PPSA and Commercial Leases: Landlords Take Note – the Transitional Period is Almost Up!

The Personal Property Securities Act 2009 (Cth) (PPSA) came into operation on 30 January 2012 and is relevant to various aspects of commercial leasing. As we draw closer to the end of the "transitional period" on 30 January 2014, landlords need to ensure that their transitional security interests (i.e. security interests contained in lease agreements that were entered into prior to 30 January 2012) are perfected to avoid losing priority. In the context of a commercial lease, where the relevant property is likely to be in the possession and control of the tenant, the appropriate means of perfection is registration on the online Personal Property Securities Register (PPSR).

Transitional security interests are afforded temporary perfection until 30 January 2014. Following this time, any security interest that has not been perfected by registration on the PPSR will lose its "temporary perfection" status and become an unperfected security interest. Unperfected security interests are afforded the lowest priority under the PPSA and will be defeated by a registered security interest, even if it came into existence later in time. Furthermore, if the tenant becomes insolvent, unperfected security interests will be unenforceable.

Registrable security interests relevant to commercial leases include:

**Leases of personal property**

Leases and bailments of goods with a duration in excess of one year are considered ‘PPS Leases’ and should be perfected by registration.

**Fittings, furnishings and fitout**

Where a landlord purchases items of the tenant’s fitout, if the lease provides that such items remain the property of the landlord, then this gives rise to a security interest under the PPSA. This includes fitting, furnishings and equipment, but excludes fixtures.

Where a fitout incentive payment is provided, such interests will constitute Purchase Money Security Interests (PMSIs) and will enjoy ‘super priority’ over all other registered security interests, even those that are registered earlier in time. However, to qualify as a PMSI, the security interest must be registered within a strict time period, which is typically within 15 business days of the tenant obtaining possession of the property.

**Security deposits**

A cash security deposit provided by a tenant to secure performance by the tenant of its obligations under the lease is a registrable security interest.

Where deposits are held in an account with an Authorised Deposit Taking Institution (i.e. a bank) (ADI), landlords should consider negotiating a priority agreement with the ADI to ensure that any security interests in favour of the ADI over the account (which are given priority over all other perfected security interests) do not defeat the landlord’s security interest in the account.

**Licences**

Leases often grant the landlord a power of attorney to deal with licences that attach to property, such as liquor licences, in the event of early termination or default. Consideration should be given as to whether such rights create a registrable security interest.

**Other arrangements**

Lease agreements may give rise to a number of further registrable security interests, for example:

- An interest in tenant’s goods abandoned upon termination of the lease; and
- Rights to enter upon leased premises and deal with property upon default.

Notably, bank guarantees and personal guarantees are, in effect, contractual ‘promises to pay’ and do not give rise to a security interest as they do not give the landlord an interest in personal property.

**Further Considerations**

With the impending expiration of the transitional period, if you are a landlord, now is the time to make sure that your security interests are registered and will be effective. While you are getting your PPSR house in order, it is also a good time to consider reviewing your standard leasing documents to ensure that they are PPSA compliant. Please contact our PPSA experts at Squire Sanders who would be delighted to assist you with this process.
The Proposed Abolition of the Clean Energy Finance Corporation

Background and Role of the CEFC

The Clean Energy Finance Corporation (CEFC) is a fund that was established on 22 July 2012 by the former Labor federal government. Its primary aim is to catalyse and leverage investment in renewable energy, energy efficiency and low-emissions technology in Australia, by working with project proponents and private sector co-financiers to develop financing solutions. It offers a substantial funding pool, sector-specific expertise and flexible financing terms suitable to projects with longer investment horizons.

The existing legislative framework provides for a special appropriation to the CEFC of AU$2 billion of Commonwealth funds per year for the next five years. Rather than distributing these funds by way of grants, the CEFC has pursued a market-based approach; investment is targeted at projects in the later stages of development and loans are issued at commercial rates. CEFC loans generally involve a private sector co-financier to ensure that the risk profile assumed by the CEFC is broadly market-based.

Since becoming operational on 1 July 2013, the CEFC has provided AU$36 million in financing, which has been supported by AU$1.55 billion in private sector co-financing. According to its September 2013 quarterly report, the CEFC has generated positive returns, with an average return to taxpayers of 7.33% (almost 4% above the government bond rate).

The Clean Energy Finance Corporation (Abolition) Bill 2013

On 13 November 2013, the new Coalition government passed a host of bills aimed at abolishing Labor’s clean energy legislation, including the Clean Energy Finance Corporation (Abolition) Bill 2013 (Cth) (Abolition Bill) which, if enacted, will abolish the CEFC.

Shortly after the introduction of the Abolition Bill, the government called on the CEFC to cease its investment activities. In response, the CEFC stated that it would continue under its existing mandate until there was a change in the law. Given the political uncertainty surrounding the future of the CEFC, despite continuous active discussions regarding existing projects, no new investments have been made since 20 August 2013. According to the CEO of the CEFC, Oliver Yates, it is unlikely to allocate more than AU$1 billion out of its AU$2 billion annual budget as a result of the uncertainty.

Potential Impact of the Abolition

Although the explanatory memorandum to the Abolition Bill estimates that there will be substantial savings as a result of the abolition, recent submissions by the CEFC suggest otherwise. In its submissions, the CEFC argues that the estimates are based on the presumption that the CEFC does not make any further investments.

Based on the CEFC’s financial performance to date, an expansion of its investment base over the next five years would result in income generation for the government. Abolition of the CEFC would then be a cost, rather than a saving, for the government.

In its inaugural year of operation, the CEFC facilitated over AU$2.2 billion worth of investment into clean energy projects equating to AU$2.90 of private sector funds for each AU$1 of CEFC investment. That being so, the abolition of the CEFC would effect a significant reduction in the flow of investment funds into the clean energy sector, making it more difficult for project proponents to source capital.

On a practical level, the Abolition Bill provides for the Commonwealth government to assume control of CEFC investments and take on its contractual obligations. The extent to which the Commonwealth government will be bound by these commitments is unclear; the Abolition Bill gives broad powers to the Commonwealth to ‘manage and dispose’ of the investments of the CEFC as required.

However, in the Second Reading Speech of the Abolition Bill, Federal Treasurer Joe Hockey indicated that the government intends to honour all of the CEFC’s current commitments, which is encouraging for existing CEFC-funded projects.

Conclusion

It is difficult to predict how the Abolition Bill will proceed. The composition of the current Senate presents a significant obstacle for the Abbott government and the prospect of a double-dissolution election seems increasingly unlikely. When the new Senate commences on 1 July 2014, the passage of the Abolition Bill will likely depend on the support of a number of minor party members. In addition, in recent weeks, there appears to have been increasing support for the continuation of the CEFC from a number of independents.

It is uncertain what the future holds for the CEFC and the renewable energy market. In the meantime, existing CEFC-funded projects can take some comfort in the fact the government has stated that it intends to honour existing CEFC funding commitments.
Introducing the “Elephant on the Construction Site”: Step-in Rights and the Personal Property Securities Act 2009 (Cth)

There’s an elephant lurking around construction sites who we affectionately call “Percy” (the Personal Property Securities Act 2009 (Cth) (PPSA)). “Percy” only arrived in Australia fairly recently (30 January 2012), after charging through Canada, New Zealand and the United States. He is a prodigious, enigmatic creature. Although occasionally known to trample on people’s toes, the business communities in those countries have become well-acquainted with and even grown fond of him. However, reactions to “Percy’s” triumphant arrival in Australia have been mixed. Many people in the construction industry would prefer to pretend that he doesn’t exist and carry on with business as usual. But “Percy’s” here to stay, so we’d like to introduce him!

A recent decision of the New Zealand High Court has highlighted the importance of registering step-in rights under construction contracts on the Personal Property Securities Register (PPSR).

The Facts

The case of McCloy v Manukau Institute of Technology [2013] NZHC 936 involved a dispute between receivers appointed by the Bank of New Zealand (BNZ) who claimed to be entitled to take possession of two hoists that were owned by Mainzeal Property and Construction Ltd (Mainzeal) prior to it being placed in receivership, which were located on property owned by Hobson Gardens (a customer of Mainzeal).

Mainzeal was a construction company and had granted a number of security interests to BNZ, including a general security interest and a specific security interest over the hoists the subject of the dispute, which BNZ had registered.

In June 2011, Mainzeal entered into a contract with Hobson Gardens, which incorporated the terms of the standard New Zealand Institute of Architect’s contract, to carry out certain remedial works on an apartment building. The contract provided that in the event Mainzeal entered into receivership and the receivers failed to take over the construction works:

• Mainzeal’s interest in, relevantly, the construction machinery on the site would be transferred to Hobson Gardens;

• Hobson Gardens would be entitled to complete the construction works (at Mainzeal’s cost) using the construction machinery; and

• Hobson Gardens would be entitled to sell the construction machinery and deduct the net proceeds from Mainzeal’s liability to Hobson Gardens.

(The Step-in Rights)

In February 2013, the receivers gave notice to Hobson Gardens that they would not be completing the construction works and Hobson Gardens (validly) terminated the construction contract. Hobson Garden then asserted that it was lawfully in possession of the hoists.

The receivers argued that BNZ’s registered security interest in the hoists had priority over any security interest that Hobson Gardens may have had in them.

Hobson Gardens advanced a number of grounds which argued, in effect, that BNZ did not have an enforceable security interest in the hoists or, if it did, that it was defeated by Hobson Gardens interest.

The issues for the court to decide were, relevantly, whether Hobson Gardens had a security interest in the hoists and, if so, which of BNZ’s and Hobson Gardens’ security interests had priority.

The Decision

Collins J, in substance, made the following findings:

• The text and purpose of the relevant clause of the construction contract was clearly intended to secure performance by Mainzeal of its obligations, thereby giving Hobson Gardens a security interest in the hoists.

• Hobson Gardens failed to perfect its security interest by registration and seizing the goods is excluded by the Personal Property Securities Act 1999 (NZ) as a means of perfection by possession. Therefore, Hobson Gardens unperfected security interest was defeated by BNZ’s registered security interest and the receivers were entitled to take possession of the hoists.
Lessons for Australian Principals

Key messages:

The key message to take away from the McCloy case is that it is highly probable that, when the time comes for Australian courts to consider this issue, they will follow suit and find that step-in rights in construction contracts (and analogous rights) constitute a security interest within the meaning of the PPSA.

Importantly, two commonly used Australian Standard construction contracts (the AS 2124-1992 and the AS 4000-1997) both contain step-in provisions, although the wording is slightly different to the provisions of the New Zealand contract considered in McCloy. The provisions in the Australian contracts allow a principal to, in effect:

- Take possession of the contractor's equipment and materials, without compensation, in order to complete the construction works; and
- Following completion of the works, if there is any debt owing by the contractor to the principal and the contractor fails to pay the debt after reasonable notice, sell the contractor's equipment and materials to satisfy the debt.

Accordingly, to ensure that these provisions can be relied upon in the event of a default or the insolvency of the contractor, principals should proceed on the basis that step-in rights constitute a security interest in the contractor's property and should take action at the earliest opportunity to perfect their security interest.

Perfection should be effected by registration on the PPSR; although it is possible to perfect a security interest by taking possession of the relevant property, exercising step-in rights would likely amount to seizure and, as is the position under the New Zealand legislation, seizure is not a valid means of taking possession under the PPSA (see section 21(2)(b)).

Furthermore, if principals delay perfecting their security interests until they become entitled to exercise their step-in rights, they risk allowing the contractor to grant a security interest in the same property to a third party in the interim which, if perfected, would take priority over the principal's unperfected security interest in a priority dispute (as was the outcome in McCloy). On a related note, if there are existing security interests registered against the contractor’s property at the time of entering into the construction contract (e.g. a senior lender), it would be prudent for the principal to negotiate a priority (tripartite) agreement, to ensure that its security interest is given priority over the relevant goods to ensure that its step-in rights will be effective.

As a general rule, principals should ensure that their security interest is registered no later than 20 days after signing the construction contract. Otherwise, in the event that the contractor becomes insolvent within six months of the registration date, the security interest will be ineffective (s 588FL Corporations Act 2001 (Cth)). Importantly, principals needn’t wait until the construction contract is signed to register their security interest; under the PPSA, it is permissible to register as soon there are ‘reasonable grounds’ to believe that the construction contract will be entered into.

Meet the Team – Tom Lennox

Please tell us a bit about your practice and what you enjoy most about it.

I have a structured finance practice which involves typically working with the deal originators and providers of equity and mezzanine capital. I work with smart, entrepreneurial people who create value. It may well be a world of “creative destruction” but I like working with the creators.

The key to good client service is…

Delivering beyond expectations.

The most interesting deal I have worked on is…

Helping a friend escape bankruptcy by negotiating a compromise of debt.

The one gift I would like to receive this Christmas is…

An 18th Century edition of The Wealth of Natives (I won’t be getting it).

My New Year's resolution is…

Be calm amid the turmoil.

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