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General Editor's note

***Karen Lee** LEGAL KNOW-HOW*

This issue of the *Australian Banking and Finance Law Bulletin* is the fourth in this year — welcome!

Let us start this issue with an article on personal property securities (PPS) by **James Lucek-Rowley** (Corrs Chambers Westgarth). We have seen many matters before the courts regarding PPS recently. James's article provides a very informative overview of some of the recent case law which has highlighted common areas of confusion and elements of uncertainty under both the Personal Property Securities Act 2009 (Cth) (PPS Act) and with respect to compliance requirements for an effective registration on the PPS Register. James also provides a summary of recent legislative amendments put forward and consideration of what is next in PPS reform.

From a wonderful summary of PPS related matters, next, we deep-dive into a recent PPS decision, *K J Renfrey Nominees Pty Ltd (Trustee), in the matter of OneSteel Manufacturing Pty Ltd v OneSteel Manufacturing Pty Ltd*.[1] This Federal Court decision concerned the construction of s 588FL of the Corporations Act 2001 (Cth) when companies in external administration grant security interests subject to the PPS Act. I am very pleased to introduce new contributors **Michael Catchpoole** and **Tom Schinckel** (Henry Davis York) to the readers of the bulletin. The authors in their article "Renfrey Nominees: court approval required when taking security from companies in external administration" give us an analysis and detailed commentary regarding the facts, issues, and very importantly, the commercial implications of this judgment. I would like to take this opportunity to welcome the authors to our community, and thank them for their contribution.

The next article is also on recent case law. Editorial board member **David Richardson** (HWL Ebsworth) gives us another one of his always-well-received case notes, this time on *AMP Bank Ltd v Brown and Kavanagh*.[2] The decision of the New South Wales Supreme Court is about contribution between co-sureties — one of two co-sureties sought adjustment of liability on the basis of the other's conduct. Banking and finance lawyers deal with guarantees and indemnities all the time, and we can always learn from case law. Find out why in this case, the relevant cross-claim was dismissed by the court.

In the recent years, Associate Professor **Lee Aitken** (TC Beirne School of Law, University of Queensland) has penned many articles for us. Next, we welcome the return of Lee, and in his article "A bank's 'no set-off clause', the guarantor and the claim for 'loss or damage' (or statutory reconfiguring of a contract)", Lee considers (among other things) two recent cases, *Palaniappan v Westpac Banking Corp*[3] and *Westpac Banking Corp v Zilzie Pty Ltd,*[4] the limitation on the operation of suspension clauses, the protection of the guarantors in equity, no set-off and statute, and much more. I have always enjoyed Lee's engaging writing style. I am sure you will find this article, just like Lee's others, interesting and insightful.

I hope you will find this issue of the bulletin a valuable resource. Please do not hesitate to share any feedback by contacting me.

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Karen Lee is the General Editor of the Australian Banking & Finance Law Bulletin and the Financial Services Newsletter. She also partners LexisNexis in other capacities, including as Specialist Editor for precedents in banking and finance, mortgages and options, and as contributing author of a number of other publications, including Australian Corporate Finance Law, Halsbury's Laws of Australia and Practice Guidance for General Counsel. Karen established her legal consulting practice, Legal Know-How, in 2012. She provides expert advice to firms and businesses on risk management, legal and business process improvement, legal documentation, regulatory compliance and knowledge management. Prior to this, Karen worked extensively in-house, including as Head of Legal for a leading Australasian non-bank lender, as well as in top-tier private practice, including as Counsel at Allen & Overy and Clayton Utz.

Footnotes

1. *K J Renfrey Nominees Pty Ltd (Trustee), in the matter of OneSteel Manufacturing Pty Ltd v OneSteel Manufacturing Pty Ltd* [2017] FCA 325.
2. *AMP Bank Ltd v Brown and Kavanagh* [2017] NSWSC 313; BC201702132.
3. *Palaniappan v Westpac Banking Corp* [2016] WASCA 72; BC201603213.
4. *Westpac Banking Corp v Zilzie Pty Ltd* [2016] QSC 238; BC201609020.

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Tips and traps of the PPS Act: avoid a defect, fix a problem and what's next — a look towards further reform

James Lucek-Rowley *CORRS CHAMBERS WESTGARTH*

Background

30 January 2017 marked the fifth anniversary of the commencement of the operative provisions of the Personal Property Securities Act 2009 (Cth) (the Act).

The substantial reforms, closely modelled on existing legislation in New Zealand, Canada and the United States, outlined default rules for the creation, priority and enforcement of security interests in personal property in order to:

- harmonise laws to replace the complex web of common law and legislation which applied to personal property securities;
- provide greater certainty and predictability for lenders, borrowers and prospective financiers; and
- simplify arrangements to make it easier for parties to establish and arrange the terms of their security transactions, reduce transaction costs and enforce security interests in personal property.

The changes were supported by the establishment of a single online register, the Personal Property Securities Register (PPSR), to replace the myriad of electronic and paper-based national, state and territory registers.

Notwithstanding the extensive consultation that took place prior to its introduction, the Act continues to present stakeholders and advisers with a potential minefield to be carefully navigated. Furthermore, the PPSR has become overly complex — "full of jargon, and unfamiliar concepts".[1]

This article provides an overview of some of the recent case law which has highlighted common areas of confusion and elements of uncertainty under both the Act and with respect to compliance requirements for an effective registration on the PPSR. It concludes with a brief summary of recent legislative amendments put forward and consideration of what is next with this revolutionary reform.

Lessons from OneSteel (Part 1) — financing statements, ABNs, ACNs and vesting

Alleasing Pty Ltd (Alleasing) and OneSteel Manufacturing Pty Ltd (OneSteel) entered into a master lease and two rental agreements in respect of a crushing plant and spare parts for the crusher for a term of 6 years.[2]

Both leases fell within the meaning of a Personal Property Securities (PPS) lease as set out in s 13 of the Act, and thus created a registrable security interest.

Registration on the PPSR is one of the three methods by which a secured party is able to perfect its security interest. Perfection provides optimal protection in the event of a priority dispute and avoids the consequences of the vesting rules on an insolvency event.

The contents for a financing statement are set out in s 153(1) of the Act and Sch 1 of the Personal Property Securities Regulations 2010 (Cth) (Regulations). This document must include "the grantor's details as prescribed in the regulations" which, relevantly, requires that where the grantor is a body corporate, the prescribed details to be inserted in the financing statement are the Australian Company Number (ACN) of the grantor.[3]

Alleasing registered a financing statement in relation to the crusher and spare parts on the PPSR. However, this registration was done by reference to OneSteel's Australian Business Number (ABN) and not its ACN.[4]

Section 164(1) of the Act provides that a registration will be ineffective if there is a seriously misleading defect in the registration, or a defect mentioned in s 165. Section 165(b) mentions circumstances which include where no search of the register by reference to the grantor's details required under s 153 is capable of disclosing the registration.

Administrators were subsequently appointed to OneSteel who later informed Alleasing that the registrations were defective, ineffective, and as a result of the vesting provisions in s 267 of the Act, its security interests had vested in OneSteel.

The decision

It was held that the registrations were defective because they did not include the ACN and thereby ineffective as a search of the PPSR would not reveal the registrations. This rendered the defects seriously misleading.[5]

While the phrase "seriously misleading" is not defined in the Act, what remains clear from this decision is that the preferred interpretation will be whether the error would prevent a registration being disclosed by a proper search of the relevant field.[6] It is an objective test and there is no requirement to prove someone was actually misled.[7]

As a consequence, Alleasing's security interests in the crusher and parts were ineffective, unperfected and vested in OneSteel pursuant to s 267 at the time OneSteel went into administration.

How to avoid problems with your financing statement

Given the highly prescriptive system, the importance of getting a financing statement right cannot be overstated.

This is particularly so given the court does not have the power to rectify a mistake and can only grant discretionary relief in certain circumstances (see such instances referred to below).

It is essential that a financing statement complies with both the Act and the information prescribed by the Regulations. It should be noted that an ineffective registration will not affect the validity of the underlying security agreement.

The fact that the ABN happens to include the ACN does not mean that inclusion of the ABN equates to inclusion of the ACN. Provision is made for registration against an ABN only where the grantor is a partner in a partnership, a trustee or a body politic.[8]

Lessons from OneSteel (Part 2) — security interests created after the "critical date"

Prior to entering administration, OneSteel used plant and equipment hired from K J Renfrey Nominees Pty Ltd (Renfrey). Following the appointment of administrators, Renfrey discovered it had incorrectly registered its security interest under a hire services agreement against OneSteel's parent company, Arrium Ltd.[9]

The administrators did not pursue their claim against Renfrey that the security interest had vested under s 267 of the Act. Instead, the parties entered into a new agreement whereby Renfrey would be granted "new" security interests.

These interests were subsequently registered on the PPSR.[10]

Despite the agreement reached, and the perfection by registration, the parties approached the court due to a concern that the new security interest may have automatically vested in OneSteel by reason of s 588FL(4)(b) of the Corporations Act 2001 (Cth).[11] That section provides that a security interest will vest in the company (OneSteel) if it first becomes enforceable against third parties after the date of the winding up (or the "critical time").

The parties contended that it was unclear as to whether s 588FL(4)(b) was engaged because of the uncertain language of s 588FL(2).[12]

The construction of s 588FL

The court held that s 588FL, read as a whole, covered security interests granted *after* the critical time. This construction avoided the anomalous result that s 588FL would only apply to security interests arising after the critical time but registered before they arise, and not to security interests arising after the critical time but registered after they arise.[13]

As a consequence of this construction, Davies J held that s 588FL was engaged by reason of s 588FL(2)(b).[14] Pursuant to that section, if a security interest is registered after the insolvency event, the interest will vest irrespective of whether it is registered within 20 business days after the security agreement came into force.

As such, but for an order under s 588FM, the security interest would vest in OneSteel.

What approach should be taken to avoid an automatic vesting?

In such circumstances, it will be open to a party to seek an order under s 588FM to avoid the operation of s 588FL on "just and equitable" grounds. The availability of such discretionary relief will depend on the factual context and the interests of creditors.

As, in this instance, there was no prejudice to creditors who had transacted with the company (OneSteel) without notice of the interest, her Honour considered it just and equitable to fix a later time for the purposes of s 588FL(2)(b)(iv) such that the vesting provisions were not engaged.[15]

Following this decision, administrators, and those whose assets are necessary for the continued operation of the business, should be mindful of making an application for such an order to avoid automatic vesting of a security interest which arises under a new security agreement entered into post-appointment.

Errors in a financing statement — what next?

In recent NSW Supreme Court proceedings,[16] an equipment finance company (the lessor) identified certain mistakes in its registration processes for financing statements on the PPSR.

While the lessor lodged financing statements on the PPSR contemporaneously with, or as close to, entering into leasing arrangements with customers, flaws existed in a document, prepared by an employee of the lessor, which outlined its policy and approach for registration.[17]

These included:

- all security agreements were classified as "transitional" (ie created and in force prior to 30 January 2012). This rendered each affected registration ineffective;[18]
- registrations for a "purchase money security interest" (PMSI) were not identified where eligible such that the lessor stood to lose its "super-priority" rights that are available where a PMSI is granted over particular collateral;[19] and
- the security interests were not lodged against the ABN of the trust where the lessee was a trustee. This also rendered the affected registration ineffective.

The lessor subsequently filed more than 200 new, corrected financing statements, and sought orders from the court to extend the time for registration to give effect to those new financing statements.

Matters for consideration

The court had to consider whether:

- the failure to register was the result of an accident, inadvertence or some other sufficient cause; and
- the granting of additional time would prejudice the position of secured parties, unsecured creditors or shareholders.

"Inadvertence" in such a context includes:

- "an innocent error in the sense of failure to register through ignorance of the legal requirement to do so";[20]
- "where a party operates under a mistake as to the consequences of failing to register a security interest";[21] or
- when the error in not attending to registration within time is innocent and does not result from any disregard of the statutory obligations.[22]

The extensions sought by the lessor were ultimately granted by the court which was satisfied that the failures were accidental or due to advertence because:[23]

- the lessor was aware of the requirement for registration under the Act yet unaware of the deficiencies in its process of registration;
- the employees of the lessor did not understand the legal significance of these deficiencies; and
- a bona fide attempt was made by the plaintiff to register its security interests as they arose and the errors were accidental.

What should you do if an error is identified?

If a review of your registrations under the Act uncovers similar defects, it will be open to make an application to the court for orders under s 293 of the Act (in respect of the PMSI interests) and s 588FM of the Corporations Act for a systemic rectification of the ineffective registrations.

Any application under s 588FM should join affected grantors, as well as other secured creditors of those grantors, to provide an opportunity for them to challenge the proposed extensions and draw any prejudice to the attention of the court.[24]

It should be noted that, although the financial position of each of the grantors was not considered in any detail, the court imposed what has been described by Brereton J as a "*Guardian Securities* condition".[25]

Such a condition provides liberty for unsecured creditors, or any persons representing their interests (such as a liquidator or voluntary administrator), to later apply to the court for a discharge or variation of the order in the event that any of the grantors are wound up, placed into voluntary administration or are subject to a deed of company arrangement within 6 months of the amended registration date.

"Regularly engaged in the business of", "affixed to land" and the modifications to the meaning of a "PPS lease"

Many practitioners will be familiar with the decisions of the NSW Supreme Court and Court of Appeal in relation to the four gas turbines leased to Forge Group Power (Forge) as part of a temporary power station in Western Australia.

For those unaware of the relevant facts, not long after the turbines were installed, voluntary administrators were appointed to Forge, and shortly thereafter, it went into liquidation. No financing statement for the lease, entered into for a rental term of 2 years, had been registered on the PPSR.

The question before the court, at first instance, was whether the Act was engaged and this turned on whether:[26]

- the lessor was regularly engaged in the business of leasing within the meaning of s 13(2)(a) of the Act (such that the lease was a PPS lease); or
- if the turbines became fixtures within the meaning of s 10 of the Act and thus the Act did not apply.

Hammerschlag J held that the lessor *was* regularly engaged in the business of leasing (and regard should not be limited to activities conducted in Australia) and observed the correct approach to such an analysis was to question whether, at the relevant time, leasing goods was a proper component of the lessor's business.[27]

With respect to whether the turbines were fixtures, his Honour held that the words "affixed to land" in the definition of fixtures in s 10 of the Act meant affixed according to common law concepts,[28] and as such, the turbines did not become fixtures.[29]

On the basis of the above conclusions, his Honour held that the lease of the turbines was a PPS lease and that lessor's interest in the turbines vested in Forge immediately before the appointment of voluntary administrators.[30]

The findings of the primary judge as to the correct interpretation of the words "affixed to land" and that the turbines had not become fixtures were later appealed. The appeal was dismissed based on certain textual and contextual indicators,[31] and the clear legislative intent discernible from extrinsic material which indicated the decision at first instance was correct.[32]

Personal Property Securities Amendment (PPS Leases) Bill 2017 (Cth)

On 1 March 2017, the Personal Property Securities Amendment (PPS Leases) Bill 2017 (Cth) (PPS Leases Bill) was read for a second time in the House of Representatives to progress what was described as "urgently needed reform of the Personal Property Securities Act 2009 to minimise the impact of the PPS regime".[33]

The PPS Leases Bill amends the definition of PPS lease in s 13 to extend the minimum duration of PPS leases from more than 1 year, to more than 2 years. The Bill also amends the Act to provide that leases of an indefinite term will not be deemed to be a PPS lease unless and until they run for a period of more than 2 years.[34]

According to the Explanatory Memorandum which accompanied the PPS Leases Bill, the intention is to reduce the regulatory impact on short-term hire and rental business, the majority of which are small to medium enterprises.[35]

Notwithstanding this, the proposed amendments would have made a significant difference in the case of *Forge Group Power Pty Ltd (in liq) (recs and mgrs apptd) v General Electric Int Inc*:[36] the original lease was only for 2 years and therefore would not have been a PPS lease requiring registration under the amended Act.

Where to next?

It remains to be seen how the federal government will approach reform to the Act now that it has been operative for over 5 years.

While, by the legislative change pushed through and outlined above, it appears to be cognisant of the need to assess and adjust new legislation to meet the needs of the Australian marketplace, a response to the *Review of the Personal Property Securities Act 2009: Final Report*,[37] delivered to the Attorney-General and the Parliamentary Secretary to the Prime Minister on 27 February 2015, is yet to be forthcoming.

This review, provided for by s 343 of the Act, considered:[38]

- the effect of the reforms introduced by the Act;
- the level of awareness and understanding of the Act;
- the incidence and causes of non-compliance with the Act;
- opportunities for minimising regulatory and administrative burdens including cost; and
- opportunities for further efficiencies.

A total of 349 recommendations were made on how to improve the Act, including simplification of the Act and of the PPSR. It cannot be anticipated how the federal government will respond to the contents of the report, however, it is clear from the growing body of case law that certain matters require clarification and further education.

Further, given the complexity and considerable length of the Act, whether or not change will continue on an ad hoc basis, such as with the PPS Leases Bill, remains to be seen.

The task will not be straightforward.

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Footnotes

1. B Whittaker *Review of the Personal Property Securities Act 2009: Final Report* (2015) 28 www.ag.gov.au/Consultations/Documents/PPSReview/ReviewofthePersonalPropertySecuritiesAct2009FinalReport.pdf.
2. *Re OneSteel Manufacturing Pty Ltd (admins apptd)* [2017] NSWSC 21; BC201700308 at [1].
3. Personal Property Securities Act 2009 (Cth) (PPS Act), s 153; Personal Property Securities Regulations 2010 (Cth) (Regulations), Sch 1, cl 1.3.
4. Above n 2, at [4].
5. Above n 2, at [80].
6. *Polymers Int Ltd v Toon* [2013] NZHC 1897; BC201364696 at [23] — as cited in above n 2, at [38].
7. PPS Act, above n 3, s 164(2).
8. See Regulations, above n 3, Sch 1, cll 1.4–1.6.

9. *K J Renfrey Nominees Pty Ltd (Trustee), in the matter of OneSteel Manufacturing Pty Ltd v OneSteel Manufacturing Pty Ltd* [2017] FCA 325 at [3].
10. Above n 9, at [4]–[5].
11. Above n 9, at [8].
12. Above n 9, at [9].
13. Above n 9, at [15] and [24].
14. Above n 9, at [25].
15. Above n 9, at [28]–[29].
16. *Re 4 in 1 Wyoming Pty Ltd & The Companies Listed in Schedule A to the Originating Process* [2017] NSWSC 407; BC201702558.
17. Above n 16, at [6].
18. See PPS Act, above n 3, s 337A.
19. Above n 16, at [11]–[14].
20. *Re Appleyard Capital Pty Ltd; 123 Sweden AB v Appleyard Capital Pty Ltd* (2014) 101 ACSR 629; [2014] NSWSC 782; BC201404636 at [10].
21. *Re Cardinia Nominees Pty Ltd* [2013] NSWSC 32; BC201300324 at [15].
22. *Re Accolade Wines Australia Ltd* [2016] NSWSC 1023; BC201606083 at [14].
23. Above n 16, at [38]–[40].
24. Above n 16, at [20] and the authorities cited therein.
25. Above n 20, at [25] and [28] — and as imposed in *Bevillesta Pty Ltd v Imagine UN Ltd* (2009) 69 ACSR 574; [2009] VSC 50; BC200900798.
26. *Forge Group Power Pty Ltd (in liq) (recs and mgrs apptd) v General Electric Int Inc* (2016) 305 FLR 101; [2016] NSWSC 52; BC201604555 at [10].
27. Above n 26, at [46].
28. Above n 26, at [79]; Whether an item has become a fixture depends upon the objective intention with which the item was put in place, "having regard to the degree and object of annexation, but each case depends on its own circumstances" — see *Agripower Barraba Pty Ltd v Blomfield* (2015) 317 ALR 202; [2015] NSWCA 30; BC201500973 at [74]–[81].
29. Above n 26, at [75].
30. Above n 26, at [137].
31. *Power Rental Op Co Australia, LLC v Forge Group Power Pty Ltd (in liq) (recs and mgrs apptd)* [2017] NSWCA 8; BC201700400 at [103].
32. Above n 31, at [44]–[49].
33. Commonwealth, *Parliamentary Debates*, House of Representatives, 1 March 2017, 1883 (Michael Keenan MP).
34. Explanatory Memorandum, Personal Property Securities Amendment (PPS Leases) Bill 2017 (Cth).
35. Above n 34, at 2.
36. Above n 26.
37. Above n 1.
38. Above n 1, at ix.