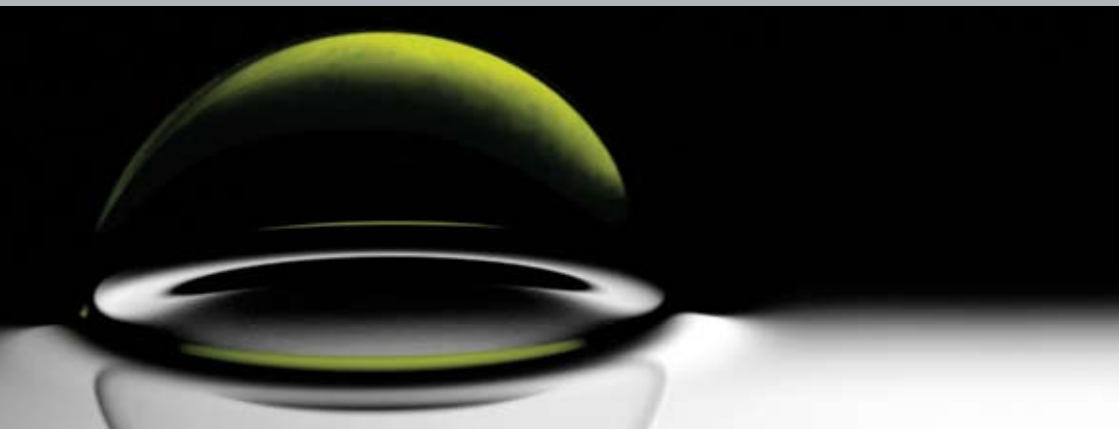


CLAYTON UTZ

Restructuring & Insolvency
Retention of title clauses



What is it?

Retaining title

Retention of title is a method by which a person who agrees to sell goods may still remain the owner of the goods (retain title to the goods) until some specified event occurs. Usually this event is payment of the price of the goods, but title to goods can be retained until payment of:

- the price of those goods, and other goods previously supplied; or
- all money owed by the buyer to the seller.

The purpose and effect of retention of title are to use the goods as a kind of security for payment of the price. To achieve this, a carefully drafted provision must be included in the contract of sale. If this is done, then after the contract of sale, but before payment, the seller remains the owner of the goods, but the buyer takes delivery, and may even sell the goods before paying for them.

Usually the clause will allow the buyer to do this as agent for the seller. On such a sale, the buyer's customer will get good title, at least if the customer buys in good faith, for value, and without notice of any restriction on the buyer's ability to re-sell.

Who needs it?

Retention of title is most useful for non-retail sellers of goods in a chain of distribution, such as:

- manufacturers or producers
- distributors
- wholesalers.

It is rarely used in retail sales, where other kinds of security arrangements (e.g. lay-by) are more usual, and where legislation on consumer credit becomes very important.

Retention of title is particularly useful if the credit period is relatively long, and the seller does not have any other arrangement with the buyer for securing payment of the price of goods supplied on credit. It operates like a security but, with care, many of the

formalities associated with ordinary securities can be avoided. It is appropriate to all types of goods, including raw materials, but the buyer's intended use may be important.

If, for instance, the goods will be used by the buyer in the manufacture of other goods, or will be attached to other goods, it may be that any attempt to retain title to these other goods will be ineffective, or result in a registrable charge. In such cases, careful contract drafting is needed to give the seller as much protection as is possible in the particular circumstances.

How does it work?

For retention of title to work, it is first essential to ensure that each contract for the sale of goods contains an appropriate clause. To achieve this, sellers may need to review their contracting procedures. A separate agreement, covering all sales, could be made with each major customer. If the retention of title clause is in a standard form "Terms and Conditions of Sale" or "Sale Note" or other document, sellers must ensure that it becomes part of each contract as made, and that the standard form is not contradicted by the buyer's own documents.

If a retention of title clause is effectively made part of the contract, it works to prevent the buyer from becoming the owner of the goods until the price is paid (or other condition is fulfilled), even though the buyer takes delivery. The clause usually provides for the buyer to store the seller's goods separately from other goods, or to take other steps to ensure that the goods remain identifiable as the seller's goods. The buyer is usually allowed to sell the goods to its own customers in the ordinary course of its business, often as agent for the seller. The effect of such sales is that the seller ceases to be owner, and the customer becomes the new owner.

What happens next?

Payment of the price

In the great majority of cases, a retention of title clause is never called in aid by the seller. If the price is paid (or other condition is met) the buyer will automatically become the owner of the goods.

Default in payment

If the buyer defaults in payment, the seller may nevertheless decide not to rely on the clause at that time. The seller may be satisfied that the buyer's difficulty is temporary only.

Enforcing the clause

Enforcement means that the seller demands return of the goods, and ultimately retakes possession of them from the buyer. Since the seller is, and the buyer is not, the owner of the goods, this demand cannot be resisted either by the buyer, or anyone claiming through the buyer, except a customer of the buyer who previously bought the goods in the ordinary course of the buyer's business. Thus the seller's claim to the goods is superior to that of a company receiver and manager appointed by a secured creditor of the buyer, and is still available to the seller notwithstanding the buyer's liquidation. If a voluntary administrator is appointed to the buyer, this may delay enforcement of a retention of title clause.

Proceeds of sale

The simplest retention of title clause allows the seller to reclaim the goods while they remain unsold and identifiable in the buyer's hands. One of the most difficult issues with such clauses is the extent to which they can be drafted so as to allow the seller to also claim the proceeds of any sale by the buyer, or to claim goods manufactured with, or that incorporate, the seller's goods. If this is attempted, there is a danger that the clause will be interpreted by a court as creating a charge on property of the seller in favour of the buyer, rather than as simply retaining title.

Retention of title and creation of security by way of charge are different concepts. A charge given by a company requires registration under the *Corporations Act 2001*, whereas a retention of title clause does not. It may be important that the seller does obtain an interest in proceeds of sale, or in other goods incorporating the goods sold, or even in the proceeds of sale of those other goods. Some of this can be achieved. The High Court decision in *Associated Alloys Pty Ltd v ACN 001 452 106* suggests, for instance, that concepts of trust law can be used to give the seller an interest in the proceeds or part of the proceeds of on-sale of manufactured goods. Such provisions need very careful drafting, and in practice may only be effective if the buyer puts appropriate accounting procedures in place.

Summary

Retention of title clauses have achieved enormous popularity with suppliers of goods in recent years. Once proper attention has been given to the seller's methods of contracting, such a clause can be made to form part of each contract of sale, cheaply and with minimal formality. The clause at least gives a right to the seller to demand the return of goods in the buyer's possession, not paid for but unsold by the buyer. Experience suggests that, if relied on by the seller only to this extent, a company receiver and manager or liquidator of a buyer will tend not to challenge the validity of the clause. Sometimes a liquidator or receiver will pay the price, if the goods are of use to the business.

Alternatively, the effect of the clause is that the seller will get the goods back, rather than having to claim the price. Either of these is a considerable advantage over having to prove for the price as an unsecured creditor in the liquidation of the buyer and probably eventually only receiving a small percentage of the value of the goods.

Restructuring & Insolvency group publications

The Restructuring & Insolvency group of Clayton Utz has prepared a series of brochures that provide an outline of the operation of relevant areas of law.

The complete set of brochures in the series comprises:

- Deed of company arrangement
- Company receivers and managers
- Third party guarantees
- Retention of title clauses
- Voluntary administration
- Liquidation
- Provisional liquidation
- Enforcing security rights

Treatment of the topic addressed in each brochure though comprehensive is not exhaustive. Moreover, a proper understanding of any particular situation demands an integrated approach. Clayton Utz is available to give advice over the whole range of issues relating to corporate restructuring and insolvency, including the position of secured and unsecured creditors, and the practical issues relating to enforcement of securities and debt recovery, structuring and restructuring transactions and litigation.

Copies of this brochure and the others referred to can be obtained free of charge from the Restructuring & Insolvency group of Clayton Utz.

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