

Retention of title (“ROT”)

Introduction

The subject of retention (or reservation) of title creates much discussion and misunderstanding. It is, however, a very simple concept whereby a supplier of goods attempts to protect itself against non-payment by retaining ownership of the goods until payment is received. This guide covers retention of title from a practical viewpoint; it is not intended to be a detailed explanation of the law.

The ability to retain title to goods derives from the Sale of Goods Act 1979 (the Act). This states that property in goods sold passes when the parties concerned intend it to pass. Thus, it is possible for a supplier to retain title to goods after delivery to a customer. In a simple commercial transaction, the customer places an order on the supplier and the supplier accepts/acknowledges that order; a contract for sale then exists and goods and payment subsequently pass. The customer treats the transaction as a purchase and the supplier treats the transaction as a sale and property in the goods passes on delivery.

However, many suppliers stipulate in their conditions of sale that the title in the goods shall not pass until those goods, and sometimes other goods, are paid for in full. According to the Act, that is not a contract of sale but an agreement to sell. Whilst in practice the supplier and the customer will treat the transaction as a sale and purchase, the supplier is stating that it will sell the goods to the customer only if the customer pays for them.

In the event of an insolvency practitioner being appointed the supplier may claim that goods supplied but not paid for are subject to retention of title and must be returned or paid for by the insolvency practitioner.

The contractual position

Unless otherwise agreed in the contract, title to goods passes on delivery. Accordingly, the onus therefore on the supplier to incorporate other terms. However, the intention as to when title will pass must be agreed, or be deemed to be agreed, by both parties, not merely imposed by the supplier.

Although the courts have taken the view that retention of title conditions are common place it is advisable for a supplier to ensure that a customer is aware of the conditions, especially if they are out of the ordinary. Accordingly, the supplier should take reasonable steps to give notice of its terms of trading to the customer before any contract is made and the customer should indicate, either actively or passively, that it accepts those terms. The supplier, in taking reasonable steps, should if possible:

- Write to the customer setting out the retention of title conditions and requesting written acceptance of those conditions by the customer, ideally when a credit account is opened.

- Avoid entering into any contract with the customer until the written acceptance is received.
- Examine the customer's conditions of trade and, where those conditions conflict, obtain written confirmation that the supplier's conditions prevail.
- Obtain renewed acceptance of the conditions if they are subsequently altered in any way.
- Incorporate the conditions in every document pertinent to each transaction, particularly the document establishing the contract. An invoice is a post-contractual document and incorporation of the conditions in that document alone is ineffective.

The insolvent customer

Subject to any contrary conditions, a supplier that has entered into an agreement to sell, but has retained title to the goods until payment is made, is entitled to recover its goods. However, in the ordinary course of trade the supplier will assume that payment will be made eventually.

An insolvency practitioner has a duty to safeguard the assets of the company to which he has been appointed. He will assume that all goods on the company's premises and in the company's possession belong to that company, and any other person claiming to be the owner of any of those goods must prove his title. An insolvency practitioner will require to be satisfied on the following:

- That the customer agreed to the supplier's retention of title conditions and to the waiver of any conflicting conditions in its own terms of trade.
- That the goods claimed can be conclusively identified as having been supplied by the supplier.
- That the goods claimed were supplied under the conditions quoted by the supplier.
- That the goods claimed can be identified specifically to unpaid invoices, or that the retention of title clause extends to goods supplied at any time.

The simple clause retaining title in goods until payment is made has given way to clauses that purport to give title to goods that are no longer the goods that were supplied, to the proceeds received by the customer from the sale of those goods, and to various combinations of both. The various types of clause are outlined below.

Claims to original goods

Where the supplier simply retains legal ownership of the specific goods until payment is made and goods can be identified against specific unpaid invoices its claim is likely to be successful and its goods should be recoverable.

Claims to altered goods

When goods are mixed up with other goods, or change in any way, it becomes more difficult for the supplier to trace its title in those goods as it cannot claim title to something that it never had. Where goods are destined to lose their identity almost immediately after delivery, the supplier cannot claim that the customer was holding those goods for the benefit of the supplier and there can be no right to trace where the original goods lose their character and what emerges is a wholly new product.

Thus, if it is known that goods are to be used in a manufacturing process before they are paid for, a supplier cannot rely on a simple retention of title claim. Where goods are incorporated into something else but retain their separate identity and can be removed without undue harm to other goods, the retention claim may succeed.

Extended claims

Many retention of title clauses contain more than a simple claim to the specific goods for which payment has not been made. A supplier may incorporate an 'all monies clause' within its conditions, so that title in the goods will be retained not only whilst those particular goods are not paid for but also while any money is owing by the customer. In such cases there is no need to identify goods against specific invoices but the goods must have remained in an identifiable and unmixed state. However, as having been supplied by that supplier the supplier's claim can relate to goods supplied only since the date on which the account between the parties showed a nil balance or a balance due by the supplier.

Claims to proceeds of sale

In order for a claim to the proceeds of sale to be successful, it appears that the following requirements should be met:

- It should be agreed between the parties that the customer is bailee for the supplier and that a fiduciary relationship exists (i.e. that the customer is effectively trustee for the supplier's good).
- The customer should be stated as being the supplier's agent if the customer sells the goods.
- There should be a requirement that the proceeds of the sale of goods be banked separately from other income of the customer.

The treatment of proceeds leads to a number of problems:

- If the supplier does not insist on separate banking but allows the proceeds of the sale of goods to mix with other income, it is creating an interest over the customer's assets and must register that interest as a charge under section 860, Companies Act 2006.
- If the supplier requires separate banking but fails to ensure that the customer is complying with that requirement, it may be construed that it has consented to a breach of the contract.

- If the contract incorporates a credit period, there is the inference that, within that period, the customer is free to use the sale proceeds and this defeats the supplier's interest in those proceeds.

The leading case on ROT

The case of *Clough Mill v Martin* was decided in the Appeal Court in November 1984 and raised a number of interesting, if contentious, matters. Clough Mill's retention of title conditions provided that ownership of the yarn that it supplied remained with Clough Mill, as did the property in any goods manufactured from its yarn. The court decided that:

- The supplier could not be expected to register a charge over its own goods when the customer had never obtained title to those goods.
- Whereas in previous cases before the court it had been decided that if part of a retention of title clause failed the whole clause failed, the court considered that each part of a clause could be treated as a separate component and that whilst some components might fail others could succeed.
- The intentions of the parties were paramount and the court would do all that it could to ensure that effect was given to those intentions. The court could see no reason why the customer could not be bailee or fiduciary agent for the supplier until such time as goods were consumed or sold, even if the supplier had no right to trace the property in its goods into the proceeds of sale.
- Although the retention of title claim on the original goods was valid, it was not possible to follow that claim into manufactured goods. The court envisaged the situation of manufactured goods made up of some goods that were paid for and some not, some goods that were subject to retention of title and some not, the incurrance of manufacturing costs and the end result of a number of suppliers each claiming title to the same goods. The effect of attempting to claim such title would constitute a charge over the customer's goods which would require registration.

Administration

Whilst administrative receivers and liquidators have no statutory protection against retention of title claims, and must deal with them on commercial grounds, administrators are given certain protection by the Insolvency Act 1986. While an administration order is in force, any goods in the company's possession under a retention of title agreement cannot be repossessed except with the consent of the administrator or the leave of the court. The administrator cannot, however, dispose of any such goods without leave of the court and the owner of the goods will be entitled to receive the net proceeds of sale or, if greater, the market value determined by the court. The supplier will, of course, have to establish the validity of its retention of title claim

How to claim ROT

You would be amazed how many suppliers have perfectly valid ROT claims they could make but simply don't bother. If you hear that a customer has gone bust and think you have a claim:

- Make your claim quickly in writing to the insolvency practitioner.
- Visit the trading premises to identify your goods. List them and make sure your representative and the insolvency practitioner's representative sign the list.
- Answer the insolvency practitioner's ROT questionnaire demonstrating your terms were incorporated.
- Don't take no for an answer.

Conclusion

Retention of title is a perfectly valid concept upheld in law in particular:

- A simple retention of title clause is likely to succeed if specific goods can be identified as being unpaid for.
- Goods that have been mixed cannot be held by the customer as bailee because it cannot give them back to the supplier. In such circumstances, it is likely that title will have passed, and a charge will be required for the supplier to maintain any further interest.
- Where goods are incorporated into something else but retain their identity and can be separated, a claim to retention of title is likely to succeed.
- An all monies clause may succeed.
- Where the supplier lays claim to the proceeds of sale, it must ensure strict adherence to specific conditions and the customer must be seen to be an agent bailee for the supplier and usually the supplier will need to have a registered charge at Companies House.

From a practical point of view, it is essential for the supplier to ensure that its retention of title conditions are known to and accepted by the customer and that, when making a claim, the supplier can identify its goods beyond doubt, preferably against specific unpaid invoices. The courts have expressed the view that retention of title clauses have become commonplace and that they will use their best endeavours to ensure that the intentions of the parties are upheld.

For further information on this or any other business rescue or insolvency related matter please contact us on 0800 085 5070.

The information provided in this report is of a general nature and should not be relied upon in specific circumstances. Always take your own independent legal or other professional advice.