

Urgent Notice to Landlords:

To protect yourself from your tenant's default your security deposits/bonds and other security interests created under commercial leases need to be registered on the PPS Register.

We have received many queries from lawyers, accountants, estate agents and others who are involved in advising and managing the affairs of their landlord clients as to whether security deposits and other security interests created under commercial leases should be registered on the PPS Register.

We set out below a selection of the most Frequently Asked Questions and Answers identifying what is and what is not a "security interest" under a standard commercial lease that should be registered on the PPS Register.

We also provide some guide on how to go about registering such interests. We hope that the following FAQs will assist you in advising your clients.

1. Do you recommend that a landlord should register a financing statement to protect their rights to a security deposit or bond on the insolvency of their tenant?

Yes, we recommend that where a security deposit or bond is paid, a landlord should register their security interest against the tenant. This is because it is strongly arguable that by setting aside the funds to meet its lease obligations to the landlord, the tenant has established rights in its property that are intended to secure its lease obligations. The security deposit and bond arrangements are therefore a security interest for the purpose of the *Personal Property Securities Act 2009 (Cth) (PPSA)*. If that security interest is not registered on the PPS Register, it is probable that on insolvency of the tenant, the landlord will have to return the funds to the tenant's Administrator, Receiver or Liquidator.

2. In which collateral class should the landlord register to protect its security deposit or bond?

The security deposit or bond will result in either:

- (a) An unsecured claim of the tenant against the landlord for return of an amount equal to the deposit or bond (where the monies are held by the landlord or their agent); or
- (b) A claim to return of moneys held in a bank account into which the security deposit or bond was paid (where the monies are held in a bank account).

In each of these situations, the landlord should ensure that it properly registers its security interest in the correct collateral class.

NOTE: If an incorrect class is entered on the financing statement, the registration may not be effective and enforceable.

We are aware that there is divided opinion among legal practitioners as to which is the correct collateral class for security deposits and bonds to be registered. Landlords and their advisers should seek their own legal advice to ensure that they correctly record the correct collateral class and collateral descriptions when registering their interests in their security deposits and bonds.

Subject to the above qualifications, where there is only a security deposit or bond involved securing payment of rent (and no other personal property is to be the subject of a security interest claim) it is our view that a landlord should register their security interest in the collateral class "Intangible Property" and in the collateral sub- class "General Intangible". The collateral description in the financing statement should be carefully crafted to suit the particular lease arrangements that are made between the landlord and the tenant regarding the deposit/bond monies.

3. In which class should a landlord register to protect their interests where there is also other personal property involved?

In situations where payment of rent is secured not only by the deposit but also by rights to deal with other property of the tenant, it may be necessary to register the landlord's security interests in other collateral sub-classes and use other collateral descriptions.

This may be necessary where the personal property to which the landlord has access includes, for example: (a) fixtures that a tenant is entitled to remove (which may be personal property), (b) chattels such as tools and furniture belonging to the landlord that are in the possession of the tenant and (c) rights conferred on the landlord to get access to tenant's insurances (eg by being noted on the policies).

In such cases legal advice should be obtained to ensure that the correct collateral sub-class and descriptions are used having regard to the terms of the particular lease.

4. Will registration give the landlord priority in relation to the security deposit/bond and other personal property?

Registration of the security deposit/bond and other personal property will give the landlord priority over the unsecured creditors of the tenant in the event of the tenant's insolvency, administration or liquidation.

If there is a prior registered secured party with rights over this category of property (for example, a bank with a general security agreement or charge over the tenant's assets), in order to obtain first ranking rights to the security deposit, the landlord should obtain a short priority agreement with the bank. This could be in a letter format. If the deposit/bond is paid into a bank account, the landlord may also need to obtain a letter from that bank postponing its rights in relation to the bank account in favor of the landlord.

5. Should bank guarantees and/or personal guarantees given in support of a lease be registered?

No, a bank guarantee is a contractual promise to pay and does not create a security interest for PPSA purposes. Similarly, a personal guarantee in a lease only creates contractual rights against the guarantor and does not give the landlord any interest in the guarantor's property. Accordingly, it also does not create a security interest under the PPSA.

6. What about property that is left behind at the end of a lease? Should the landlord register their interest in such property?

This type of right in a lease can create a security interest. But often there is no need to register this type of security interest because the relevant clause of the lease simply affirms the right of the landlord to exercise its remedy of distraint against the tenant's goods. In that case it is a security interest to which the PPSA does not apply (section 8(1)(b) or (c) depending upon which State or Territory we are talking about).

Different considerations apply if the clause in the lease contains its own remedies of sale or dealing with the property that go beyond the right to the remedy of distraint (see paragraph 7 below).

7. Is a security interest created where there is a clause in a lease that allows the landlord to sell any property that the tenant leaves behind at the end of a lease and to use the proceeds to either reduce the tenant's debt or to use the proceeds in satisfaction of the tenant's obligations under the lease?

Yes, a security interest is created with such a clause secures the payment of obligations of the tenant under the lease and therefore the better view is that the security interest should be registered.

8. Should landlord fit outs be registered?

Yes, to the extent that the fit out involves personal property that are not fixtures in premises leased for one year or more or where the lease is for an indefinite term. The PPSA does not apply to property that is properly described as "a fixture".

However, if the property is not attached to the land (such as before installation and after removal) they become subject to the PPSA and should be registered.

Even if the fit out is a fixture, it is also advisable for the landlord to register if the lease includes a contractual right for the tenant to remove the fit out in certain circumstances. This could occur, for example, if the fit out was installed in the premises at the landlord's expense as part of an incentive to the tenant to occupy the premises, and if the tenant is entitled to remove the fit out on expiry of the lease. In that case it is arguable that the parties have contractually elected to treat the fit out as if it was not a fixture (and it should therefore be properly characterized as personal property).

9. Should a lease incentive be registered?

Generally speaking the answer is "no". If the amount is paid in cash to the tenant, or if there is a rent free period under the lease, there will be no property of the tenant to which the landlord will have access to satisfy obligations owed by the tenant.

If an incentive is to be paid in cash at some later date by the landlord to the tenant (for example, if the tenant performs under the lease for a certain period), depending on how the relevant clause is drafted, the right to the incentive may be a "flawed asset" of the tenant. If it is a flawed asset, and if it is intended that it should not be payable where the tenant is in default, the safe course is for the landlord to register.

10. Should retention sums held under construction contracts be registered?

Yes, while not strictly a lease issue, when a landlord undertakes a fit out for a tenant or constructs new premises for them, they sometimes need to hold money back under their construction contract with the builder. These monies are held to meet obligations arising the contract (namely, to meet the costs of a default or expenses incurred or to be incurred from a default by the builder). The monies, therefore, are intended to secure obligations of the builder under the contract and therefore are a security interest that should be registered under the PPSA.

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Should you have any queries regarding any of the above matters, please do not hesitate to contact the authors. In particular, they can advise you on the class in which you should register the landlord's security interest, suggest appropriate PPSA wording for the collateral description required for your registrations and assist you in drawing any necessary PPSA lease terms or priority agreements that may be required. They can also advise you on any other PPSA queries that you may have from time to time.

(FAQs re security deposits under commercial leases 30 Sept 2014)