

The *Sam Hawk* supply chain creditors, stakeholders and the PPSA

Ship 'Sam Hawk' v Reiter Petroleum Inc. [2016] FCAFC 26



Peter Mills explores some of the complications that can arise for goods in transit when one of the 'links' in a modern supply chain becomes insolvent.



The article discusses some of the issues for stakeholders in modern supply chains.

These involve the 'stoppage notices' under the *Sale of Goods Act 1896* (Qld) and similar laws (SOG laws), and rights under the *Personal Property Securities Act 2009* (Cth) (PPSA) and similar unitary model secured transactions laws (PPS laws).

These are equally relevant to sellers, buyers, transport and logistics providers (as carriers), financiers and credit risk insurers of each stakeholder, and controllers who might be appointed to any of the stakeholders.

The writer recently acted¹ on behalf of the South Korea-appointed controller of Hanjin Shipping Co Ltd (Hanjin)². Hanjin was carrying some US\$14 billion worth of cargo – it was the carrier of some 10% of the total annual cargo shipped into the west coast of the United States – and its worldwide creditors were owed about US\$840 million³ when the administrator was appointed by a Republic of (South) Korea court.

Supply chain creditors

In modern commerce and supply chains, businesses buy and sell goods⁴ (which become part of the end mass or product,⁵ or are consumed (for example, fuel)) several times before an end user acquires them, as well as provide finance, insurance, transport and logistics.⁶ These stakeholders are often from more than one jurisdiction (both within and outside of Australia).

The goods will transit through one or more jurisdictions, and multiple stakeholders will have possession from time to time (for example, carriers). Often, one insolvent stakeholder will cause a chain reaction of payment problems both up and down the supply chain.

The PPS laws are designed to enable the efficient and transparent recording and priority over goods of 'security interests' of sellers or other financial transactions.⁷ The SOG 'stoppage notices' are designed to provide additional rights to the unpaid seller if the goods are still in transit when a buyer becomes insolvent.

Sam Hawk – the unpaid fuel supplier – no lien and no right to give a stoppage notice – possible PPS rights

The *Sam Hawk* was chartered by its owner to an Egyptian company, Egyptian Bulk Carriers (EBC). Fuel (worth US\$122,000) was ordered by EBC and supplied to the vessel in Istanbul, but was not paid for.

As the buyer of the fuel had already obtained possession, it was likely that a SOG 'stoppage notice' was not able to be given. The fuel supply contract stated that the laws of the US applied. Under the US maritime lien laws, a supplier of fuel is entitled to a maritime lien (as opposed to a contractual lien) over the vessel, and to have the vessel arrested, despite having no contract with the owner. The law of Australia, however, is that the supply of fuel does not give rise to a maritime lien under the *Admiralty Act 1988* (Cth).

The *Sam Hawk* was arrested in Australia under a Federal Court arrest warrant under the *Admiralty Act*. The creditor asserted that, as the contract provided for the US law, the *Admiralty Act* allowed for the arrest.

The Full Federal Court rejected this argument and held that the Australian law was the applicable law and so no lien existed. The *Sam Hawk* was ordered to be released. This effectively left the fuel supplier as an unsecured creditor.

Hanjin's chartered vessel, the *Hanjin California*, was arrested in Australia under a Federal Court *Admiralty Act* warrant by another fuel supplier, for fuel supplied in Singapore. The vessel was immediately released following the *Sam Hawk* decision with a similar outcome. The supplier also remained potentially liable for damages and costs of the unlawful arrest, due to provisions and undertakings required under the *Admiralty Act* and Federal Court practice.

It is worth noting that orders were also granted by the Federal Court under the model law,⁸ to restrain the arrest of any further Hanjin vessels and allow the unloading of cargo in Australia, so as to reduce additional claimants and claims up and down the supply chain.

If, however, the fuel suppliers in each case had been granted a security interest (for example, its retention of ownership of fuel until paid) and perfected it by registration under the PPS laws, they might have been entitled to obtain preservation orders, including the seizing of the vessel to preserve the collateral (being the unpaid fuel). This may have given the suppliers potential leverage in obtaining payment.

PPS laws and 'stoppage notices'

Under many goods supply contracts, the ownership of the goods is retained until payment in full is made. This is a registered 'security interest' under the PPS laws.⁹ This issue was not apparently argued in the *Sam Hawk* or *Hanjin California* cases.

The PPS laws recognise the transit of goods entering countries which have PPS laws, even though they may not have previously been subject to PPS laws before entry.¹⁰ This gives rise to several issues when you have an insolvent party in a supply chain who is a supplier, carrier, buyer or seller. These are just some of the examples and possible options:

- A buyer who gives possession of the purchased goods (which they own) to their insolvent seller (as bailee) is not normally granted a PPS laws security interest,¹¹ and so their ownership will not be lost if they have not registered against the insolvent seller.¹²
- Lack of familiarity with the PPS laws of a country into which the goods will be located can result in substantial loss being suffered by a non-compliant lessor or owner of goods.¹³
- Under many SOG laws, an unpaid seller may recover unpaid goods that are in transit by providing a 'stoppage notice' to the bailee/carrier before the goods are delivered to the buyer.¹⁴ This right will generally still arise despite lack of a security interest or perfection under PPS laws.
- The seller must give this stoppage notice as soon as possible and ensure that the goods are not released to the buyer (or their agent).
- Its purpose is to ensure that the 'stopped goods' do not become the property of the buyer/debtor's insolvent estate,¹⁵ so that the seller's rights in the stopped goods and sale proceeds remain superior to those of the buyer's controller and other creditors of the buyer.
- If the goods are released, despite the notice, the seller will lose their rights to recovery of the goods, but will be left with rights of conversion against the carrier and/or proof of debt against the insolvent buyer.¹⁶
- A supplier of goods to an insolvent buyer (which buyer has obtained possession of the goods) should check whether the supply contract grants the supplier a PPS laws security interest in the goods. Generally:
 - under the common law, commingling (for example, mixed supplies of fuel held in a tank) or processing of the goods (for example, refining) with other goods destroys the supplier's right of ownership in the goods.¹⁷ In some jurisdictions which do not have PPS laws (for example, the United Kingdom), this problem has been addressed in part by statute,¹⁸ following numerous cases involving goods such as commingled wine barrels,¹⁹ grain²⁰ and bullion²¹

- under PPS laws, a supplier's security interest in the goods automatically becomes a security interest over the whole of the commingled or processed product or mass.²² As such, a supplier of fuel which has become commingled with other suppliers' fuel may still be able to perfect and enforce priority over the whole of the fuel²³
- priority in commingled or processed goods is not determined by the date of lodgement,²⁴ for example, if one supplier lodges earlier than the others, it will not have priority ahead of other, later suppliers' registrations, and they will share under a statutory formula in the PPS laws
- the security interest should be perfected in the other jurisdictions and in Australia. Most registers are online, and take little time to effect a suitable registration, though they too have stringent rules as to the correct data to be lodged
- rights under bills of lading and other rights might also arise or have to be dealt with, instead of or in conjunction with exercising any rights under the SOG and PPS laws.²⁵

Takeaways

Suppliers and sellers in the supply chain should ensure that they have suitable contract terms and procedures to be:

- granted and register security interests under the PPS laws in whatever country the goods may be located in from time to time, and
- able to give 'stoppage notices' under SOG laws in a timely fashion, in addition to any rights under PPS laws.

Consider if goods are to be commingled or processed in the supply chain, and whether you can use PPS laws to overcome shortcomings in SOG laws.

Take steps to ensure that rights under the SOG or PPS laws are not lost due to delay in giving stoppage notices or lodging registrations.

It is also in the interest of financiers and credit risk insurers of sellers (and other members of the supply chain) to ensure that effective regulatory compliance for each of these rights is put in place, in order to minimise loss of property and risk exposure.

This article appears courtesy of the Queensland Law Society Banking and Financial Services Law Committee. Peter Mills is a special counsel at Thomson Geer and a member of the committee.

Notes

- ¹ By myself in PPSA and my colleague, Dr Neil Hannan, who is an expert on international insolvency.
- ² *Tai-Soo Suk v Hanjin Shipping Co Ltd* [2016] FCA 1404 and *Suk v Hanjin Shipping Co Ltd* [2017] FCA 404 – Hanjin was once one of the world's largest container ship operators, and was a key member of literally thousands of businesses' supply chains.
- ³ Urgent court orders were obtained to protect Hanjin's vessels and cargo, so as to enable the delivery of cargo to businesses of the supply chain/s and so reduce claimants from Australia and elsewhere. The application was based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency that has been incorporated into the domestic law of Australia under the *Cross-Border Insolvency Act 2008* (Cth) and those of a number of its trading partners.
- ⁴ Which become part of the end mass or product, or are consumed (for example, fuel). Section 10 definition of 'goods' PPSA.
- ⁵ See commingling provisions of the PPSA.
- ⁶ More often as carriers or storers of the goods.
- ⁷ See section 12 PPSA. This includes mortgages, charges, assignment of receivables and chattel papers, commercial consignments and PPS leases.
- ⁸ *Cross-Border Insolvency Act 2008* (Cth).
- ⁹ Section 12 (2)(d) PPSA. Examples: Section 17(1) *Personal Property Securities Act 1999* (NZ); Article 9 *Uniform Commercial Code* (USA); section 2(2) *Personal Property Security Act 2011* (PNG); Chapter 1 Article 2 Clause (kk)(i) UNCITRAL Model Law on Secured Transactions. There are more than 50 countries now subject to PPS laws.
- ¹⁰ See section 39 PPSA (relocation of collateral or grantor to Australia).
- ¹¹ *THC Holding Pty Ltd v CMA Recycling Pty Ltd* [2014] NSWSC 1136.
- ¹² See, however, lessors and bailors under PPS leases (section 13 PPSA) and section 267 PPSA.
- ¹³ *Power Rental Op Co Australia, LLC v Forge Group Power Pty Ltd (in liq) (receivers and managers appointed)* [2017] NSWCA 8 (6 February 2017) – loss of \$50m of equipment – both original lessor and buyer of the lessor's business did not apparently do due diligence as to PPS laws in Australia, as Article 9 *Uniform Commercial Code* (US) (where the equipment originated from) does not have 'PPS leases' for operating leases.
- ¹⁴ Examples: See sections 42(1), 46, 47 and 48 of the *Sale of Goods Act 1923* (NSW) and Division 3 *Sale of Goods Act 1896* (Qld); Article 2, § 2-705, *Uniform Commercial Code* (US).
- ¹⁵ See especially *Re Amerind* [2017] VSC 127 (subject to appeal).
- ¹⁶ *Toll Holdings Ltd v Stewart* [2016] FCA 256; see also opinion at *O2Cool LLC v TSA Stores Inc. (In re TSAWD Holdings Inc.)*, No.16-51014-MFW, 2017 Bankr. LEXIS 559, *2 (Bankr. D. Del. March 1, 2017).
- ¹⁷ *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25, 44-45.
- ¹⁸ For example, see section 18 rule 5(3) and (4) and sections 20A and 20B *United Kingdom's Sale of Goods Act 1979*. Similar, but not exactly the same provisions or having the same affect, appear in section 25A *Sale of Goods Act 1923* (NSW) (see discussion in *THC Holdings Case*, op. cit.) No equivalent provisions appear in the Queensland *Sale of Goods Act 1896*.
- ¹⁹ *Re Stapyton Fletcher Ltd* [1994] 1 WLR 1181 (ChD).
- ²⁰ *Re Wait* [1927] 1 Ch 606 (CA).
- ²¹ *Coleman v Harvey* [1989] 1 NZLR 723 (CA).
- ²² Section 99 PPSA and equivalent provisions in other secured transactions laws.
- ²³ See Part 7.2 PPSA esp. section 238.
- ²⁴ See section 98-103 PPSA.
- ²⁵ See section 8(1)(a) PPSA.