

ALERT

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The PPSA and the changing face of unfair preference payments

One topic that has received little attention to date is the changes to the unfair preference regime brought about by the introduction of the *Personal Property Securities Act 2009* (**PPSA**). This article considers the effect of the new regime, and especially retention of title (also known as 'Romalpa') clauses, on claims for unfair preference payments.

Most suppliers of stock include retention of title terms in their terms and conditions. As set out in our previous alerts and articles, the new PPSA regime will improve the position of these suppliers if the debtor company enters liquidation (provided that those suppliers register their rights). As a result, it will reduce the availability of unfair preference claims to liquidators and decrease the pool of assets available for distribution to unsecured creditors.

Unfair preference payments: a snapshot

Broadly speaking, a liquidator will have a claim against a creditor for unfair preference payments if the following requirements are met:¹

1. the company (now in liquidation) made payments to that creditor within the 6 months prior to the 'relation back day'

(generally, the date of the appointment of an administrator or liquidator);

2. the creditor's debt was unsecured with respect to the company;
3. at the time that the payments were made to the creditor, the company was insolvent (or became insolvent as a result of the payments); and
4. the payments resulted in the creditor receiving from the company more than it would have if the payment was set aside and the creditor were to prove for the debt in the winding up of the company.

If the requirements are met and the creditor does not have an available defence, the creditor will be required to disgorge the payments to the liquidator. The liquidator will then distribute those monies in accordance with the priority rules set out in the *Corporations Act 2001* (**Corporations Act**).

¹ Section 588FA *Corporations Act 2001*



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'Unsecured' creditors

The key change made to the law of unfair preferences as a result of the PPSA is the alteration in what constitutes an 'unsecured' and 'secured' creditor.

Pre-PPSA law

Under pre-PPSA law, a creditor was classified as 'unsecured' if their debt owed by the company was not secured by a charge, chattel mortgage or other form of security.

A retention of title agreement provides that, notwithstanding that a purchaser may take possession of goods, the supplier retains title and ownership of the goods until receiving payment in full (either of the entire debt or for those specific goods, depending on the clause).

Even though the supplier retains rights over the goods, pre-PPSA law provided that a retention of title clause did not constitute a

security. This is based on the principle that goods the subject of a retention of title are owned by the supplier, not the company.²

A supplier of goods under retention of title was therefore considered to be an unsecured creditor. As a result, payments received by that supplier were in respect of an unsecured debt and so could be held to be unfair preferences and required to be disgorged to a liquidator.

Example: Steve's Cables (SC) sells cables wholesale to Cables R Us. SC's terms and conditions contain an 'all monies' retention of title clause which provides that SC retains title over all the goods it supplies until all its debts are paid.

Cables R Us is in debt to SC. It makes payments to SC in March and April. In May it enters liquidation.

Result:

SC will retain its rights and be able to collect from the liquidator any of its stock not yet sold by Cables R Us (to the value of the debt).

However the liquidator will be able to pursue SC for recovery of the payments made by Cables R Us to SC in March and April as unfair preferences.

New position under the PPSA

The PPSA alters this position. With the commencement of the PPSA, a new section 51E was inserted into the Corporations Act. This provides that a creditor will be a 'secured creditor' if its debt is the subject of a security interest under the PPSA.

The categories of 'security interest' set out in the PPSA are broad. They include both:

- arrangements previously considered as giving rise to a security, such as charges, debentures and chattel mortgages; and
- title-based arrangements such as retention of title, hire purchase arrangements and leases, which traditionally were not classified as securities.

Under the new Corporations Act provisions, any PPSA security interest will give rise to a creditor being secured, regardless of the nature of that interest.

As a result, suppliers trading under a retention of title arrangement who have properly registered their rights on the PPS Register will now be 'secured' and not open to unfair preference claims (subject to our comments below).

This alters the example referred to above, as follows.

Result:

If SC has properly registered its rights, it will still retain its rights and be able to collect from the liquidator any of its stock not yet sold by Cables R Us (to the value of the debt).

SC is now a secured creditor with respect to the debt owed to it by Cables R Us. As a result, the liquidator will not be able to pursue SC for the recovery of payments made by Cables R Us to SC in March and April as unfair preferences.

² *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liquidation)* (2000) 171 ALR 568



It is important to note that this protection will be lost if the creditor has not properly registered its rights under the retention of title arrangement.

Value of security

That the scope of what constitutes a 'secured creditor' has broadened is clear. It is then important to consider the value of the security held by the creditor.

Under section 588FA(2) of the Corporations Act, a debt will be secured only to the value of the security. For any amounts which are not reflected in the value of the security, the debt will be unsecured. As a result:

1. if the value of the assets is greater than the value of the debt, the entire debt is a secured debt and any payments will not be unfair preferences;
2. if the value of the assets is less than the value of the debt, the debt is only secured to the value of the assets and some of the payments may still be unfair preferences. We make further comment on this below.

Section 588FA(2) becomes relevant if the security is only over specific assets, such as in a retention of title arrangement. It will become particularly relevant if the value of the stock on hand is less than the total value of the debt owed to the supplier.

To date, there has been little judicial consideration of specifically what is meant by the term 'value of the security'.³ Nor has there been consideration of how payments are to be allocated for the purpose of this section.

When dealing with unfair preferences and retention of title claims, the liquidator and creditor will need to consider questions including:

- How is the 'value' of the security determined? Is it the invoice value of the goods supplied, the resale value of those goods, or a third alternative (such as the value of the debt secured⁴)?
- How do you determine whether payments made to the supplier are to be allocated to the unsecured or secured portion of the debt?

It will be essential for both liquidators and creditors to consider these new points in unfair preference claims going forward.

³ *Great Wall Resources Pty Ltd (in liq) v Davidovic Pty Ltd* [2011] NSWSC 660

⁴ As argued in *Great Wall Resources Pty Ltd (in liq) v Davidovic Pty Ltd* [2011] NSWSC 660

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