Inventory and Supply Chain Finance

This paper builds on the General Policy Paper from July 2016 and the discussion papers of January 2017 in particular the Registration, Asset Finance, Receivables, and Priorities papers. The paper covers the potential reform of inventory and supply chain finance as distinguished from asset finance.

Asset finance refers to conditional sales agreements, hire purchase and finance leases. A conditional sale is, as you might guess, a sale of goods where title remains in the seller until the fulfilment of a condition, normally payment of the purchase price and the conditional sale normally contains a provision that the buyer will not dispose of the asset prior to that point. In that way the seller renders the conditional sale inappropriate for inventory sales where it is anticipated that the buyer will in fact sell on the items. A hire purchase agreement is different in that the owner of goods agrees to hire out the goods with an option in the hirer to purchase them at the end of the hire term. That option to purchase is often accompanied by the need to pay a (nominal) sum. The two transactions are often used as alternative forms of vendor credit providing for the retention of title by the owner to have a security function. A finance lease is an alternative where the goods have a limited useful life and where the lessee has no interest in obtaining title. Ownership of the goods is retained by the bailor or lessor and the lessee merely has a possessory interest. These finance leases are to be contrasted with operating leases where goods with a reasonably long useful life are hired out successively to different parties. They do not have a security function, but are often pulled into the secured transactions regime by the Commonwealth Personal Property Security Acts. These mechanisms are dealt with in the paper on asset finance by Magda Raczynska.

With asset based finance the client owns the asset; finance is often secured by way of a fixed or floating charge, although receivables are usually purchased outright. Asset based finance can take place against a variety of different types of asset, such as stock; in such cases the financier will consider the make-up of the inventory: finished goods, work in progress, raw materials, its turnover historic levels and write-off in deciding the level of funding. Plant and equipment might be used, or intangible assets, such as IP, or invoices. The amount a financier will advance will depend on the type of asset. Invoices can be up to 90%, but stock, plant and equipment may only be 75%.

Inventory finance therefore refers to mechanisms which include the retention of title clause whereby the buyer acquires assets for use, manufacturing or on-sale. We can divide this into vendor credit, where the seller is extending credit terms so that the buyer does not need to pay in advance or on delivery, or lender credit. A bank may also extend credit - in essence a loan
made to a company so it can purchase products for sale. Those products, or inventory, serve as collateral for the loan if the business does not sell its products and cannot repay the loan. Inventory financing is especially useful for businesses that must pay their suppliers in a shorter period of time than it takes them to sell their inventory to customers. It also provides a solution to seasonal fluctuations in cash flows and can help a business achieve a higher sales volume - for example, by allowing a business to acquire extra inventory to sell during the holiday season. However, lenders may be inclined in practice to see these as unsecured loans because if the borrower is unable to sell the inventory the bank may not be able to either.

Supply chain and receivables finance relies on the assignment of book debts. Sale of receivables is dealt with in a paper by Hugh Beale. In a straight sale of receivables A sells on book debts owing by his customers at a discount to a factor, so the financing is arranged by the supplier – and in most cases the financier will also take a floating charge over assets of the company so as to secure the right to appoint an administrator. This can provide a simple and cost-effective cash flow solution. There are two sorts. In a factoring transaction the factor not only buys the debts but takes over the collection process, managing the ledger and providing credit control support. Invoice discounting does not involve this additional service. Because inventory finance settles on sale of the product it can be combined with invoice financing; the finance from the invoice can be used to settle the inventory finance. In a supply chain finance arrangement the financing is arranged by the customers. In other words the customer arranges for the supplier to bill the financier for the goods or more usually having certified the invoice passes it to the financier, who pays the supplier directly; the customer subsequently pays the financier. The financier therefore decides on the financing on the basis of the credit of the customer, not the supplier and can therefore both pay the supplier quicker and allow the customer a greater period of credit. It also reduces the chance of disputed invoices between the customer and the factor because the receivable is only assigned when the customer certifies it. Often a non-assignment clause (except to the supply chain financier) is added.

As stated in the Receivables Paper

The provisional view of members of the STR project is that the proposed scheme should apply to outright sales of "receivables" as defined in the Small Business, Enterprise and Employment Act 2015 for the purposes of priority, so that priority over competing assignments of receivables, whether sales or by way of charge, will be determined by the order of registration. We also think there is a good case for providing that an outright sale of receivables that has not been registered before the onset of the Supplier's insolvency should be ineffective against the Supplier's liquidator, administrator or trustee in bankruptcy. The scheme should not apply, however, to sales of receivables that do not have a financing purpose.

The paper does not explicitly deal with supply chain finance solutions, but given that there is still under such solution an assignment of the confirmed invoice from the supplier to the financier registration would presumably still be required, although again it would be possible
for the money from the supply chain financier to go to satisfy the inventory financier. In circumstances where bank stock finance is used this could be the same financier.

There are three issues relating to the balancing of interests in this "eco-system". The first is whether notice of a proprietary interest is given to other creditors (the publicity issue). Should the retention of title clause or assignment of receivables be registered? Related to that is the question of the effect of non-registration. That could be invalidity, as in most PPSA jurisdictions or as in New Zealand or Quebec, postponement of priority. The second issue is whether any such interest has priority over interests created or registered earlier (the super-priority issue). A later interest which has priority over an earlier interest undermines the security of the earlier creditor, but may be justified on policy grounds if it brings new value into the business. With a retention of title clause the vendor is providing new value – the asset itself that may be resold or used in a manufacturing process. The seller retains title in order to secure payment of the purchase price and if re-characterised as a security, as it would be under a Personal Property Security Act, it would be a purchase money security interest where the security secures payment of the money used to acquire the very asset over which it is secured. A decision then must be made as how far that super-priority extends. The third is whether a proprietary interest is limited to the amount it secures or whether the holder of the interest is entitled to surplus value (the surplus issue). The surplus issue is also examined in the asset finance paper. We can divide the paper up into several sections.

In the first we examine the current law and practice in more detail, and in later sections at possible reforms and their implications. It has become common to ask whether retention of title clauses should be registered and if so whether they should be re-characterised. This was not a question addressed in the Registration Discussion Paper from January 2017, which concentrated on how registration should be done, not what should be included, but was examined by the 2013 paper by WGA on Registrable Interests and the Issue of their Re-characterisation. There are four options.

1. Registration as a priority point; unregistered interests are invalid; re-characterisation (the “standard” PPSA model)
2. Registration as a priority point; no invalidity, but re-characterisation (the NZPPSA model)
3. Registration as a priority point; no invalidity or re-characterisation (the Quebec model)
4. Registration as a priority point, invalidity for non-registration; no re-characterisation

We can also refer to the re-characterisation models (1 and 2) as the unitary model, which is the phraseology used in the UNCITRAL Legislative Guide on Secured Transactions. Under this model, as we see, all devices with a security function including retention of title clauses are treated in the same (unitary) manner. The other two cases where re-characterisation (3 and 4) does not take place can be referred to as the registration-only model because title to goods remains where it would otherwise lie in the general law. It is worth pointing out that there are some important practical problems with registration of retention of title clauses, because there are likely to be numerous repeat contracts, particularly where RoT clauses over inventory are
concerned. The issue is less important with RoT clauses over capital equipment, or over high value assets such as airplanes, and with loan credit facilities, where a lender provides credit to the borrower who uses the money to purchase the asset over which the security is taken. In those two latter cases there will be just one security agreement.

(A) Current Law and Practice

In the current law a seller of goods may seek to retain legal title to those goods pending payment. He may seek to take title to products or proceeds – it may be that the goods are to be raw materials in the buyer’s manufacturing process, or inventory for on-sale. Historically in English law this has not been permitted. Cases such as *Re Bond Worth*¹ have made it clear that a contractual clause purporting to achieve this outcome will succeed only in creating a floating charge. Since that charge is not registered, it is void against the liquidator and third parties in insolvency and this has permitted the factoring and invoice discounting industry to develop. The vendor does not – and cannot – take priority over the factor taking an assignment of the book debts that comprise the proceeds of sale. More recently two decisions have threatened this ecosystem.

The first case is *Caterpillar (NI) Ltd v John Holt & Co (Liverpool) Ltd.*² In that case the clause required the buyer to “hold the products as Seller’s fiduciary agent” and “to account for the proceeds of sale. Patten LJ said that an obligation to account for the entire proceeds of sale was only consistent with the buyer remaining a fiduciary agent throughout the sub-sale. The clause was not well drafted to convert the retention of title clause into a charge necessary to secure only the remaining outstanding balance. A proceeds clause may therefore establish an agency relationship. This creates a significant difficulty in that by allowing an unregistered interest to take priority over receivables financing it upsets the current balance of financing and introduces a priority threat to receivables financiers. This creates another problem. If the sale is an agency contract, so the buyer is sub-selling on behalf of the original seller, property never passes to the intermediate buyer and the price of the goods is not recoverable under section 49 Sale of Goods Act 1979. This is a definite case of “Be careful what you wish for because you might get it!”

The second is *PST Energy 7 Shipping v OW Bunker Malta Ltd.*³ That case involved bunker fuel, “sold” subject to a retention of title clause but which had been used up. The final users’ attempt to argue that there was no claim under section 49 could have ended with their obtaining something for nothing. To avoid this, the Court of Appeal resorted to denying it was a sales contract at all. In the Supreme Court, Lord Mance, with whom all the other Justices agreed, held that the contract was not a sale on the facts of *PST Energy 7*; rather it was a contract to allow consumption of bunker fuel – without property passing – and on payment of the price for all the bunkers, consumed and unconsumed, property in anything left over would pass. However, lessening the risk of distortion in the future, he also held that the price may be

¹ [1980] Ch 228
² [2013] EWCA Civ 1232, [2014] 1 All ER (Comm) 393
³ [2016] UKSC 23, [2016] 2 WLR 1193
recoverable under the terms of the contract outside of the scope of section 49 in circumstances where property has not passed, but the property is at the buyer’s risk.

It is the combination of these cases that causes the problems.  

1. If the “sale” is not a sale what is it? To what extent do the implied terms in the Sale of Goods Act apply for example?

2. What scope is left for sales? The logic is that no contract where the “buyer” is expected to do something – like consumption or on-sale of the goods - rendering it impossible to transfer title to the buyer on payment counts as sale.

3. After Caterpillar the retention of title contract between seller and a buyer, expected to sell on, is likely to be one of agency. If so, priority problems relating to invoice discounters and factors remain

Invoice financiers clearly do not have a practical problem with asset based lending where the lender is taking a floating charge. It is unlikely that the floating charge restricts sales of receivables as such sales are likely to be in the ordinary course of business.

**(B) Options for Registration**

At present English law concentrates on the form of the interest rather than its function and, despite the functional similarities with security, takes the view that retention of title clauses need not be registered, which makes their existence harder to detect. The precise method of how registration should take place, as opposed to what should be registered, was discussed in the 2017 Registration Discussion Paper, but we saw earlier a distinction between loan credit where there is only one security agreement which can – under a notice filing system – be registered in advance and inventory finance by retention of title clauses where numerous repeat contracts exist. A notice filing system, described in more detail in Part 7.A of the 2017 Registration Discussion Paper, would enable there to be one filing covering all the contracts between the parties in these latter cases. This makes registration much more practical for the parties, but also means that priority will be backdated to the date of registration. Pmsi super-priority, where the clause obtains priority even against prior registered interests, makes this less important, however, except in cases where that super-priority is lost, such as in competitions with receivables financiers.

The City of London Law Society maintain this distinction, stating at article 6.2 of the Secured Transactions Code that whether a proprietary interest secures an obligation does not depend on the economic or functional effect of the transaction. The City of London Law Society⁵ argue that the substance of the transaction is that the parties do not want title to pass to the transferee

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⁴ L Gullifer “‘Sales” on Retention of Title Terms: Is the English Law Broken?” (2017) 133 LQR 244

and therefore we are ignoring the stated intentions of the parties by re-characterising. It simply is not true, however, that English law does not re-characterise against the expressed intentions of the parties. Even without registration, English law has engaged in the re-characterisation of retention of title clauses as floating charges to the extent that they purport to cover proceeds and products. See *Re Bond Worth*, above. There are options that do not involve registration and we look at them in section C.

(i) **Registration as Priority Point, Invalidity for Non-Registration & Re-Characterisation**

The Australian Personal Property Securities Act 2009, in common with basically all other PPSAs, defines a security interest, in section 12(1), as an interest in personal property that in substance secures payment or performance of an obligation. These are referred to therefore as “in substance” security interests and they depend on the existence of an underlying obligation. The definition includes (expressly under section 12(2)) such things as retention of title agreements, referred to in section 12 as conditional sales. As a unitary system everything that “in substance” secures an obligation to pay is treated for the purposes of the legislation as a security interest.

Retention of title clauses are brought within the system as purchase money security interests or pmsis. These are security interests that secure the payment (or repayment) of money used to purchase the goods over which the security is taken. Pmsis have super-priority. What that means is that provided the required registration requirements are met (set out in appendix A) they take priority over prior-registered security interests, which in effect replicates current English law. This scheme means that under a sale on retention of title terms title to the goods passes directly to the buyer and the seller retains a security interest which must be registered within a certain time frame – and sometimes notified to prior security interest holders - for him to obtain such super-priority. Under the “standard” model an unregistered security interest is void.

The justification for registration is discussed in more detail in Part 2 of the *Registration Discussion Paper*, but in part is the protection of potential creditors (*Transparency benefiting other Market Participants*, at Part 2.B). In the absence of registration such a party may decide to deal with the debtor on the basis that the debtor has substantial assets, or that there is no need for a security interest of his own. Registration of security interests provides for the publication of information on prior secured finance transactions and moves the burden from potential creditors undertaking due diligence to past creditors providing the information. The standard position, as explained in the *Priorities* paper, is that priority reaches into proceeds, but all PPSAs subordinate the retention of title creditor to prior assignees of receivables (as set out in appendix B). The reason for this is the protection of invoice discounters and factors. Such financiers cannot protect themselves against a future retention of title creditor who retains super-priority in proceeds and therefore will not purchase invoices and receivables, thus decimating an important sort of finance.
Registration also requires significant changes to the nemo dat provisions to protect third parties who, for one reason or another, cannot be expected to search the register. All Personal Property Securities Acts provide for what are called “taking free” rules. These rules provide for when a third party buying or otherwise acquiring legal title to the asset take free of, ie not subject to, the security. Often they provide for those selling in the usual course of business to pass unencumbered title; buyer-in-possession and seller-in-possession provisions are usually superseded by the PPSA provisions and frequently the PPSA explicitly provides for this as in New Zealand.

This option has two important points in its favour. It solves the Bunkers problem. Invoice discounters and factors, and supply chain financiers no longer need to concern themselves with whether any retention of title clause has a proceeds sub-clause, meeting the Caterpillar requirements. Secondly, the current rules around section 24 and 25 Sales of Goods Act 1979 and sections 8-9 Factors Act 1889 are complex due to the contorted drafting of the sections. In particular the results in cases such as Re Highway Foods and Fairfax Gerrard Holdings Ltd v Capital Bank plc are difficult. By contrast, while there is a difficult factual question whether a transaction is in the ordinary course of business under a PPSA, it is no harder than deciding the same matter for the purposes of a floating charge.

The option has a significant disadvantage. It is counter-intuitive in that it reverses the party who has under the general law the title to the assets sold and many creditors, particularly sellers of inventory, will not know or have the expertise to register. In other words the creditor, who as a matter of general law owns the asset (although he does not own it for the purposes of the Personal Property Security Act), loses all interest in the asset if he does not register. For some (such as the City of London Law Society) this is an unacceptable vulnerability of ownership, and certainly some businesses may be taken by surprise by this result. This is an education matter, however, and what has happened in Australia is that intermediaries have sprung up offering to register interests on behalf of businesses unable or unwilling to do it themselves.

(ii) Registration as a Priority Point, No Invalidity for Non-Registration and Re-Characterisation

This is the New Zealand system. The retention of title creditor does not count as an unsecured creditor if the clause is not registered and therefore has some priority, ranking in time order amongst other unperfected security interests. Nonetheless he definitely will lose something if he does not register. An example of such from New Zealand is New Zealand Bloodstock v Waller where the lessor of a stallion, who had failed to register his interest, was subordinated in priority terms to the debenture holder, Lock who had registered a financing statement. Had

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6. [1995] 1 BCLC 209
7. [2007] EWCA Civ 1226
8. [2005] NZCA 254
the lease been registered, it would have taken priority. This reduced effect of non-registration might have helped gain the support of inventory financiers.

Originally the New Zealand Act provided for the purchase money security interest to have super-priority that also extended into accounts receivable. However, section 75A Personal Property Securities Act 1999 has reversed that position.

(iii) Registration as a Priority Point; no Invalidity for Non-Registration and No Re-Characterisation

This is the Quebeccois position and relevant statutory extracts are found in appendix C. In Re Ouellet\(^9\), it was decided that failure to register the retention of title device does not convey ownership to the buyer and in a reversal of the position in common law Canada the retention of title creditor’s interest binds the debtor’s trustee in bankruptcy. However, registration must take place within 15 days under article 1749 of the Quebec Civil Code (QCC) and late or non-registration means that the retention of title clause is postponed to prior-registered security interests, or one acquiring the asset from the buyer. The thinking behind requiring registration is outlined in Maschinenfabrik Rieter AG v Canadian Fidelity Mills,\(^10\) Nuss JA explained in that case that the idea was to avoid “apparent ownership”, where a creditor believes the debtor has greater assets than in fact he has. Despite the fact of the continued validity of the registration of title clause if unregistered, the creditor’s title is necessarily compromised to some degree by the deferral of priority needed to give an incentive to register. Registration is also necessary if a lease, where the lessor agrees to provide moveable assets for rent for a period over a year, is granted, or a credit-bail is created where the lessor acquires moveable assets from a third party at the request of the lessee and the nominal lessor is merely a financing conduit. As with unregistered retention of title clauses an unregistered lease remains effective against the lessee’s trustee in bankruptcy so that the lessor retains title to the asset (this is the opposite result to that in the common law provinces of Canada where the Personal Property Security Acts provide for the ineffectiveness of the unregistered interest; see Re Giffen\(^11\)). This result and that in Re Ouellet has been criticised by Cuming, Wood and Walsh as ignoring the different rules for hypothecs;\(^12\) a hypothec is the Quebeccois equivalent of a charge and non-registration of a hypothec does lead to complete invalidity and therefore the chargee (unlike the lessor or the retention of title creditor) is unable to enforce it against the debtor’s trustee in bankruptcy.

Under the Cape Town Convention on International Interests in Mobile Equipment retention of title clauses over aircraft is a registrable international interest under article 2(2)(b); however, whether it is re-characterised is a matter for domestic law. This discussion may seem off-topic. The CTC is firmly concerned with equipment and capital assets. However, it is an example in

\(^9\) 2004 SCC 64, [2004] SCR 355
\(^10\) 2005 QCCA 1003
\(^11\) [1998] 1 SCR 91
\(^12\) RCC Cuming, CJ Walsh and RJ Wood, Personal Property Security Law (2nd edn Irwin Toronto 2012) 113
English law of a regime where a retention of title clause must be registered and where non-registration does not lead to invalidity against the liquidator. As such there are parallels which are worth drawing out. The CTC provisions can be found in appendix C. English law, as we have already noted, does not re-characterise retention of title clauses. Priority for registered retention of title clauses is maintained by article 29(1) which provides that a registered international interest has priority over subsequent registered interests and any unregistered (whether registrable or not); see also International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015, reg 16(1). If promptly registered this protects the retention of title creditor against everyone. However, the priority of a conditional buyer or lessee against the registered interest of a third party depends on the interest of the seller or lessor (see reg 16(4)). An unregistered retention of title clause will be effective in England, because article 30 provides that while registered international interests are valid in insolvency unregistered might also be if they are under the domestic law (see regulation 36(1)). This has the effect that a lease or retention of title clause that is not registrable under English law will be effective in an English insolvency even if not registered as an international interest. Non-registration will mean, however, that the retention of title creditor ranks subsequent to any registered international interest. In other words should the retention of title clause not be registered, but a subsequent aircraft mortgage is taken over the plane by a bank which registers it in Dublin, the registered mortgage takes priority despite the retention of title clause creditor being at general law the owner of the airplane. This is – likewise – the least required to provide a registration incentive. The Cape Town Convention regime amounts therefore to the same as the Quebecois regime.

This option appears to be a compromise between those who do not want to see invalidity as a consequence for non-registration and do not want to see re-characterisation, but might be prepared to contemplate registration. The advantage, as suggested, in the discussion above is one of publicity and transparency; third parties are able to gain a better picture of what liabilities the debtor has and what assets without having to do due diligence as to whether goods are subject to retention of title clauses. The City of London Law Society, while rejecting emphatically the possibility of re-characterisation accept the possibility of registration, although it is clear that such an outcome is not one they favour. It may not be necessary. It may be for example that possible creditors and third parties will assume the existence of retention of title clauses and inventory financing precisely because of its frequency. There are also a number of difficulties. They basically stem from the inevitable effects of registration, and we have already seen that it is not possible to have an effective registration system without providing an incentive to register and therefore not fully respect the creditors’ (unregistered) title to goods. If we are to register RoT clauses over inventory, it therefore makes sense to expressly re-characterise since we are inevitably driven that way even in the absence of express re-characterisation.

Further arguments point in this direction. One important question is the relationship with the nemo dat provisions of the Sale of Goods Act 1979, particularly the buyer and seller-in-possession provisions in sections 24-25, and the corresponding sections 8-9 Factors Act 1889. Section 9 provides,

Where a person, having bought or agreed to buy goods, obtains with the consent of the seller possession of the goods or the documents of title to the goods, the delivery or transfer, by that person or by a mercantile agent acting for him, of the goods or documents of title, under any sale, pledge, or other disposition thereof, or under any agreement for sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of any lien or other right of the original seller in respect of the goods, shall have the same effect as if the person making the delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner.

The section in bold is additional to the provision on section 25 Sale of Goods Act 1979. Section 8 is in similar terms (likewise section 24). Those provisions make the third party’s position dependent on notice of the prior parties’ title or interest and become difficult when that title is registered given that registration counts as constructive notice. This was briefly noted in the Priorities Paper where we asked

Will the fact of registration provide notice to a subsequent buyer of the first sale so that the second buyer is bound by the first buyer’s rights? This will depend on whether the second buyer can be expected to search the register – if the second sale is in the ordinary course of business may be not. However, Section 24 (and a similar question arises in the context of Section 25(1)) is not framed in that way so the possibility arises of different sales being treated differently under these rules.

It is unclear that this can be accommodated by the Sales of Goods Act provisions as they stand; it may be necessary to deal with these cases in the context of the registration scheme itself. This is given some credibility by the fact that the Quebecois provisions do exactly this. They provide for the same rules to apply to retention of title clauses over universalities (classes) of property to apply as to hypothecs – primarily that the seller in the usual course of business can pass good title.

It may therefore be that it is not possible to combine a registration scheme with goods that are expected to be sold-on or used in manufacturing and sold on without changing the nemo dat rules to be functionally the same as those for charges – and the UNCITRAL Legislative Guide on Secured Transactions in discussing its non-unitary option, where a retention of title clause would be registrable but not formally re-characterised, states that outcomes should be functionally the same as for the unitary option. The question whether

15 art 2961.1 QCC
16 With inventory this would usually be covered by contractual provision for sale or use, although currently that creates all sorts of issues as discussed early wrt Bunkers.
17 UNCITRAL Legislative Guide on Secured Transactions (2007) Recommendation 188; the non-unitary option was dropped for the UNCITRAL Model Law on Secured Transactions
this is also the case where the asset is not expected to be sold on – ie asset finance cases - can be left for another paper.

It seems that in Quebec real subrogation (the equivalent very roughly of tracing) will not allow the title to the original collateral to be shifted to sales proceeds. Consequently any factor taking an assignment of receivables would not be impacted by the former’s interest. This means that Quebec law can give no appropriate steer as to how to balance the competing interests of the parties, since the creditors’ interests do get transferred by Bunkers/Caterpillar. Factoring arrangements would be threatened by any attempt to prioritise the inventory financier and so, unless another option is found – from the non-registration options following – it would be necessary to provide for the priority position between those parties in the legislation. With that in mind moves to register inventory retention of title clauses should probably include their re-characterisation

(iv) Registration as a Priority Point, Invalidity on Non-Registration and no Re-Characterisation

In essence this is Cuming, Walsh and Wood’s preferred position for Quebec law. We have seen that in Quebec an unregistered hypothec is invalid against the trustee in bankruptcy, and they believe the same result should follow from an unregistered retention of title clause or finance lease. From the perspective of consistency, this seems clearly correct. However, as also noted the City of London Law Society considers that the removal of ownership rights on non-registration to be too great an imposition or sanction. Postponement of priority might be a better way of encouraging agreement by inventory and stock financiers and this seems to have been the case in New Zealand.

(v) Products

Currently the position is not as clear as it might be, but under Re Bond Worth proceeds and products would be treated the same and so the retention of title clause is transformed into a void – unregistered – floating charge. Under a PPSA the position is in fact better. The default is that, if the charge or security interest is properly perfected, the security transfers to the product or proceeds. Pmsi super-priority is not retained in such cases, but the security is valid and takes priority from date of registration.

18 LD Smith ‘Unauthorised Dispositions of Trust Property: Tracing in Quebec Law’ (2013) 58 McGill LJ 795; Poulin v Serge Morency et Associés Inc [1999] 3 SCR 351; see also Grondin v Lefaivre (Trustee) [1931] 2 DLR 114
(C) Non-Registration Options

There appear to be two.20

1. Re-analyse the passage of property rules by returning to the pre-Bunkers position

That analysis was that property passed to the buyer at the moment of sub-sale and then passed directly to the sub-buyer. Where goods are consumed or used in manufacturing, property passes at or immediately before the moment of extinction. The seller is then left with an (unsecured) claim for the price. However, the approach actually taken in Bunkers contradicts this, however, despite its having been assumed to be the case over many years. It is hard to know how we return to the previous position except through legislation. It is conceivable that Caterpillar and Bunkers might be distinguished, but an appropriate decision would have to come up in the Supreme Court.

2. Sale of Goods Act revision

This would require a new piece of legislation to decide on the implied terms and other unclear matters left by Bunkers. That legislation is probably necessary for others reasons, for example to deal with digital content.

(D) Surplus

If the retention of title clauses were fully re-characterised as a security interest, the surplus will pass to the debtor rather than the RoT supplier, although it would need to be decided whether such surplus was held under a trust or whether it is was a personal accounting obligation. Under a pledge in English law, where there is a surplus that is returned to the debtor under a trust. With that in mind, it is worth noting that in Mathew v TM Sutton21 the pawnor was held to be a fiduciary with respect to the surplus. This also seems to be true of bailees,22 and mortgagees.23 Consistency suggests that this should hold true within an English or UK PPSA as well, although this is not always explicit in the Commonwealth legislation – eg Personal Property Securities Act 1999 (NZ), ss 117-119, Personal Property Security Act 1993 (Sask) s 60, and Personal Property Securities Act 2009 (Cth) s 140.

In practice a seller of inventory is likely to do one of two things – either use the interest to insist on repayment by the insolvency practitioner, or repossess. Either way he is probably unlikely to want to worry about accounting for a surplus, which is likely to be impractical in the context of individual assets, although it might be possible under an all monies clause. This is not the practical issue with regard to capital equipment where any accounting is likely to be much easier, but even in that context the debtor will have at most under current law – or a registration-

20 Gullifer (n 4)
21 [1994] 4 All ER 793
22 Aluminium Vaassen v Romalpa Aluminium [1976] 1 WLR 676
23 Law of Property Act 1925, s 105; Cuckmere Brick Co. v Mutual Finance Ltd [1971] Ch 949
only scheme – a contractual right to the surplus, as discussed in the Asset Finance Discussion Paper of 2017.

(E) Conclusion

Registration schemes inevitably result in not fully respecting the property right that the registrant has in cases where it is unregistered – otherwise there would be no incentive to register. Nonetheless they do allow for publicity of financing devices to third parties and the lowering of search costs. In cases where the asset is expected to be used up or sold on, there is a question as to what the “taking free” rules ought to be. This may be a less pressing issue in cases where the asset is not expected to be sold on, but the main point is that registration of any sort will lead to compromises between the functionality of the register and the effectiveness of title remaining in the creditor, either through re-characterisation or otherwise.

24 And those cases of asset financing and capital equipment are dealt with by Magda Raczynska’s Discussion Paper
**Appendix A**

This appendix examines the registration prerequisites for super-priority; in some cases the legislation requires the pmsi holder to provide notice to prior registered security holders that he intends to or will obtain a pmsi in specified assets.

**Australia:**

Inventory:

Personal Property Securities Act 2009 (Cth) section 62(2): The purchase money security interest has priority if it perfected by registration when the grantor… obtains possession of the inventory (if it is goods) or for any other kind of inventory the purchase money security interest attaches to the inventory and the registration that perfects the purchase money security interest states… that the interest is a purchase money security interest.

Personal property other than inventory:

Personal Property Securities Act 2009 (Cth) section 62(3): The purchase money security interest has priority if perfected by registration “before the end of 15 business days after whichever of the following days applies

(i) for goods--the day the grantor… obtains possession of the property;

(ii) for any other property--the day the interest attaches to the property; and

(c) the registration that perfects the purchase money security interest states… that the interest is a purchase money security interest.”

This is subject to super-priority by control.

**New Zealand:**

Inventory:

Personal Property Securities Act 1999 (NZ), section 74: A purchase money security interest in inventory or its proceeds has priority over a non-purchase money security interest in the same collateral given by the same debtor if the purchase money security interest in the inventory or its proceeds is perfected at the time the debtor, or another person at the request of the debtor, obtains possession of the collateral

Intangibles:

Personal Property Securities Act 1999 (NZ), section 75: A purchase money security interest in an intangible or its proceeds has priority over a non-purchase money security interest in the same collateral given by the same debtor if the purchase money security interest in the intangible or its proceeds is perfected not later than 10 working days after the day on which the security interest in the intangible attached.
Everything else:

Personal Property Securities Act 1999 (NZ) section 73(1):\(^{25}\) A purchase money security interest in collateral or its proceeds, other than inventory or intangibles, has priority over a non-purchase money security interest in the same collateral given by the same debtor if the purchase money security interest in the collateral or its proceeds is perfected not later than 10 working days after the day on which the debtor, or another person at the request of the debtor, obtained possession of the collateral, whichever is earlier.

**Ontario:**

Personal Property Security Act 1990 (Ont) section 33(1): A purchase-money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor, if the purchase-money security interest was perfected at the time the debtor obtained possession of the inventory.

Before the debtor receives possession of the inventory, the purchase-money secured party must give notice in writing to every other secured party who has, before the date of registration by the purchase-money secured party, registered a financing statement that describes the collateral as

(i) items or types of inventory, all or some of which are the same as the items or types of inventory that will be subject to the purchase money security interest,

(ii) inventory

(iii) accounts

The notice must states that the person giving it has or expects to acquire a purchase-money security interest in inventory of the debtor,

If it is not inventory section 33(2) provides that a purchase-money security interest has priority over any other security interest in the same collateral given by the same debtor if the purchase-money security interest were perfected, in the case of collateral, other than an intangible within 15 days of

(i) the debtor obtained possession of the collateral as a debtor, or

(ii) a third party, at the request of the debtor, obtained or held possession of the collateral,

whichever is earlier; or

In the case of an intangible it must be perfected before or within 15 days after the attachment of the purchase-money security interest in the intangible.

**Uniform Commercial Code:**

UCC article 9-324(a) provides that a purchase money security interest other than in livestock or inventory must be perfected within 20 days of the debtor taking possession. Under article 9-324(b) where the collateral is inventory perfection must take place before the debtor takes

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\(^{25}\) There is an exception under section 103A for security created by a participant in a settlement system in favour of the operator.
possession and a notice must be sent to the conflicting security holder to be received no less than 5 years before the debtor takes possession.\textsuperscript{26}

Article 9-324(d) provides for pmsis in livestock.

Software is dealt with separately under the UCC; remember that pmsis are not normally possible in intangible goods under the UCC, seemingly because of a lack of demand for such super-priority. However, the article does need to deal with the problem of integrated software.

Article 9-324 (f) provides, “Except as otherwise provided in subsection (g), a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in Section 9-327 a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.”

This is subject to super-priority by control of deposit account under article 9-327

\textbf{Law Commission:}

Although in the final report the re-characterisation of retention of title clauses was dropped, originally para 3.219 of the Consultative Report stated, “We provisionally recommend that a PMSI over goods that are not inventory should have priority over any other conflicting SI provided that it is perfected not later than 10 days after the debtor obtains possession of the collateral. In the case of a PMSI over intangibles, the 10 day period should date from attachment.”

Where it was inventory a notice was also required. By para 3.214 the Law Comm argued, “We provisionally recommend that for an SI over inventory to have PMSI status, it must be perfected, and a notice must have been given to any other secured party who has filed a financing statement covering the same type of collateral, before the debtor (or another person on its behalf, if earlier) obtains possession of the collateral. The notice must state that the person giving the notice expects to acquire an SI in inventory, and describe the inventory by item or kind.”

\textsuperscript{26} Nb lack of time limit for the notice in Ontario
Appendix B

This appendix examines the relationship between retention of title financiers and invoice financiers under a Personal Property Security Act

**Australia:**

Personal Property Securities Act 2009 s 64 provides that a pmsi with super-priority will not take priority over a previously registered non-pmsi in accounts. A factor can also gain priority over the pmsi if his interest in accounts is later in time than the PMSI but he provides a statutory notice to the pmsi holder.

**New Zealand:**

Personal Property Securities Act 1999, s 75A: A non-proceeds security interest in accounts receivable that is given for new value has priority over a purchase money security interest in the accounts receivable as proceeds of inventory if a financing statement relating to the security interest in the accounts receivable is registered before the purchase money security interest is perfected or a financing statement relating to it is registered.

This was an amendment (Personal Property Securities Amendment Act 2004) to the original position which gave priority to the pmsi holder.

**Ontario:**

Personal Property Security Act 1990, s 33(1) provides for pmsi super-priority over prior registered security in accounts

This is not a solution that will commend itself to invoice financiers, was abandoned in NZ and is not replicated elsewhere in Canada. See Personal Property Security Act 1993 (Sask), s 34(6)

**Law Commission:**

Because the Law Commission (*Company Security Interests* (Law Comm no 296 2005) para 1.14) do not recommend extending the scheme to retention of title and other title financing devices, the law regarding the relationship between those devices and assignments of receivables is left untouched.

Under the consultative report – para 3.223 – the Law Commission recommended that a secured party claiming an account as original collateral should have priority over a secured party claiming the account as the proceeds of a pmsi, provided that the receivables financier perfected its interest by filing before the pmsi secured party supplied the goods in question or filed in respect of its security interest. The Law Comm therefore adopts the more common approach and rejects the Ontarian system.
Appendix C

Here we have some selected provisions regarding the registration and priority position of retention of title clauses, but where the clause is not re-characterised.

Quebec Civil Code

Art 1749: …. If the reservation of ownership required publication but was not published, the seller or transferee may take the property back only if it is in the hands of the immediate buyer; the seller or transferee takes the property back in its existing condition and subject to the rights and charges with which the buyer may have encumbered it. If the reservation of ownership required publication but was published late, the seller or transferee may likewise take the property back only if it is in the hands of the immediate buyer, unless the reservation was published before the sale of the property by that buyer, in which case the seller or transferee may also take the property back if it is in the hands of a subsequent acquirer; in all cases, the seller or transferee takes the property back in its existing condition, but subject only to such rights and charges with which the immediate buyer may have encumbered it at the time of the publication of the reservation of ownership and which had already been published.

Art 1847: The rights of ownership of the lessor may be set up against third persons only if they have been published; the rights may be set up against third persons from the date of the leasing contract provided the rights are published within 15 days. As well, the transfer of the lessor’s rights of ownership may be set up against third persons only if it has been published.

Art 1852: The rights resulting from the lease may be published. Publication is required, however, in the case of rights resulting from a lease, with a term of more than one year, of a road vehicle or other movable property determined by regulation, or of any movable property required for the service or operation of an enterprise, subject, in the latter case, to the exclusions provided by regulation; the rights may be set up against third persons from the date of the lease provided they are published within 15 days. A lease with a term of one year or less is deemed to have a term of more than one year if, by the operation of a renewal clause or other covenant to the same effect, the term of the lease may be increased to more than one year.

Art 2700: A movable hypothec on property that is not alienated in the ordinary course of business of an enterprise and that is not registered in a file opened under the description of the property is preserved by filing a notice of preservation of hypothec in the register of personal and movable real rights. The notice must be registered within 15 days after the creditor is informed in writing of the transfer of the property and the name of the acquirer, or after he consents in writing to the transfer. The creditor transmits a copy of the notice to the acquirer within the same time. The notice must indicate the name of the debtor or grantor and of the acquirer and contain a description of the property.
Art 2961.1: The registration of reservations of ownership or rights of redemption, or of any transfer thereof, where it concerns a universality composed of movable property that is of the same kind and that may be sold or transferred in the ordinary course of business between persons who operate enterprises, preserves all the rights of the seller or transferee not only in that property but also in any property of the same kind for which reservations of ownership, rights of redemption or transfers between those persons are granted subsequent to the registration. However, such reservations, rights or transfers may not be set up against a third person who acquires any such property in the ordinary course of business of the seller’s enterprise. The registration is effective for a period of 10 years; the period may be extended if the registration is renewed. These rules also apply to the registration of rights of ownership under leasing contracts and of rights under leases with a term of more than one year, or of any transfer thereof, where the registration concerns a universality composed of movable property that is of the same kind and that may be the subject of such contracts in the ordinary course of business between persons who operate enterprises.

Convention on International Interests in Mobile Equipment:

Art 2.1: For the purposes of this Convention, an international interest in mobile equipment is an interest, constituted under Article 7, in a uniquely identifiable object of a category of such objects listed in paragraph 3 and designated in the Protocol:

(a) granted by the chargor under a security agreement;
(b) vested in a person who is the conditional seller under a title reservation agreement; or
(c) vested in a person who is the lessor under a leasing agreement.

An interest falling within sub-paragraph (a) does not also fall within sub-paragraph (b) or (c).

Art 7: An interest is constituted as an international interest under this Convention where the agreement creating or providing for the interest:

(a) is in writing;
(b) relates to an object of which the chargor, conditional seller or lessor has power to dispose;
(c) enables the object to be identified in conformity with the Protocol; and
(d) in the case of a security agreement, enables the secured obligations to be determined, but without the need to state a sum or maximum sum secured.

Art 29.1 A registered interest has priority over any other interest subsequently registered and over an unregistered interest.

2. The priority of the first-mentioned interest under the preceding paragraph applies:
(a) even if the first-mentioned interest was acquired or registered with actual knowledge of the other interest; and
(b) even as regards value given by the holder of the first-mentioned interest with such knowledge.

3. The buyer of an object acquires its interest in it:
   (a) subject to an interest registered at the time of its acquisition of that interest; and
   (b) free from an unregistered interest even if it has actual knowledge of such an interest.

4. The conditional buyer or lessee acquires its interest in or right over that object:
   (a) subject to an interest registered prior to the registration of the international interest held by its conditional seller or lessor; and
   (b) free from an interest not so registered at that time even if it has actual knowledge of that interest.

5. The priority of competing interests or rights under this Article may be varied by agreement between the holders of those interests, but an assignee of a subordinated interest is not bound by an agreement to subordinate that interest unless at the time of the assignment a subordination had been registered relating to that agreement.

6. Any priority given by this Article to an interest in an object extends to proceeds.

Art 30.1 In insolvency proceedings against the debtor an international interest is effective if prior to the commencement of the insolvency proceedings that interest was registered in conformity with this Convention.

2. Nothing in this Article impairs the effectiveness of an international interest in the insolvency proceedings where that interest is effective under the applicable law.