

Transitional period under the Personal Property Securities Act ends 31 January 2014 - implications for mining and resources operations and joint ventures

Mining & Resources Update

Overview

The enactment of the *Personal Property Securities Act 2009* (Cth) (PPSA) on 30 January 2012 saw the replacement of various Commonwealth, State and Territory legislation and securities registers, with a new regime governing the creation, registration and enforcement of securities that affect personal property in Australia.

The PPSA greatly expands the scope of transactions that constitute security interests in personal property. Many transactions that were not considered security interests under pre-PPSA law are security interests under the PPSA. Holders of these interests need to protect their rights to the personal property by satisfying specific requirements (for example, oral agreements will not be enforceable) and registering on the Personal Property Securities Register (PPSR). In particular, parties with ownership interests under retention of title arrangements, finance leases and certain operating leases and bailments are now holders of security interests. In addition, contracts which give one party a right to use the property of another and sell that property upon default to recover a debt, have also been found to constitute security interests.

If these new types of security interests were created, or contemplated by a contract entered into, prior to the PPSA's commencement, then a 2 year transitional period applies. Rights to the personal property subject to these security interests are preserved automatically throughout the transitional period allowing the holders time to identify their security interests and take steps to ensure that their rights continue beyond the transitional period. In most instances, the registration of a financing statement on the PPSR during the transitional period is the step that should be taken. The transitional period comes to an end on 31 January 2014. Failing to register before the end of 31 January 2014 could result in the holders of these interests losing the right to reclaim the personal property.

Who does this affect?

- Parties to contracts arising prior 30 January 2012 that create security interests for purposes of the PPSA.
- Joint venture parties.

Article Highlights

- The PPSA transitional period expires on 31 January 2014.
- The PPSA expands the scope of transactions that constitute security interests and should be registered under the PPSA.
- Common rights in mining joint venture agreements and other arrangements in the resources industry may require registration under the PPSA to protect interests in personal property.



Certain contractual rights under joint venture and other mining and resources related agreements that pertain to “personal property” may constitute security interests under the PPSA and should be registered to preserve rights to the personal property.

Consequences of failure to register

Failing to register may have significant adverse consequences on the holder of a security interest. It is important to note that the PPSA ignores the concept of title when determining which party has priority over personal property subject to security interests. If the holder of a security interest fails to register, then its rights will be defeated where the party who granted the security interest becomes insolvent. The holder of the unregistered security interest will not be able to claim the personal property from the insolvent party (even though the holder has title) and the property becomes available to satisfy the debts of the grantor’s unsecured creditors.

For example, a security interest is created if equipment is leased to a mine operator under a lease hire arrangement for a term of more than one year. If the lessor fails to register its security interest and the mine operator becomes insolvent, the lessor will lose its ownership rights in the equipment which then becomes available to satisfy the debts owed to the mine operator’s unsecured creditors. In addition, a competing secured creditor who registered general security over all the mine operator’s assets will have priority to the equipment over the lessor’s unregistered security interest.

The PPSA and the resources industry

The PPSA applies to “security interests” in “personal property”. “Personal property” is defined to include any form of property (including a licence) other than land and certain statutory rights and authorities that have been declared by law not to be personal property for the purposes of the PPSA. The definition of “security interest” is also very broad extending, with certain exceptions, to any interest in personal property that, in substance, secures payment or performance of an obligation.

Security interests such as mortgages and caveats over mining licences and leases are not subject to the PPSA because exploration, mining and other licenses and leases created under mining and resources legislation have been declared by each of the States and Territories not to be personal property for the purposes of the PPSA regime. However, various contractual interests in mining and resources projects (including joint ventures) relate to personal property and may be subject to the PPSA.

Joint ventures

The PPSA regime applies to certain contractual arrangements that have traditionally been viewed as security interests such as joint venture cross

Contact



Will Moncrieff
PARTNER

t: +61 8 9426 6605
e: wmoncrieff@jacmac.com.au



Hilary Hunt
PARTNER

t: +61 8 9426 6623
e: hhunt@jacmac.com.au



Tim Williams
SENIOR ASSOCIATE

t: +61 8 9426 6886
e: twilliams@jacmac.com.au



charge arrangements. Importantly however, certain additional contractual rights in respect of mining and resources projects and joint venture agreements that were not previously considered security arrangements may now constitute security interests under the PPSA.

- **Farmin rights**

If a Farmin Agreement specifies that a party can earn a 10% interest in a joint venture project upon carrying out certain works or paying certain monies and the project contains personal property, the party should register its interest in that 10%. This will ensure that it can exercise its right to require the property to be transferred to it in priority to other interested creditors and to ensure those future ownership rights are not lost upon an insolvency.

If a Farmin Agreement specifies that a party is granted a 10% interest in a second party's property (i.e. property which includes personal property) with a provision for the first party to transfer that property back if work is not carried out or payment is not made, the second party would need to register its interest in that 10% interest in order to ensure that it could exercise its right to require the first party to give the property back in priority to other interested creditors and to ensure those future ownership rights are not lost on an insolvency.

- **Acquisition rights on default**

A joint venture agreement providing rights to a joint venturer to acquire and deal with a defaulting joint venturer's interest in the joint venture project is likely to constitute a security interest since moneys recovered from the sale of the joint venture interest would normally be applied to rectify defaults in performing a task or in payment of unpaid cash calls.

- **Acquisition rights in a non-default scenario**

If a buy-out right has the effect of allowing a third party (normally the other joint venturer) to acquire personal property at a discount to market value then these rights bear the hallmarks of a security interest because they enable a third party to essentially 'take' some personal property for no consideration and therefore dilute the rights that other secured creditors thought they had in a share of the assets of a joint venture party. For example, a bank funding a joint venture party would anticipate that the party's interest in product would be something that would fluctuate from time to time. However, it would not anticipate that core assets comprising key equipment could be taken by another party in priority to its interest as secured creditor. In the Bank's eyes, the exercise of that right to buy at a discount has the same impact as a prior competing security interest. This right could therefore constitute a security interest despite the fact that any funds received were not going to be applied to reduce a debt owing



to the acquirer. As an aside, whilst a Bank in the example mentioned could run an argument that it did not release its security interest from the personal property in question, most Banks expressly or impliedly permit the joint venture parties to carry out any transaction contemplated by the joint venture agreement and so would not easily win that argument.

- **Dilution rights**

Dilution rights under a joint venture agreement are likely to constitute a security interest because these rights are normally triggered upon a default and the proceeds of payment are used to first pay off unpaid cash calls of the defaulting party. However, even if these rights were triggered due to failure to perform and the proceeds were not used to repay a debt owing to the acquirer, they still bear the hallmarks of a security interest because they enable a third party to essentially ‘take’ some personal property for no consideration and therefore dilute the rights that other secured creditors thought they had in a share of the assets of a joint venture party.

- **Rights to withhold product or proceeds of product**

A security interest may arise in the product and/or proceeds in a scenario where one joint venture party has the right to withhold proceeds of product otherwise due to them because it is likely that the proceeds of the product are often first applied in satisfaction of outstanding cash calls owing to that joint venture party.

- **Drag along rights**

A joint venture agreement that provides for the majority joint venturers seeking to sell their interests in a joint venture to also compel the sale of the minority joint venturers’ interest may also create a security interest because the minority joint venturer’s interest could be seen as securing the right of the majority joint venturer to purchase the interest.

The broad definition of “security interest” gives rise to significant grey areas and not all commentators agree that the PPSA will apply to all the interests discussed above. Nevertheless, it is best to err on the side of caution given the dire consequences of not registering. It is advisable, therefore, to register these interests in order to adequately protect the rights of the holder.

Even if a security interest is registered, it will not grant the security holder priority over other interested creditors under the PPSA regime unless the security agreement is in writing. Therefore, parties which enter into informal joint venture or contractual arrangements or make ad hoc verbal changes to those arrangements, including agreements for the resolution of disputes, will not be able to protect their security interests solely through registration. Parties to those arrangements should therefore ensure



that all agreements, side arrangements and related dispute resolution agreements which may possibly create a security interest over personal property are formally documented in writing.

Other common contractual arrangements

Other than joint ventures, the PPSA regime affects many other arrangements that are common in the mining and resources industry. These include:

- **Retention of title arrangements**

Offtake arrangements may contain retention of title rights in product comprising personal property which will constitute security interests in favour of the owner of the product.

The PPSA enables a holder of a registered retention of title arrangements to enforce its security interest against a share of any co-mingled product to the value of the product at the time the product was co-mingled. This may have particular application to:

- gas balancing arrangements where one party is over-lifting and taking more than its entitlement of gas, while a second party has a priority right to that gas because the second party had under-lifted; and
- sole risk operations where a successful sole risk party becomes entitled to a specified amount of a nonparticipating party's share of production in satisfaction of the agreed risk premium for having undertaken the operation as its sole risk.

- **Assignments of receivables**

Receivables such as cash flows from sales of goods are personal property under the PPSA. Therefore, contracts which provide for the assignment of receivables (whether as security or an outright assignment) create a security interest in favour of the assignee which should be registered under the PPSA.

- **Royalty interest**

A royalty interest constitutes personal property under the PPSA. Therefore, any security interest over a royalty interest including the granting or assignment of a royalty to secure performance under a joint venture or other contractual arrangement will create a security interest and should be registered.

- **Leases and bailments of plant and equipment**

The PPSA removes the legal distinctions between the rights of parties under certain finance leases, hire purchase arrangements, operating leases and bailments. An owner of goods that is entering into any kind of lease or bailment arrangement for a term of 1 year or more (or



90 days or more if the lease or bailment relates to a motor vehicle, aircraft or watercraft) is a secured party for the purposes of the PPSA and the lessee or bailee is treated as granting a security interest in the plant and equipment. The owner will lose its rights as owner of the plant or equipment if the owner fails to register at the time the lessee or bailee becomes insolvent.

Confidentiality of contracts

When considering whether or not contractual rights in mining contracts could constitute security interests, the parties should also consider whether or not the contract which houses those contractual rights contains price sensitive information which should be kept confidential whenever possible. If so, the parties should ensure that these contractual rights are separated out into an isolated document so that competing creditors can only compel disclosure of that particular document. It is common practice to also include a number of protective provisions which address rights to “contract out” of certain provisions of the PPSA.

Conclusion

Contracting parties and joint venture participants should review contracts entered into prior to 30 January 2012 to identify any arrangements that may now constitute security interests for PPSA purposes and register those security interests before the end of the transitional period on 31 January 2014.

Parties entering into new contractual arrangements should consider whether security interests exist under those agreements, and if so, register those security interests within the applicable timeframes required under the PPSA.

Even if a party discovers that a contract entered into prior to 30 January 2012 contained a clause that could have been registered before the end of the transitional period, it is still possible to register after the transitional period ends. It is not mandatory to register within a certain period of time (as it was under the old ASIC regime). The consequences of failing to register as early as possible only impact the priority position of the secured party. However, a secured party should register as soon as it becomes aware of the oversight because they can then establish their priority position ahead of other parties which might have an interest in the personal property but have not yet registered that interest.

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Contact Us

t +61 8 9426 6611 **f** +61 8 9321 2002 **e** jacmac@jacmac.com.au
a Level 25, 140 St Georges Terrace, Perth, Western Australia 6000
GPO Box M971, Perth, Western Australia 6843