral "vest" in the debtor from the "date of commencement" of the bankruptcy if the creditor was not perfected as at such date of commencement⁶.

- In the case of a corporate debtor
 - The debtor will be controlled by a liquidator, voluntary administrator and/ or deed administrator⁷.
 - The "date of commencement" is the **earlier** of:
 - The date of when the court orders that they be made bankrupt; or
 - The directors of the debtor appoint a voluntary administrator by a board resolution, or its shareholders resolve to appoint a liquidator. No warning is required to be given to creditors before either of these occurs.

Example

Debtor A Pty Ltd takes possession of a large piece of equipment from Creditor X under a lease for an indefinite period on 1 July 2015, and the goods are inventory. Creditor X does not register on the PPSR.

Creditor Y, who is also owed money and has no security interest, files court proceedings on 21 July 2015 asking that Debtor A be declared bankrupt.

Debtor A Pty Ltd's directors appoint a voluntary administrator on 28 July 2015

Debtor A Pty Ltd's cheques (see: checks) bounce and so Creditor X repossesses the equipment on 10 August 2015.

A Court orders on 10 September 2015 that Debtor A is bankrupt.

Creditor X's interest in the goods automatically and retrospectively vests in Debtor A Pty Ltd as from the bankruptcy's commencement date of 28 July 2015, despite the subsequent repossession. Creditor X must hand the equipment over to the liquidator of Debtor A Pty Ltd, and must simply claim as an unsecured creditor for the amount owed under the hire purchase agreement.

Scenario Two

Retrospective Vesting of Your Interest, if You Failed to Perfect by Registration, within 20 Business Days and Debtor Goes Bankrupt within 6 Months of Agreement

- This provision is contained not in the PPSA, but in the *Corporations Act 2001*⁸.
- Its general purpose is to maintain the transparency and correctness of the PPSR as to the interests of secured creditors (whether or not they are PMSI's), so that all creditors who advance funds in the 6 months immediately preceding the commencement date of the bankruptcy of the debtor are able to see who is secured by registration. It often punishes last minute registrations by creditors who ought to have registered earlier.
- This period has caught many, including foreign companies trading in Australia, at great expense.

Example

Debtor A Pty Ltd is a construction company. From March 2014 creditor "X" (a foreign company) leased formwork equipment to A Pty Ltd for indefinite periods. Formwork equipment was provided to A Pty Ltd in 2014, while some had been leased in February and March 2015. Most of the formwork equipment was leased to A Pty Ltd on or before 2 January 2015. (20 business days after 2 January 2015 was 20 February 2015.)

On 23 February 2015 "X" registered a PPSR security interest.

A Pty Ltd's directors appointed voluntary administrators to the Debtor on 7 April 2015, and had possession of the formwork equipment. All of "X"'s formwork equipment leased to A Pty Ltd before 21 January 2014 (i.e. 20 business days before 23 February 2015 PPSR registration) and still in the possession of A Pty Ltd was lost as it vested in A Pty Ltd.

"X" had registered one day too late for most of its equipment. The value of such formwork equipment was more than \$1 million⁹.

Scenario Three

"Clawback" for Unfair Preference Transactions Might Give Rise to a Retrospective Recovery of Collateral by a Bankruptcy and Its Liquidator

- These provisions of the *Corporations Act*¹⁰ have not yet been considered by the Australian courts in the context of the PPSA. They are commonly called "claw back" or "unfair preferences" provisions.
- Their purpose is to ensure that generally the liquidator can "claw back" any payment/ property received by an unsecured creditor within 6 months prior to the commencement date of the bankruptcy (**called the "relation back period"**), so that the creditor does not receive an "unfair" preference ahead of other unsecured creditors¹¹.
- There is a very high risk that a court in Australia (subject to some exceptions) dealing with a creditor who does not have continuous perfection during the whole of the relation back period, would order the delivery up of the repossessed collateral to the liquidator of the bankrupt debtor as an unfair preference¹².

Example

Debtor A Pty Ltd acquires possession of goods from creditor X under a conditional sale contract on 1 July 2015, which goods are inventory. By the conditional sale contract, A Pty Ltd acquired a proprietary interest in the goods which attached upon A Pty Ltd obtaining possession of the goods¹³.

X was granted a security interest by A Pty Ltd obtaining possession, and was required (it being "inventory") to perfect its security interest by registration before possession was obtained¹⁴. X never registers its security interest.

X repossesses its goods on **20 August 2015** due to default by A Pty Ltd.

Creditor Y, who is also owed money but has no security interest, files court proceedings on **1 December 2015** asking that Debtor A be declared bankrupt.

A Court orders on **30 January 2016** that Debtor A is bankrupt, which is within 6 months of 20 August 2015, and "X" is liable to hand back the assets to the liquidator as an "unfair preference."

Execution creditors of A Pty Ltd would normally have priority over X if they had executed such judgment against the goods (X having an unperfected security¹⁵. Such execution creditors would also however been required to disgorge such amounts obtained under such judgment to the liquidator¹⁶).

That to allow X to retain the goods would enable it to obtain a better position than that which would have occurred if such execution creditors had taken priority over the collateral, and does not accord with either the principle or policies of the PPSA/ UCC or the Corporations Act/ US Code¹⁷.

Takeaways

- The PPSA uses similar terminology and principles as Article 9; however they are not the same.
- The PPSR actively and continuously "talks to" and "verifies" data from other government data bases created under such laws. This assists in generally ensuring that perfection is obtained and maintained.
- Foreign businesses operating with Australian enterprises, or who have assets in Australia, have lost due to lack of PPSA compliance. You should immediately ensure you are in compliance with the PPSA.
- Creditors who fail to properly effect a timely registration are exposed to losing their assets, sometimes even after repossessing the assets.
- In certain cases, strict rules can be overcome by court applications, however it is expensive and does not necessarily give complete certainty if the debtor does become bankrupt.

About the Author

The writer Peter Mills is a Special Counsel at Thomson Geer Lawyers www.tglaw.com.au. His is a recognised expert in this area of the PPSA. Peter advises controllers (voluntary administrators and liquidators), trade creditors, banks, accountants, Small and Medium Enterprises, subsidiaries of local & overseas companies and other law firms.

Peter is currently the Vice-President (Qld Division) of the Australian Institute of Credit Management (**AICM**), a member of the Queensland Law Society's Banking & Financial Services Committee and a Working Group Member of the United Kingdom's Secured Transactions Law Reform Project. In 2010 Peter received an AICM National award for services in relation to PPSA, in 2013 received the inaugural AICM Marion Hintz award and publishes regular monthly newsletters.

¹ The term "in liquidation", "under administration", or "subject to a deed of company arrangement" are generally used to describe an insolvent Australian company which has been placed into an arrangement with its creditors, however for convenience the terminology "bankrupt" and "bankruptcy" are used to describe these given the audience is intended to be U.S. creditors.

² Entities associated with the U.S. company APR Energy, have been involved in a dispute with the Australian and New Zealand Banking Corporation Limited concerning who has priority under the PPSA over \$50 million turbines which were apparently leased to the bankrupt Australian company Forge Group.

³ PPSA and its regulations.

⁴ See PPSA Regulations Part 5 item 5.3, and might include orders obtained from a U.S. or other court. Examples might include court orders "freezing" the rights of a debtor or another from dealing with their and other's assets, or orders made as to determining property rights of partners in domestic relationship or commercial disputes. The order of priority

⁵ Section 55 PPSA and 74 PPSA

⁶ Section 267 PPSA

⁷ I will not consider other possible controllers such as receivers and managers or court appointed statutory trustees or provisional liquidators for the purposes of this paper.

⁸ Section 588FL Corporations Act 2001. Such times can be extended by the courts however that process is expensive and are still subject to being set aside by another judge if the debtor does go bankrupt within the 6 months. *In the matter of Barclays Bank plc* [2012] NSWSC 1095

⁹ See example in this case, though the court appears to have miscalculated "business days" as defined under section 10 PPSA.

Carrafa, Gountzos & Lofthouse (as liquidators of Relux Commercial Pty Ltd (in liq)) & Anor v Doka Formwork Pty Ltd [2014] VSC 570

¹⁰ Section 588FA and 588FE Corporations Act 2001

¹¹ The purpose and effect of the PPSA and the unfair preference provisions of the Corporations Act appear generally similar to Article 9 and the US Bankruptcy Code.

¹² It could be said that otherwise it would create an inconsistent interpretation of the Corporations Act and the PPSA.

¹³ Section 19 PPSA; see also 12(1) Personal Property Security Act, S.B.C. 1989; see also 9-203 UCC

¹⁴ Section 62 and 63 PPSA/see 9-310 UCC

¹⁵ Section 74 PPSA

¹⁶ Section 588FA

¹⁷ Whilst the writer is not an expert in Article 9, the commentary in the unanimous decision of the United States Supreme Court in *Fidelity Financial Services Inc – v – Fink*, 522 U.S. 211 (1998) and as subsequently applied in *Re Taylor*; *SAA Federal Savings Bank – v – Thacker*, United States Court of Appeals for the Ninth Circuit, 26 February 2010) (Cor, Harry Pregerson, John T. Noonan and Carlos T. Bea would appear to support this position.