Australian
Construction Law
Bulletin

Personal Property Securities Act — priority contest between secured lender and developer over builder's on-site personal property

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Background

Where a construction company has entered into a general financial agreement with its banker or other financier such agreement will often result in the financier acquiring a security interest over the personal property of the builder, including personal property used by the builder on its building sites. In those circumstances the financier will have obtained a security interest within the meaning of the Personal Property Securities Act 2009 (Cth) (PPSA), and to perfect and protect its security interest will need to register its interest on the register established under the PPSA.

Significantly, such property of the builder utilised on building sites may also be the subject of a "builder's default" clause commonly found in construction contracts between builders and developers. Typically such default clauses provide that where the developer is entitled to terminate the construction contract on grounds of the builder's default, for example, where the builder becomes insolvent:

- the developer is entitled to take control of the building works;
- the builder's interest in the materials, fittings, construction machinery and equipment on the site is transferred to the developer;
- the developer may employ any other person to complete the contract work using the materials, fittings, construction machinery and equipment for that purpose; and
- the developer may sell any surplus materials, fittings or construction machinery and equipment. The net proceeds are to be deducted from the builder's liability to the developer.

The effect of such default clauses is to secure for the developer the payment or performance of an obligation by the builder. Such security, in so far as it attaches to the builder's personal property, amounts to a "security interest" within the meaning of s 12(1) PPSA (Cth). As a consequence developers will need to be aware of the requirements of the PPSA to ensure that their security interest is protected and perfected under the Act.

From the above it is apparent that, in the event of the builder's insolvency, a competition may arise between the respective security interests of the financier and developer with regards to the on-site personal property of the builder.

This issue arose for consideration in a recent New Zealand case, *McCloy v Manukau Institute of Technology*.[1] The New Zealand court's resolution of this issue has relevance for Australian financiers and developers given the similarity between the New Zealand and Australian PPSA legislation with respect to the future use of "builder's default" clauses.

McCloy v Manukau Institute of Technology

Facts

In this case the construction company became insolvent and went into receivership before it had completed building works. Prior to the appointment of the receivers the construction company had placed two hoists on to the exterior of the building under construction. All assets of the builder, including the hoists, were the subject of a security agreement between the builder and its banker, Bank of New Zealand (BNZ). The security agreement had been registered under the PPSA (NZ) by the banker.

Significantly, under the terms of the building contract, in the event that early termination occurred as a result, inter alia, of the insolvency of the builder, the rights to "materials, fittings, and construction machinery on the site" was transferred to the developer. Thereafter the developer was entitled to use the property to complete the works, and, in due course, sell the property applying net proceeds in reduction of the builder's liability to the developer.

On 20 February 2013, the receivers gave notice to the developer that they would not continue the construction work. The following day the developer gave formal notice to the receivers that the construction contract was at an end. In its notice the developer also advised that in

accordance with the construction contract it was now lawfully in possession of the hoists.

The receivers then filed an application for directions with the court under which they raised the following questions:

- does BNZ have a security interest in the hoists owned by the builder prior to it being placed in receivership;
- what interest does the developer have in the hoists; and
- if the developer and BNZ both have security interests in the hoists which of those security interests has priority?

Findings of the court

In response to the receivers' application the court arrived at the following conclusions:

- Both parties had security interests in the hoists within the meaning of the PPSA (NZ) (see also, s 12 PPSA (Cth)). It was therefore necessary to determine which party's security interest had priority.
- Under the PPSA (NZ) the priority rules state that where security interests are perfected the first to register or the first to take possession has priority (see also, ss 55(4) and (5) PPSA (Cth)).
- In this case it was arguable that the BNZ had perfected its security interest by registration while the developer had perfected its security interest by acquiring physical possession of the hoists on 21 February 2013.
- However, under the PPSA (NZ) seizures or repossessions are excluded from actions that constitute acquiring possession for the purposes of perfecting a security interest (see also, s 21(2)(b) PPSA (Cth)). On the facts of this case the actions of the developer amounted to seizure of the hoists.
- As a result it was BNZ only that had a perfected security interest, which under priority rules prevailed over an unperfected security interest (see also, s 55(3) PPSA (Cth)).
- In any event if the developer had perfected its security interest by taking possession on 21 February 2013 that date was well after the dates BNZ had perfected its security interest by registration, such that BNZ's perfected security interest being first in time would prevail.

As a consequence the receivers were entitled to take possession of the hoists and exercise all of BNZ's rights in respect of the hoists. As previously stated this decision is of relevance for Australian financiers and developers given the similarity between the NZ and Australian legislation on the issue under consideration.

One difference that should be acknowledged relates to "builder's default" clauses in existence prior to the commencement date of the PPSA (Cth), 30 January 2012. With respect to pre-existing "builder's default" clauses which were not deemed to be security interests prior to the introduction of the PPSA (Cth), consideration needs to be given to transitional provisions introduced by the Act. Under the PPSA (Cth), temporary perfection has been bestowed on such security interests for a two year transition period without reliance on perfection by either registration or possession. However, "builder's default" clauses entered into after the 30 January 2012 will not have the benefit of transitional provisions and will be subject to the normal operation of the PPSA (Cth). Given that the focus of this paper is on the consequences of the PPSA (Cth) for the future use of "builder's default" clauses, a full account of the implications of temporary perfection under transitional provisions is not appropriate for present purposes.

Conclusions

The *McCloy* case is an informative decision from New Zealand on a number of fronts. First, the case reinforces the approach that both the New Zealand and Australian PPSA enactments adopt when defining "security interest", ensuring that all transactions that function to secure debt or performance of an obligation are caught by the security interest concept. In functional terms "builder's default" clauses in construction contracts, in so far as they attach to a builder's personal property, secure payment or performance of obligations, and, accordingly, constitute a security interest under the PPSA in the same manner of more conventional security interests.

Next, the case reviews the significance of priority rules, and the critical concept of perfection in ensuring effective priority ranking. With respect to perfection under the PPSA the case recognizes the possibility of perfection by possession, but importantly the exclusion of seizure or repossession from the meaning of possession is well-illustrated by the case.

Finally, the case encourages developers and their advisors to review the future effectiveness of "builder's default" clauses in construction contracts in light of PPSA concepts that clearly have a direct and significant impact on the intended operation of such clauses.

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Footnotes

1. *McCloy v Manukau Institute of Technology* (2013) NZHC 936, 1 May 2013.