Are your retention of title provisions effective?

Retention of title clauses are found in most contracts for sale of goods. The concept of retention is a simple one whereby the supplier of goods protects itself against non-payment by retaining ownership of goods until payment is received from the customer.

The concept arises from the Sale of Goods Act 1979. The Sale of Goods Act provides that property in goods will only pass when the parties to the transaction intend it to pass, thus allowing a supplier to retain title to goods after delivery of those goods to the customer.

A seller wishing to retain title to goods until payment is made, must ensure that this intention is expressly stated in its contract with the customer; otherwise it is implied by the Act that title will pass on delivery.

Although a relatively simple concept, in practice, enforcing retention of title clauses can give rise to a number of problems.

Many predict that as the economy improves, we will see more corporate failures as weaker players in the market struggle to compete against stronger competitors. Businesses supplying goods on credit would be well advised to take a close look at their standard terms and conditions to check that they include a valid retention of title clause before these effects take place.

The purpose of this article is to provide a summary of the law on retention of title and to look at some of the issues that commonly arise, particularly in the context of insolvency.
THE BENEFIT FOR SUPPLIERS

Retention of title clauses are a powerful weapon for suppliers.

A supplier with the benefit of a valid retention clause will be able to assert that goods supplied remain its property and if the customer enters administration or liquidation, the goods will not form part of the customer’s insolvent estate and will not be subject to the insolvency regime. This means the goods will not be subject to the rights of secured creditors. In corporate insolvencies there is rarely enough money to pay all creditors and the opportunity for suppliers to avoid the rights of secured creditors is often invaluable.

If a customer enters administration or liquidation, the normal rule is that the assets of that company should be distributed in accordance with the *pari passu* rule and all unsecured creditors should be treated equally.

Retention of title clauses are designed to provide additional protection for unsecured creditors. The tendency for unsecured creditors to receive a low rate of return in formal insolvencies has led the Court to look on retention of title clauses with sympathy.

RETENTION OF TITLE CLAUSES

The Insolvency Act 1986 specifically defines a ‘retention of title agreement’ as an:

‘... agreement for the sale of goods to a company, being an agreement – (a) which does not constitute a charge on the goods, but (b) under which, if the seller is not paid and the company is wound up, the seller will have priority over all other creditors of the company as respect the goods or any property representing the goods’.

The term ‘goods’ is not defined in the Insolvency Act 1986; however, in the event of a dispute, the Court is likely to adopt the definition contained in the Sale of Goods Act 1979.

Retention of title clauses can be broadly categorised into four types:

1. a ‘simple’ retention of title clause whereby a supplier seeks to retain title to the specific goods supplied under the contract until it has received full payment for the goods;
2. an ‘all monies’, ‘all sums’ or ‘all accounts’ retention of title clause whereby a supplier seeks to retain title to all goods supplied to the customer, including the goods supplied under the contract and any other goods supplied by the seller, regardless of how the indebtedness arose;
3. a ‘proceeds of sale’ retention of title clause whereby the supplier permits the customer to sell the goods but seeks to retain a right to the proceeds of any sales; and
4. a ‘mixed goods’ or ‘manufacture’ retention of title clause whereby the seller sells goods to the customer for use in a manufacturing process, permits the customer to mix or combine the supplied goods with other goods, and seeks to retain rights to the new item or rights to the proceeds of sale from the new item.

As a general rule of thumb, the more extensive the rights claimed by the supplier in the retention of title...
clause the more difficult it will be for the supplier to enforce those rights.

MATTERS TO BE CONSIDERED BY A SUPPLIER CONSIDERING A RETENTION CLAIM

Incorporation

Many retention of title disputes centre on whether the seller has successfully incorporated its terms and condition, including the retention of title clause, into its relationship with the customer. This is a matter of contract law.

The most effective way of a supplier evidencing incorporation is by producing an agreement in writing, signed by the customer confirming its assent to the terms. Other modes of incorporation include taking steps to give reasonable notice of the terms, demonstrating that the terms have been incorporated in the parties overall relationship through a course of dealing or proving that industry standard terms are reasonably available to each party and applicable to the parties’ relationship.

Retention of title clauses commonly fail where a supplier seeks to rely on written terms and conditions printed on an invoice or delivery note, where no written contract was in place before the goods were supplied. Invoices and delivery notes are generally viewed as documents created in the execution of an existing contract, rather than documents with separate contractual effect, and a supplier seeking to rely on a retention of title clause printed on the reverse of an invoice or delivery note will not normally be treated as having incorporated the retention of title clause into the contract.

Consistency with other contractual terms

Suppliers should ensure that their retention of title clauses are consistent with their terms and conditions as a whole and the general purpose of the contract with the customer. In the case of Bulbinder Singh Sandhu (trading as Isher Fashions UK) v Jet Star Retail Ltd (trading as Mark One) (In Administration) & ors [2010], the High Court held that, although a retention of title clause had been successfully incorporated into the contract, the clause was ineffective because its operation would have been inconsistent with the contract as a whole. One of the key problems in this case was that the retention clause did not clearly identify when the operation of the clause was triggered.

Suppliers should take great care in drafting retention of title clauses to ensure that on insolvency there is an automatic trigger requiring the customer to immediately identify any remaining goods and provide possession of those goods to the supplier. Suppliers should also ensure that their retention provisions take into account the complete context of their contract with customers, otherwise the provisions may be ineffective.

Identifying the goods

A supplier with the benefit of a retention of title clause will only be able to reclaim goods supplied if the goods can be identified with sufficient certainty. As a result, it is good practice for suppliers to use distinctive packaging or marking, so that goods can be easily identified against the delivery note and invoice under which they were supplied. For electronic goods, serial numbers may also assist with identifying the goods. It is also good practice for sellers to incorporate a term in their terms and conditions requiring customers to store supplied goods separately from other goods so that they can be easily identified in the event of a customer’s insolvency. Of course, the later may not be possible where the goods are to be mixed or combined with other goods.
Right to enter the customer’s premises to reclaim the goods

In the event of a customer’s insolvency, many suppliers will want to be able to enter the customer’s premises to reclaim goods subject to a valid retention of title clause. Suppliers should therefore include an express term in their terms and conditions allowing them to have access to the customer’s premises for the purpose of collecting supplied goods, if required. Without a licence to enter the customer’s premises, a seller risks a complaint of trespass and a claim for damages.

Additional matters for ‘all monies’ clauses

Where a supplier has the benefit of an ‘all monies’ retention of title clause, title to goods supplied will not pass until all sums due under any contracts with the insolvent customer have been paid. If a valid clause exists, the seller will need to check that the goods being claimed relate to an unpaid invoice. It is important to remember that a supplier will not be able to claim title to goods supplied on any date prior to there being a nil or credit balance on the insolvent customer’s account because title to those goods would have passed to the customer at the point at which no monies were due to the supplier under the ‘all monies’ clause.

Tracing proceeds of sale

Where suppliers seek to assert a right to trace the proceeds of sale for goods supplied, there is a real risk that this will create an equitable charge. This creates a problem in the event of a customer’s insolvency because s87 of the Companies Act 2006 provides that such a charge is void and unenforceable against an insolvent estate unless it is registered at Companies House. Suppliers should ensure that their retention of title provisions are appropriately drafted to avoid the creation of a charge to avoid this problem arising. It is now generally accepted, following the decision in Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd [1976], that most ‘proceeds of sale’ clauses will be constructed as a charge and void for want of registration at Companies House. It has been suggested that the same could apply to an ‘all monies’ clause; however, the House of Lords decision in Armour v Thyssen Edelstahlwerke AG [1990] (a Scottish decision) is persuasive authority for the assertion that an ‘all monies’ clause does not create a charge. Given the difficulties with proceeds of sale clauses, it is advisable for sellers to use ‘simple’ retention of title clauses as far as possible because such clauses are likely to be successful and the goods should be recoverable in the event of a customer’s insolvency.

PRACTICAL ADVICE ON ENFORCING RETENTION PROVISIONS IN THE EVENT OF A CUSTOMER’S INSOLVENCY

If a customer is insolvent or looks likely to become so, suppliers should immediately check their terms and conditions to establish the extent of any retention claim.

Where a customer enters liquidation or administration, any supplier with the benefit of a retention of title clause should also notify the administrator or liquidator of its claim to retain title to goods promptly. If possible and reasonably practicable, the supplier should also arrange a visit to the insolvent company’s premises to identify the goods.

The method of enforcing the retention provision will depend on the type of insolvency. In a voluntary liquidation there is no statutory moratorium, so the seller will be able to enforce the retention clause against any supplied goods, providing the liquidator is satisfied on all aspects of the supplier’s claim. If the customer enters administration, the statutory moratorium will prevent the customer’s creditors enforcing their rights. The seller will not be able to enforce a retention clause during the period in which a statutory moratorium endures, unless it obtains the administrator’s prior consent or it obtains permission from the Court. The
Court will only lift the moratorium if the purposes of administration will not be impeded and if a balancing exercise favours such action. Such orders are rare and applications to Court should only be considered if the administrator’s consent is not forthcoming.

SPEED IS OF THE ESSENCE

The onus is on the supplier to prove its claim to the satisfaction of the administrator or liquidator so it is important that a supplier acts promptly. A supplier will normally need to provide the administrator or liquidator with a copy of the terms and conditions it seeks to rely on, including the retention provision, and a schedule of goods supplied to the customer. The insolvency practitioner will then examine the retention of title clause to ascertain the extent of the supplier’s claim.

The Insolvency Act 1986 provides some protection to insolvency practitioners who dispose of property which is not the property of the company. Insolvency practitioners have a duty to safeguard the assets of the company to which they have been appointed and will typically assume that any goods at the company’s premises and in the company’s possession belong to the company, unless they have reason to believe otherwise. Sections 234(3) and (4) of the Insolvency Act 1986 provide that insolvency practitioners can allow any property that they have reasonable grounds to believe belongs to the company to be disposed of without incurring any liability to the true owner of that property.

These provisions emphasise the need for suppliers to notify the insolvency practitioner of any retention provisions promptly. In the event of a company entering administration, it is likely that the administrator, in order to fulfil one of the statutory purposes of insolvency, will have to realise company assets and there is a clear risk that the insolvency practitioner will sell the supplier’s goods if they are not aware that the goods are the subject of a valid retention of title clause.

In the event of a pre-pack scenario, where the insolvency practitioner completes a sale of the business soon after their appointment, the supplier may need to notify both the insolvency practitioner and the buyer of the business of its intention to enforce its retention of title claim. It should be noted that the buyer taking possession of the goods does not obtain better title to the goods than the insolvent customer, under the standard terms of sale in insolvency, so the supplier’s proprietary rights remain enforceable.

SUMMARY AND COMMENT

Retention of title clauses are a powerful weapon for suppliers who would otherwise rank as mere unsecured creditors in the event of a customer’s insolvency; however, it is important that such clauses are carefully drafted to ensure that they remain effective in the event of a customer’s insolvency.

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