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The Conundrum of the PPSA and Successive Proceeds Claims

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On occasion, property to which a perfected security interest is attached under the *Personal Property Securities Act 2009* (Cth) (*PPSA*) is transferred in return for proceeds, and those proceeds are also transferred, all of which takes place without the consent of the security interest holder. In theory, the process could continue indefinitely where further transfers of the collateral take place in exchange for different proceeds, and so on.

There is currently uncertainty about whether the *PPSA* permits the security interest to extend to proceeds beyond those that arise from the first transfer in the series. If it does, then this would potentially expose innocent third parties to the risk of undiscoverable security interests. On the other hand, if the security interest goes no further than the first proceeds in the series, then the protection afforded by the *PPSA* to a secured party is potentially eroded in relation to proceeds claims. Despite a recommendation and exposure draft bill being released that has drafting designed to create clarity, the bill has not yet passed. Potential issues also arise with the drafting of the relevant provision in the bill, which may have the result that clarity on this issue will not be achieved, even if the bill is passed.

Summary of the Uncertainty

The uncertainty arises due to the limitation provided in s 31(3)(a) of the *PPSA* as to what constitutes "proceeds" under the *PPSA*, combined with the broad definition of "grantor" in s 10. To qualify as proceeds under s 31(3)(a), the grantor must have an interest in the proceeds or have the power to transfer rights in the proceeds to the secured party or their nominee. However, the definition of "grantor" in s 10 extends not only to the original grantor of the security interest but also to a transferee of, or successor to, the interest of such a person. A question arises whether s 31(3)(a) of the *PPSA* ought to be read down to cover only the original grantor and not any subsequent grantor.

The following example (modified from the explanatory memorandum accompanying the exposure draft of the bill referred to below) is illustrative of the issue.

> A secured party has a security interest in a grantor's car. The grantor sells the car to a buyer without the secured party's consent. The buyer cannot rely on the 'take-free' provisions, so the security interest remains attached to the car. The buyer later on-sells the car to a third party. The consideration paid by the third party to the buyer is the transfer of a truck as a trade-in.

In general, and under s 31(1), if personal property to which a security interest is attached gives rise to proceeds, the security interest attaches to the proceeds, unless the security agreement provides otherwise.

The question is whether the security interest attaches to the truck as proceeds of the car. Arguably, the truck is derived directly or indirectly from a dealing with the car and therefore qualifies under the definition of "proceeds" in s 31(1)(a). However, s 31(3) must also be complied with. If the term "grantor" as it appears in s 31(3) is limited to the original grantor of the security interest (i.e. the original owner of the car), s 31(3)(a) prevents the security interest attaching to the truck. Even though the truck derives from a dealing with the car, the original grantor does not have, and never did have, an interest in the truck. Accordingly, if the term "grantor" is limited in this way, the reach of a secured party's claim to proceeds is limited to those proceeds obtained by the original grantor and not anyone else.

On the other hand, if the term "grantor" is given its full meaning as it is defined in s 10, the buyer of the car is also a grantor because, among other things, the buyer became a transferee of, or a successor to, the interest of the original grantor in the car in accordance with paragraph (e) of the definition of "grantor". Now that the buyer has acquired the truck as a trade-in, the buyer (as a grantor) has an interest in the proceeds (i.e. the truck) and the security interest would attach to the truck.

The approach of treating the grantor in this context as including transferees or successors to the interest of the original grantor has been criticised on the basis that it would allow a "geometric multiplication of proceeds claims" if the original collateral (i.e. the car) was sold multiple times.[1] That approach has also been criticised because it would (unacceptably) expose third parties to the risk of undiscoverable security interests.[2]

1 A Duggan & D Brown, *Australian Personal Property Securities Law* (2nd edition) (LexisNexis, 2016), Para 11.13.

2 *Ibid.*

If the security interest was registered, it is only likely to have been registered against the original grantor in relation to the collateral (in this case the car) and not the truck in the hands of the buyer. A search by a third party of the truck may not reveal the existence of the security interest and therefore the third party may unwittingly acquire the truck subject to the security interest. However, despite these criticisms, there is nothing expressly stated in the current version of the *PPSA* that operates to limit the broad definition of "grantor" in s 10 when that term is used in s 31(3).

Proposed Reform of the PPSA

In 2015, a statutory review of the *PPSA* (known as the Whittaker Review) recommended that the *PPSA* be amended to make it clear that s 31(3)(a) only applies to the original grantor.[3] In 2023, the Commonwealth government accepted the recommendation, and a proposed amendment to the *PPSA* is contained in the exposure draft of the *Personal Property Securities Amendment (Framework Reform) Bill 2023*. That exposure draft proposes the following amendment be inserted after subsection 31(3) of the *PPSA*:

> "(3A) Paragraph (3)(a) does not apply to a person who is the grantor of the collateral because of paragraph (e) of the definition of "grantor" in section 10.
>
> Note: Paragraph (e) of the definition of "grantor" includes as a grantor a transferee of, or successor to, the interests of another grantor."

Issues With the Proposed Amendment

Unfortunately, while the proposed amendment prevents the application of paragraph (e) of the definition of "grantor" in s 10, it may not go far enough to exclude from the security interest proceeds in the hands of a subsequent owner that were generated from the on-sale of the collateral.

This is because while the proposed amendment will exclude transferees captured by paragraph (e) of the definition of "grantor", it does not expressly exclude paragraph (a) of the definition. Paragraph (a) provides that a grantor includes "a person who has the interest in the personal property to which a security interest is attached (whether or not the person owes payment or performance of an obligation secured by the security interest)."[4]

In the example, when the car is sold to the buyer without the consent of the security interest holder (and without application of the 'take-free' provisions), the security interest remains attached to the car.

The buyer now has an interest in the car to which the security interest is attached even though the buyer does not owe payment or performance of any obligation to the security interest holder under the security agreement. Accordingly, in addition to becoming a grantor as a transferee by virtue of paragraph (e) of the definition, the buyer may also qualify as a grantor by virtue of paragraph (a).

If the amendment was made in the terms proposed in the exposure draft, then in order to implement the recommendation contained in the Whittaker Review, a court would have to read down paragraph (a) of the definition of grantor for the purposes of s 31(3)(a) so that it did not apply to subsequent grantors where paragraph (e) was also engaged. Arguably, this could be achieved by interpreting the proposed s 31(3A) to mean, in effect, that once a person qualifies under paragraph (e), then that person is excluded as a grantor for the purposes of s 31(3)(a) even if that person may also qualify as a grantor under some other paragraph of the s 10 definition of "grantor". In this way, the Whittaker Review recommendation could be implemented with what is currently proposed in the exposure draft of the bill.

Conclusion

Pending any amendment to the *PPSA*, some uncertainty remains in this context regarding the position that a court would take on a security interest holder being able to make a claim against proceeds of sale in the hands of a buyer of the collateral that were generated by the buyer on-selling the collateral. In our view, it is also unfortunate that the proposed amendment to the *PPSA* to resolve this issue does not do so with more clarity. We continue to watch this space.

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3 B Whittaker, *Review of the Personal Property Securities Act 2009* (Commonwealth of Australia, 2015), Para 7.4.1.1.3.

4 *Personal Property Securities Act 2009* (Cth), s 10. definition of "grantor", paragraph (a).