Guide to ensuring you have a valid Security Interest: Attachment & Perfection

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There is more to taking a security interest than simply entering into a security agreement. There are additional steps that must be taken in order to ensure that you have a valid security interest that takes priority over other security interests.

The *Personal Property Securities Act 2009* (Cth) **(PPSA)** sets out specific rules which must be followed in order for you, as a secured party, to protect your security interest and ensure that you do not lose your rights in the relevant assets secured. This guide discusses the enforceability of security interests and how you can ensure that you have a valid security interest.

SECURITY INTEREST

A security interest is an interest in personal property that secures payment of a debt or other obligation. The definition of a security interest under the PPSA incorporates standard forms of security such as mortgages and charges and also includes retention of title clauses in contracts, leases and bailments.

ENFORCEABILITY

For a security interest to be valid, it must:

1. have **attached** to the relevant assets secured; and
2. be **perfected**.

ATTACHMENT

A security interest must have attached to the relevant assets in order for the security interest to be enforceable against the **grantor** of the security interest.

A security interest **attaches** to collateral when:

1. the grantor of the security interest has rights in the collateral (this generally applies where the relevant assets are supplied to the grantor or are otherwise held by the grantor); and
2. the grantor accepts value (consideration) or does some other act by which the security interest arises.

Most commonly, a security interest arises when the parties enter into a security agreement and the secured party gives effect to the relevant arrangement contemplated, such as by supplying the relevant assets to the grantor, providing services to the grantor or loaning funds to the grantor.

PERFECTION

Even though a security interest may have attached to the relevant assets, it must be *perfected* in order for it to take priority over third party security interests. Perfection is the optimal form of protection for a secured party under the PPSA and is stronger than attachment alone. The perfection of a security interest will affect the priority it has relative to other security interests in the assets and its status in the event of the insolvency or bankruptcy of the grantor.

A security interest will be **perfected** if it:

1. has attached to collateral (as discussed above);
2. is enforceable against third parties; and
3. can be either registered on the Personal Properties Securities Register **(PPSR)** or the collateral is in the possession or control of the secured party.

Perfection is generally achieved by a secured party registering their security interest on the PPSR within certain timeframes.

Example – Failure to Perfect

An example of the effects of a failure to perfect is as follows:

1. John lends $50,000 to Simon.
2. The parties enter into a loan agreement and a general security agreement, under which Simon grants John a security interest over all of Simon's assets in order to secure the funds loaned.
3. John proceeds to loan the funds, and the security interest **attaches** to Simon's assets purchased with the loan monies.
4. John fails to register his security interest on the PPSR, and therefore does not perfect it.
5. Simon later obtains a loan from a third party bank, and that bank registers their security interest on the PPSR.
6. Simon becomes insolvent and does not pay either John or the bank back.
7. The bank will take priority over John, and will have first rights to seize and sell Simon's assets to recoup their money. Once the bank has been fully paid out, John will then share in whatever is left over (if anything).
8. If John had registered his security interest, he would have taken priority over the bank.

PRIORITY

As you can see from the above example, a perfected security interest takes priority over an unperfected security interest.

Priority between two or more perfected security interests is determined in favour of the earliest time of attachment, as is the case with two or more unperfected security interests.

KEY TAKEAWAY

A failure to ensure that you have a valid and enforceable security interest may ultimately result in you losing your assets or access to the grantor's property in the event of their insolvency. There are only two key steps to comply with, being attachment and perfection, however each step has its own technical intricacies which must be complied with. For example, when registering your security interest you need to ensure that you register it against the correct grantor identifier and correctly identify whether you have a purchase money security interest or not.

If you would like assistance with securing your interests under the PPSA, please contact our team today.