

PPSA retention of title property

Introduction

Retention of title property, in general terms, describes any property which is in the possession of one party (pursuant to the terms of some agreement) but where the title to the property does not pass to the possessor either at all, or until some precondition is met (for example payment of a supply invoice).

That general definition is mirrored in section 9 of the *Corporations Act* ("**Act**"), which defines **retention of title clause property** as being subject to a retention of title clause under a contract for the sale of property:

- (a) if the contract contains a provision the effect of which is that the seller retains title in the property until the purchase price, or another amount, has been paid in full; and
- (b) if the purchase price, or the other amount, as the case may be, has not been paid in full; and
- (c) to the extent that the contract does not give rise to a PPSA security interest in the property.

Section 51F of the Act provides that property is **PPSA retention of title property** of the corporation if:

1. the property is personal property; and
2. the property is used or occupied by, or is in the possession of the corporation; and
3. the corporation does not have title to the property; and
4. a PPSA security interest is attached to the property within the meaning of the *Personal Property Securities Act* ("**PPSA**"); and
5. the corporation is the grantor in relation to the PPSA security interest.

The important distinction between these definitions is to be found at point 4 & 5 – that is, that the arrangement creates a PPSA security interest in favour of the grantee. The Corps Act imports the relevant definition from section 12 of the PPSA (excluding transitional interests) which provides:

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).

That definition is reflected in section 51F which goes on to provide examples of property which is PPSA retention of title property:

1. property that is subject to an agreement to sell subject to retention of title, or a hire purchase agreement, that secures the payment or performance of an obligation — see section 12(2) of the PPSA;
2. property that is the subject of a lease, or a consignment agreement, that secures the payment or performance of an obligation — see section 12(2) of the PPSA;
3. goods that are the subject of a commercial consignment — see subsection 12(3) of the PPSA; and
4. goods that are leased or bailed under a PPS lease — see section 12(3) of the PPSA.

Importantly, section 51F(2) of the Act also provides that:

“A reference in this Act to the property of a corporation does not include a reference to any PPSA retention of title property of the corporation, unless provided otherwise expressly or by necessary implication.”

Winding up/liquidation

Property of the company will include PPSA retention of title property only if it has vested in the company because of the operation of section 267 or 267A of the PPSA, or section 588FL of the Act.

Retention of title assets are **circulating assets** (in terms of section 340 of the PPSA) because:

“the secured party has given the grantor express or implied authority for any transfer of the personal property to be made, in the ordinary course of the grantor’s business, free of the security interest”.

Nonetheless, it seems likely that retention of title security interests are not circulating security interests. That is because the definition of circulating security interest in section 51C of the Act defines **circulating security interest** to mean a security interest that is:

- (a) a PPSA security interest, if:
 - i. the security interest has attached to a circulating asset within the meaning of the PPSA; and
 - ii. the grantor (within the meaning of the PPSA) has title to the asset.

As the grantor does not have title to retention of title property, it cannot be the subject of a circulating security interest.

Section 561 of the Act deals with priority of employee claims over circulating security interests. Section 561 deals only with the proceeds of “property of the company” and, as a consequence, does not provide for payment of employee entitlements in priority to the interests of PPSA retention of title property holders.

Receivership

For the same reason as noted above, the priority provisions of section 433 of the Act do not apply to retention of title property as it is not “property of the company”.

Further, a person must not be appointed receiver of property of a corporation if the person is a secured party in relation to any property (including PPSA retention of title property) of the corporation – see section 418(1).

Voluntary administration

Under section 435B, for the purposes of part 5.3A of the Act, property of the company includes any PPSA retention of title property of the company.

That observation notwithstanding, the right of indemnity afforded by section 443D of part 5.3A does not extend to PPSR retention of title property. Of course, this is only the situation with respect to perfected security interests.

Section 440B of the Act poses restrictions on the exercise of third party property rights. Those restrictions apply to retention of title property. Similarly, the decision period requirements of section 441A of the Act also

apply to PPSA retention of title property security interests – provided that the interest extends to the whole or substantially the whole of the property of the company.

Section 442C(1) of the Act prohibits an administrator (and deed administrator) from disposing of:

1. property of the company that is subject to a security interest; or
2. property (other than PPSA retention of title property) that is used or occupied by, or is in the possession of, the company but for which someone else is the owner or lessor.

Section 442C(2) of the Act authorises disposal in the following circumstances:

1. in the ordinary course of the company's business; or
2. with the written consent of the secured party, owner or lessor as the case may be; or
3. with leave of the court.

Such a disposal by the administrator extinguishes the security interest — see section 442C(7) of the Act.

The sale of the entirety of a company's plant, equipment and stock will not be a sale in the ordinary course of business – *THC Holdings Pty Ltd v CMA Recycling Pty Ltd* [2014] NSWSC 1136 at 118.

Section 442CB of the Act imposes upon the deed administrator a specific duty to act reasonably in exercising a power of sale in respect of PPSR retention of title property and retention of title clause property.

Proceeds of sale – retention of title clause property

Section 442CC(2) of the Act deals with the application of sale proceeds in respect of property subject to a retention of title clause. The section relevantly provides:

- (a) if the net proceeds of sale equals or exceeds the total of:
 - (i) so much of the purchase price, or other amount, under the original contract as remains unpaid; and
 - (ii) if there are one or more securities over the property—the debts secured by the securities;

the administrator must:

- (iii) set aside so much of the net proceeds as equals that total; and
 - (iv) apply the amount so set aside in paying that total; or
- (b) if the net proceeds of sale fall short of the total of:
 - (i) so much of the purchase price, or other amount, under the original contract as remains unpaid; and
 - (ii) if there are one or more securities over the property—the debts secured by the securities;

then:

- (iii) the administrator must set aside the net proceeds; and

- (iv) the administrator must apply the amount so set aside in paying those debts in order of priority, on the basis that if the amount is insufficient to fully pay debts of the same priority, they must be paid proportionately; and
- (v) if any of those debts is not fully paid so much of the debt as remains unpaid may be recovered from the company as an unsecured debt.

Proceeds of sale – PPSA retention of title property

For PPSA retention of title property, section 442CC(1)A of the Act requires that the net proceeds of sale of must be applied in the same way as a secured party is required, under section 140 of the PPSA to apply an amount received as a result of enforcing a security interest. There is no definition for “net proceeds” but the PPSA may assist.

Section 140 of the PPSA provides that the proceeds of secured property must be applied in the following order:

- (a) obligations to persons holding interests (other than security interests) in the collateral that have a higher priority (whether under this Act or otherwise) than the interest of the secured party;

NB: The interests referred to in this paragraph might be interests to which this Act would otherwise not apply (see subsection 8(2)). For example a lien or charge.

- (b) reasonable expenses incurred in relation to the enforcement of security interests against the collateral, to the extent that the expenses are secured by the security interests;

NB: Reasonable expenses in relation to the enforcement of a security interest are taken to be secured by the security interest unless the parties agree otherwise (see subsection 18(5)).

- (c) obligations to persons holding security interests in the collateral that have a higher priority (whether under this Act or otherwise) than the interest of the secured party;
- (d) obligations to the secured party that are secured by the security interest in the collateral;
- (e) obligations to persons holding interests or security interests in the collateral that have a lower priority (whether under this Act or otherwise) than the interest of the secured party; and
- (f) to the grantor.

A potential area of tension will arise between the priority provisions provided for under section 140 of the PPSA, and the interests of prior ranking creditors who hold a circulating security interest. This might arise in circumstances where an ROT retention of title grantee has failed to note their interest as a PMSI. In those circumstances, their priority would be deferred to a prior ranking secured creditor. If that secured creditor had a circulating security interest, then competing priority provisions (such as section 561 of the Act) would come into play. It should be noted however that section 140 of PPSA provides:

“This section does not prevent the operation of another law of the Commonwealth, or a law of a State or Territory, to the extent that the law requires the amount, personal property or proceeds to be applied towards one or more obligations to persons that do not hold security interests (or any other interests) in the collateral before being applied towards any (or all) of the obligations mentioned in subsection 140(2).

Example: this section does not prevent the operation of section 561 of the *Corporations Act*, which gives priority to the satisfaction of certain unsecured obligations over the claims of the secured party holding a circulating security interest in a debtor's property."

Case example: Renovation Boys Pty Ltd (administrator appointed)

Some of the provisions which have been discussed were considered by the New South Wales Supreme Court in the matter of *Renovation Boys Pty Ltd (administrators appointed)* [2014] NSWSC 340 (25 March 2014).

In that case administrators were appointed to Renovation Boys which was a retailer of bathroom and kitchen products. Its customers were general homeowners carrying out renovation works.

The administrators sought directions under section 447D of the Act in relation to three categories of stock.

Category A stock consisted of items for which customers had paid in full and where, as at the date of the administrators appointment, those items had been allocated to specific customers in the company's electronic stock control system. There were no relevant PPSA securities.

The court had regard to the provisions of the *Sale of Goods Act*, which dealt with circumstances in which title of property passes. In particular, section 5(1) provides:

"Where there is a contract for the sale of unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer."

As a result, Black J concluded that the administrators were justified in proceeding on the basis that title had passed in respect of each item of category A stock to customers who had ordered and paid for those items.

Some of the category A items, also fell into what was described as category E stock. That was stock in respect of which the suppliers of the relevant stock to the company had registered, on the PPSR, a security interest as a conditional sale agreement (i.e. an agreement to sell subject to retention of title). His Honour was taken to the provisions of section 46 and section 47 of the PPSA, which provides (in summary) that a buyer of personal property will take that property free of a security interest given by the seller if the personal property was sold or leased in the ordinary course of the seller's business of selling property of that kind.

His Honour readily concluded that the sale had been conducted in the ordinary course of business, and directed that the administrators would be justified in treating category E stock on the basis that property in those items had passed to the purchasers.

The court was also asked to consider property which was described as category C stock. That category described stock for which customers had paid in full, and where stock had been allocated in the company's stock management system — but involved an over-allocation, with the result that there was insufficient stock items to fill all customer orders. The administrators urged the court to find that the relevant provisions of the *Sale of Goods Act* did not apply in these circumstances, and that they would be justified in treating category C stock as property of the company. Ultimately, Black J did not accept that (primary) submission of the administrators. It was appropriate to treat property in category C stock as having passed to all of the purchasers, with that class of purchasers sharing title as tenants in common. This was the same result reached in *Couch v Adams* [2006] NSWSC 1029. A direction was given that the administrators were justified in selling the goods and making a distribution *pari passu* (equally).

The administrators also sought and obtained an order recognising that they held an equitable lien in respect of the costs of identification, preservation and realisation of property. This, of course, was important

because the retention of title property was excluded from the operation of the administrator's statutory lien under 443F of the Act.

For more information or to discuss your personal circumstances, please contact Partner, Tim McGrath on 4036 9700.