



Restructuring and insolvency

Retention of title

Summary and implications

The purpose of this briefing is to provide basic guidance on retention of title (ROT) clauses and claims. This briefing provides a short summary. Each case is different and specific advice should be taken on an individual basis.

The benefit to a supplier of a ROT clause

Where a company enters liquidation or administration or an individual becomes bankrupt, by the applicable insolvency law, the assets of that company or individual are required to be distributed in accordance with the **pari passu** rule, which in essence requires that creditors of equal status be treated equally by being paid from the assets of the insolvent party in proportion to the amount of their claim.

The low rate of return for unsecured creditors in formal insolvencies has incentivised suppliers to protect themselves from becoming mere unsecured creditors in the event of a buyer's insolvency by incorporating a ROT clause into their contracts with their buyers. Ordinarily title to goods passes on delivery but there is nothing to stop the parties to a supply of goods contract agreeing that title is to pass at a later date. Goods to which a ROT clause attaches do not become assets of the buyer on delivery but when the further conditions as laid down in the ROT clause are satisfied, typically when the buyer has paid for the goods supplied. In this way, the supplier can avoid becoming a mere unsecured creditor in the event of the buyer's insolvency as title to the goods supplied never transferred to the buyer.

Four types of ROT clause

Retention of title clauses may be categorised into four different types:

1. a "simple" ROT clause where the supplier seeks to retain title only to those goods supplied under the contract that have not yet been paid for;
2. an "all monies" or "all accounts" ROT clause where title is retained to **all** goods supplied by the supplier including those that have been paid for until the buyer has paid all monies owed to the supplier for the entirety of the goods supplied;

Ask a question

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3. a “proceeds of sale” ROT clause where the supplier permits the buyer to sub-sell the material supplied with the supplier seeking to establish rights to the proceeds of those sales; and
4. a “manufacture” ROT clause where the supplier permits the buyer to use the material together with other materials either owned by the buyer or by a third party to manufacture a new item with the supplier seeking to establish rights to the new item or rights to the proceeds of sale of the new item.

In our experience, the more extensive are the rights claimed by a supplier in a ROT clause, the more likely it will be that a claim by the supplier seeking to enforce those extensive rights can be successfully defended by a buyer.

In particular, “proceeds of sale” and “manufacture” ROT clauses as more precisely described above have typically been held by the courts to give rise to charges requiring registration.

Suppliers looking to incorporate a ROT clause into their supply contracts should consult their lawyers for advice on the best type of clause and the proper wording of the clause in light of the supplier’s circumstances.

Four basic points for a supplier or insolvency practitioner dealing with a ROT clause to bear in mind

1. *Has the retention of title clause been incorporated into the contract by which the goods were supplied by the supplier to the buyer?*

This requires consideration of basic contract law principles. One of the most common causes for the failure of an ROT claim by a supplier is where the parties do not enter into a written contract in advance of the supply and the ROT clause on which the supplier seeks to rely is instead contained in the supplier’s written terms of business printed on the reverse of the invoice or delivery note. Typically, this will have the effect that the ROT clause is not incorporated into the contract and the supplier will not have retained title to the goods supplied under that contract. It is strongly preferable to get the buyer to sign off on written terms of supply that include the ROT clause in advance of the supplier’s supplying the goods.

2. *Can the goods being claimed by the supplier be identified?*

It is supplier’s best practice to mark the goods with its name and to require as a term of the contract of supply that the goods be kept separate from the buyer’s goods. Ideally, the goods will be marked so that it is possible to identify the specific invoice under which they were supplied. This will lower the risk of the insolvency practitioner’s being able to argue that, even though some goods were supplied by the supplier under a valid ROT clause, they were not kept separate from the buyer’s other goods and so are no longer identifiable.

If the clause is a “proceeds of sale” or “manufacture clause”, identifying whether there is still property to which the supplier is entitled may depend on complicated tracing rules, the details of which are outside the scope of this briefing.

A ROT clause seeking to trace into manufactured goods where the process of manufacture is irreversible and does not involve the simple mixing of homogenous goods will likely not be upheld by a court save as a charge, in which case the supplier, whether dealing with an individual, a

partnership or a company, must go to the expense and hassle of registration else the charge may be void as against a subsequently appointed liquidator/administrator or trustee in bankruptcy.

3. Do the goods that are being claimed by the supplier under the ROT clause relate to an unpaid invoice?

If the ROT clause is a “simple” clause as detailed above, title to the goods will remain with the supplier only if they were supplied pursuant to an unpaid invoice, even if there are other invoices for the supply of other goods still unpaid by the buyer. This limitation does not affect “all monies” or “all accounts” ROT clauses. Even in the case of these more extensive clauses, however, the supplier will not be able to claim title to goods supplied on a date prior to there being a nil balance on the buyer’s account.

4. Does the contract permit the supplier to enter on the buyer’s premises to reclaim goods that are subject to the ROT clause?

It will also be a supplier’s best practice to include a term in the contract permitting the supplier to have access to the buyer’s premises for the purpose of collecting the supplied goods in the event that they are not paid for. Such a term may nevertheless be unenforceable where the buyer is in administration and so enjoys a statutory moratorium protecting the assets in its possession from enforcement action. It is important to understand that such a moratorium does not affect the underlying substantive rights, it merely prevents them from being enforced as long as the moratorium endures. Furthermore, the moratorium can be lifted to permit the supplier to take enforcement action with the consent of the administrator or the court. Relevant case-law is to the effect that the court should lift the moratorium:

- if to do so will not impede the purpose of the administration; and
- even where the purpose will be impeded, if the balancing exercise favours it.

Any supplier proposing to take enforcement action against a party in administration should first seek to obtain the consent directly from the insolvency officeholder, only if this is not forthcoming, should an application to court then be considered.

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