The new Australian Personal Property Securities Act: aviation finance issues

A major reform of personal property securities in Australia began on 30 January 2012, and the current law and practice in Australia relating to security interests over personal property (ie most property other than land) will change.

The reforms affect a wide range of services and businesses in a broad range of sectors, including, in particular, the banking and finance sectors, together with sectors not previously subject to security registration regimes.

In addition, the reforms have specific implications for particular industry groups, including the aircraft finance and leasing industries.

Overview

As part of the personal property securities reform package, the Personal Property Securities Act 2009 (Cth) (PPSA) establishes a national system for the registration of security interests in personal property, whether given by a company or a natural person, together with new rules for the creation, priority and enforcement of security interests in personal property.

The new, centralised Personal Property Securities Register (PPS Register) established under the PPSA regime has replaced many of the existing Federal, State and Territory based registration regimes and registers.

When does the PPSA apply?

The PPSA applies to a security interest in goods or financial property if:

- the goods or financial property is located in Australia; or
- the grantor is: an individual located in Australia; a company *or registrable Australian body (within the meaning of the Corporations Act 2001 (Cth));* a corporation sole established under Australian law; or a State, Territory or Australian government authority or agency.

Scope of registrable interests

Relevantly, as foreshadowed, the PPSA makes registrable as security interests certain transactions which are currently not registrable.

In addition to conventional securities such as mortgages, charges and pledges, the concept of "security interest" under the PPSA now also encompasses:

- transactions that, in substance, secure payment or performance of an obligation, irrespective of form. For example: hire purchase agreements, finance leases, conditional sale arrangements (including agreements to sell

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subject to retention of title), goods leases, trust receipts and transfers of title; and

- certain other transactions (whether or not they in substance secure payment or performance of an obligation) including a transferee's interest under a transfer of an account (such as a transfer of a receivable) or chattel paper, commercial consignments and certain lease and bailment arrangements relating to goods.

Many of the arrangements included within the broader concept of security interest under the PPSA may be found in general commercial documentation, which may therefore require registration.

Some personal property which is identified by a unique serial number, such as aircraft and aircraft engines, motor vehicles, watercraft and certain intellectual property should be specifically identified by serial number when notice of a security interest over such items is registered under the PPSA. The failure to do may result in the priority contemplated by the secured party to be lost to third parties, or the PPSA registration may be ineffective.

How the PPSA affects aircraft finance and the aviation industry

The PPSA will affect all forms of aircraft finance, such as secured loan transactions, bailments, operating and finance lease arrangements and hire-purchase arrangements (including hybrid arrangements, such as leveraged lease arrangements and cross-border leases).

Definition of "aircraft"

"Aircraft" is defined in the Personal Property Security Regulations 2010 (PPSR) such that it combines the concept of "aircraft equipment" under the Cape Town Convention[i] (Cape Town Convention). Accordingly, the definition extends to aircraft engines, airframes (including technical records, installed parts, accessories and equipment, other than engines and helicopters) (each as defined in the Cape Town Convention).[ii] Generally:

- aircraft certified to carry at least eight persons, or goods exceeding 2.75 tonnes; or
- smaller aircraft having nationality and registration marks assigned to them under the Chicago Convention,[iii]

will fall within the definition of "aircraft" under the PPSR. Aircraft used for military, customs or police services are excluded.

Jurisdiction

In addition to the general PPSA jurisdictional provisions, the PPSA contains specific jurisdictional provisions that affect aircraft arrangements.

Although the general rule under the PPSA is that the validity of security interests in 'goods' (which includes aircraft) is governed by the law of the jurisdiction in which the goods are located when the security interest 'attaches' (ie, the moment where a security interest is recognised against the particular goods defined in a security agreement), when goods are of a kind normally used in more than one jurisdiction and are not used predominantly for personal, domestic or household purposes, the relevant jurisdiction will be based on the location of the 'grantor' when the security interest attaches to the goods.

International commercial aircraft (and their engines) are an obvious category of such goods. The position is complicated when aircraft are of a type that are capable of flying internationally but are, in fact, flown predominantly domestically. In this circumstance, we expect the market will adopt a conservative approach and register their interests under the PPSA.

Where a grantor of a security interest over aircraft is located in Australia, Australian law will govern the security interest if that is expressly provided in the security agreement.

Impact of PPSA on various types of aircraft lease finance

Aircraft lease finance (whether bailment, operating lease, finance lease, hire purchase, etc) will involve the greatest change under the PPSA as compared with the pre-PPSA position.

If a type of lease finance arrangement in substance secures the payment or performance of an obligation, the interest of the owner/lessor of the aircraft will be deemed, under the PPSA, to be a security interest in the aircraft by the operator/lessee.

Some bailments or operating leases may not secure the payment or performance of an obligation. Those arrangements will not be deemed to involve a security interest unless they qualify as PPS leases.

If a lease or bailment is for a period of 90 days or more (including for an indefinite period), then provided the aircraft or engine is described by their respective serial numbers in accordance with the PPSR, such lease or bailment will be a PPS lease. If such an arrangement is a PPS lease, then it will be a deemed security interest under the PPSA and will fall within the system of priorities set out in the PPSA.

Generally, a PPS lease of an aircraft will be a 'purchase money security interest' (PMSI). PMSIs are afforded a "super priority" under the PPSA. Generally, the rationale is that it would be inequitable to allow a prior secured party a windfall increase in its security value brought about not with the debtor's money or new funds injected by the prior secured party but with the financing provided by a later secured party.

The implication is that the default priority rules in the PPSA are altered such that the holder of a PMSI perfected (ie, a registered PMSI on the PPS Register) later in time prevails over an earlier perfected security interest that is not a PMSI.

Aircraft operators commonly prefer to retain their direct contractual nexus with the aircraft manufacturer and to acquire title initially when the aircraft is delivered, then to on-sell the aircraft to the lessor and to lease it back. Such a sale and lease-back is excluded from being a PMSI under the PPSA.

However, in order to protect itself, a lessor could achieve equivalent security position (ie, priority over a prior-registered all assets security granted by the operator) by having a priority deed with the prior secured party.

Transitional issues – hire purchase and lease arrangements

For existing hire-purchase or lease transactions, the transitional provisions of the PPSA allow a period of 24 months in which the lessor can register its security interest under the PPSA and maintain its priority position.

It is crucial that lessors register their arrangements or otherwise perfect them under the PPSA before the expiry of the 24-month transitional period (and, preferably as soon as possible). In addition, to gain the protection of registration by serial number, an aircraft financier/lessor will also need to lodge separate notices of its security interests (ie, financing statements) for the airframe and each engine.

Impact of PPSA on aircraft secured loan finance

The implications of the PPSA on secured loan arrangements to finance aircraft, although significant, are less significant than those affecting aircraft lease financing arrangements.

A vanilla secured loan arrangement to finance an aircraft will typically involve a chattel mortgage over the aircraft or an all assets security (ie, a pre-PPSA fixed and floating charge) over all of the assets of the operator.

These arrangements will involve a security interest in the aircraft and, provided the loan proceeds are used to fund the acquisition of the aircraft, the security interest will be a PMSI.

Transitional issues – aircraft secured loan finance

Existing aircraft secured loan finance transactions involving an Australian operator will generally involve an existing registered charge under the Register of Charges established under the Corporations Act 2001 (Cth). These charges were migrated to the PPS Register on 30 January 2012.

However, the migration itself does not solve the issues for a financier. For instance, migrated charges will not be registered by reference to the serial numbers of the relevant aircraft the subject of the charges.

To gain the protection of registration by serial number, an aircraft financier will need to lodge for registration on the PPS Register separate financing statements for the airframe and each engine prior to the expiry of the 24-month transitional period.

Questions or comments?

If you require any assistance in understanding the impact of the PPSA and how to manage the transitions (including assistance in determining what security interests need to be registered for each aircraft and aircraft engine in respect of completed or new transactions), please contact any of the authors of this briefing, or your usual Clifford Chance adviser.

[i] *Cape Town Convention on Matters Specific to Aircraft Equipment, Cape Town, 16 November 2001, being a Cape Town Convention to the Convention on International Interests in Mobile Equipment, Cape Town, 16 November 2001 (Cape Town Convention).*

[ii] *Although the PPSR definition duplicates various definitions from the Cape Town Convention, the Australian Government has not acceded to the Cape Town Convention. The Australian Government released a consultation paper in 2010 and is currently considering whether to accede to the Cape Town Convention.*

[iii] *Convention on International Civil Aviation, Chicago, 7 December 1944, as amended by the applicable Cape Town Conventions.*

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