

Double and triple cocktails under the PPSA: shaken but not stirred?

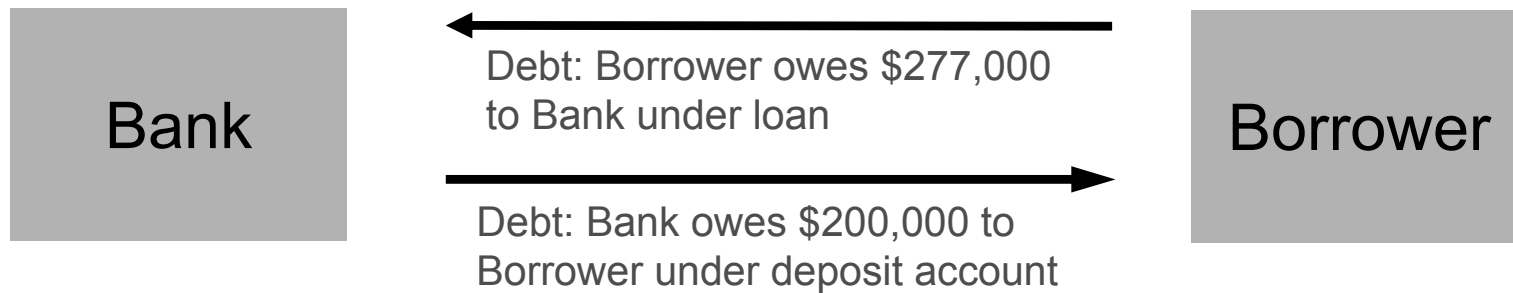


Banking & Financial Services Law Association 28th Annual Conference 2011
6 August 2011
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What this presentation is about

- impact of the PPSA on double cocktails and triple cocktails

Double cocktail



Flaw

Bank need not repay deposit until Borrower repays loan

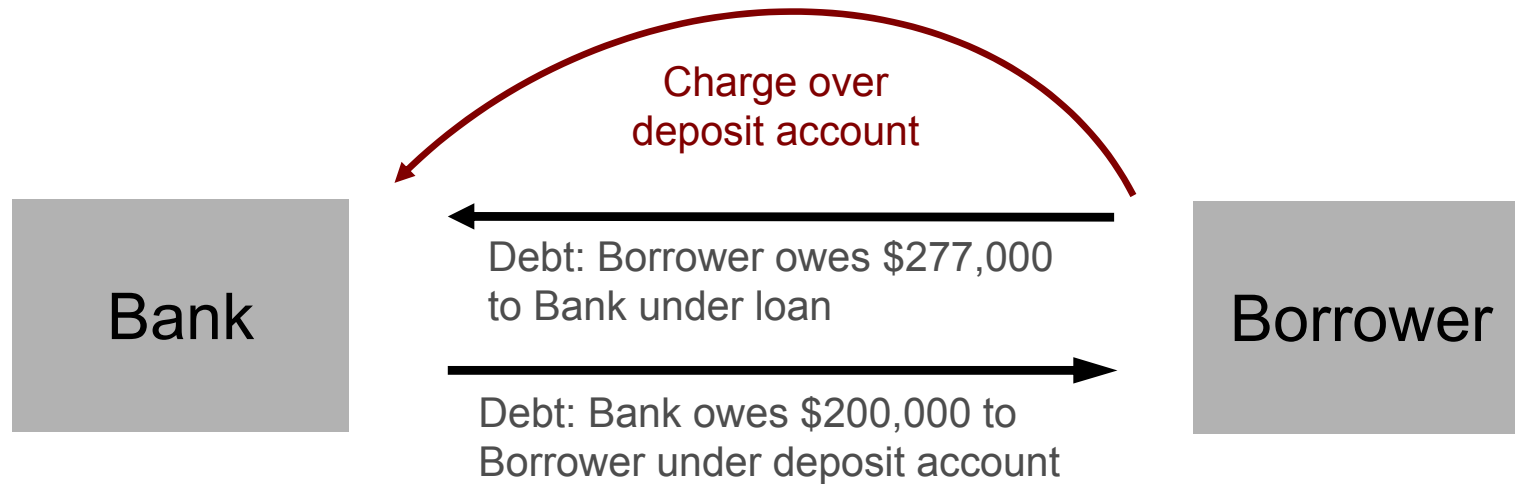
Set-Off

If Borrower defaults in repayment, Bank may set-off deposit against amount owed by Borrower

Restriction on transfer

Borrower may not transfer interest in deposit account without Bank's consent

Triple cocktail



Flaw

Bank need not repay deposit until Borrower repays loan

Set-Off

If Borrower defaults in repayment, Bank may set-off deposit against amount owed by Borrower

Charge-back

If Borrower defaults in repayment, Bank may set-off deposit against amount owed by Borrower

Restriction on transfer

Borrower may not transfer interest in deposit account without Bank's consent

Elements of double and triple cocktail - analysis

Element	Current law	PPSA
Flaw	Not a security interest	Security interest: s12(2)(l)
Set-off	Not a security interest	PPSA does not apply: s8(1)(d)
Charge-back	Conceptually impossible	Expressly permitted: s12(3A) and 12(4)(b)
Restriction on transfer	Effective	Ineffective: s79

What is a security interest under the PPSA?

A ***security interest*** means an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property): s12(1).

For example, a ***security interest*** includes an interest in personal property provided by any of the following transactions, if the transaction, in substance, secures payment or performance of an obligation:...

a flawed asset arrangement: s12(2)(I)

A little background....

There is no creditable explanation for the random arrangement... From time to time someone would think of a new point and a new sentence would be thrown into the hopper. Fortunately, no real harm seems to have been done; except for its untidy appearance and the bewilderment it may cause the unfamiliar reader, the ramshackle structure holds together reasonably well.

Grant Gilmore

Flawed asset arrangement

- can it be argued that a flawed asset arrangement can never satisfy the definition of a security interest because it only gives the financier contractual rights and does not create a proprietary interest in the deposit account?

Arguments that a flawed asset arrangement is a security interest

- unclear what “interest” means
- expressly included as example of a security interest
- using pre-PPSA principles in a post-PPSA world
- compare to charge-back
- compare to set-off
- Canadian Supreme Court decision in *Drummond* case

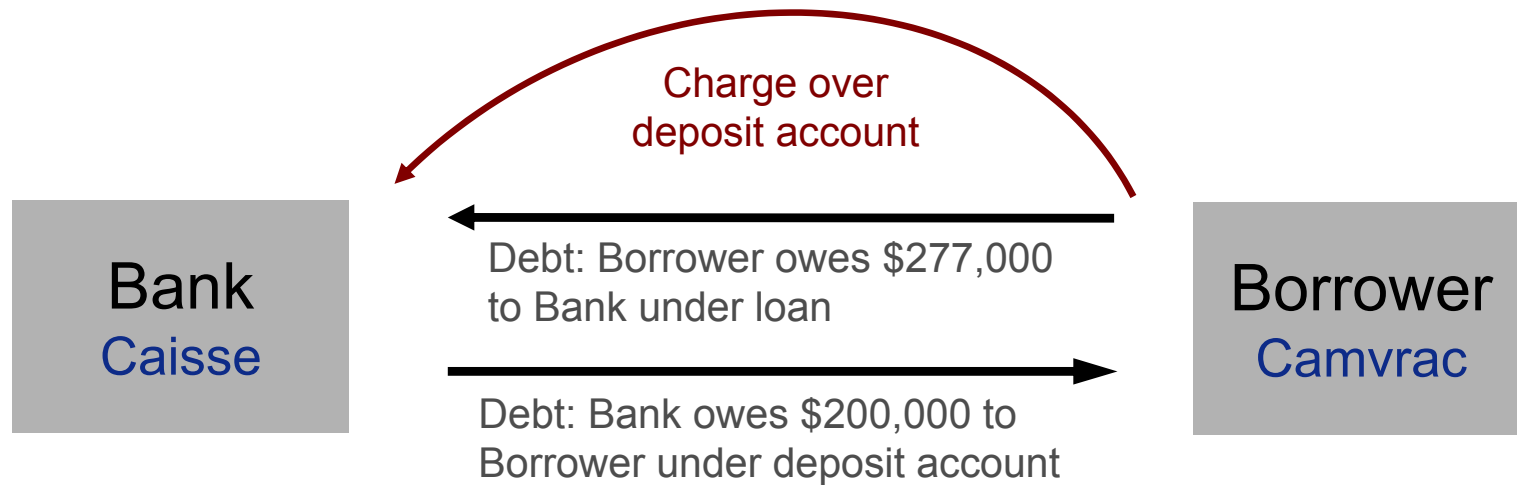
Caisse populaire Desjardins de l'Est de Drummond v Canada
[2009] 2 SCR 94 (“*Drummond case*”)

Supreme Court of Canada held that a double cocktail gave rise to a “security interest” within the meaning of a federal tax act

Why is this a big deal?

- tax act definition is in substance the same as the definition of security interest under Canadian (and NZ and Australian) PPS legislation
- the tax act did not include any express reference to a flawed asset arrangement

Drummond case – the facts



<p>Flaw</p> <p>Bank need not repay deposit until Borrower repays loan</p>	<p>Set-Off</p> <p>If Borrower defaults in repayment, Bank may set-off deposit against amount owed by Borrower</p>
<p>Restriction on transfer</p> <p>Borrower may not transfer interest in deposit account without Bank's consent</p>	

Charge-back

If Borrower defaults in repayment, Bank may set-off deposit against amount owed by Borrower

Drummond case – how did it happen?

- considered all the relevant terms of the agreement
- question is not whether set-off alone is a security interest
- must assess whether the agreement functions as a security interest

Drummond case – what the majority said

Rothstein J

- the flaw and restriction on transfer (and the obligation to maintain deposit account) created rights and obligations to ensure the bank would remain liable to the borrower if the bank had to resort to set-off as a remedy
- these rights were “encumbrances” that created an interest in the borrower’s property
- the agreement secured the bank’s right to effective set-off by conferring on the bank an interest in the property

Drummond case – what the minority said

Deschamps J

- security interest requires bank has a proprietary interest in the deposit account
- combination of personal rights (flaw plus set-off) does not create a proprietary interest

Consequences of double cocktail being a PPSA security interest

- perfection
- impact on insolvency set-off

Perfection

- secured party is not required to register (or otherwise perfect) a security interest but failure to do so exposes it to priority, “taking free” and insolvency risk
- if financier decides that it does want to perfect its security interest in the deposit account, how it should do so depends on:
 - ⇒ nature of the deposit account
 - ⇒ identity of borrower
 - ⇒ whether double cocktail entered into before (“**pre-PPSA double cocktails**”) or after PPSA registration commencement time (“**post-PPSA double cocktails**”)

Perfection

If financier is ADI and deposit account is an ADI account:

- automatically perfected with control super-priority
- but, if corporate borrower, may need to perfect to ensure priority over Corporations Act preferred creditors

Note that pre-PPSA double cocktails will be automatically perfected by control from RCT and no need to register to ensure priority over Corporations Act preferred creditors

Threat to insolvency set-off

- PPSA permits the borrower to deal with its interest in the deposit: s79
- if borrower assigns its interest in deposit account before insolvency, may destroy mutuality
- financier may not be able to exercise its rights of set-off
- for post-PPSA double cocktails, the financier can rely on fall-back remedies in PPSA which achieve outcome similar to set-off (for example, seize or retain)
- for pre-PPSA double cocktails, no such fall-back PPSA remedies (because enforcement provisions do not apply:s314) but flaw remains intact if otherwise perfected

Arguments that set-off should remain effective

- inability to set-off prejudices financier: s79(2)
- set-off integral part of security interest
- set-off is not a method of enforcement of law
- set-off excluded from PPSA

Where do we end up?

- double cocktail is likely to be a PPSA security interest
- triple cocktail is a PPSA security interest
- flawed asset will still be as effective under PPSA as it is under current law provided that it is perfected
- if financier is an ADI and the deposit account is an ADI account, flawed asset arrangement automatically perfected and has control “super-priority” (but registration may be needed to defeat preferred creditors)
- financier may not be able to exercise its set-off rights

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