Retention of title - weaknesses and reforms

Will your safety net catch you or tear apart when tested?

By Karl Hill*

While an effective RoT clause can be your saving grace if you are unfortunate enough to deal with defaulting and/or insolvent creditors, relying on a poorly drafted RoT or overlooking recent legislation reforms could leave you with nothing when push comes to shove.

Creditors should be aware of the recent Personal Property Securities (PPS) reform legislation. This now treats RoT clauses as security interests which require registration if they are to receive priority amongst competing claims.

In recent times we have acted in a number of matters where well-drafted RoT clauses have saved suppliers from losing their goods to defaulting and/or insolvent creditors.

What is a retention of title clause?
Businesses who sell goods on credit may incorporate an RoT clause (also referred to as a Romalpa clause) within their trading terms. Such a clause provides that title (or ownership) of the goods supplied does not pass to the customer until the customer has made payment for those goods. This applies even if the customer has taken possession of the goods.

If the customer does not pay, the supplier retains ownership of the goods and may take action to reclaim possession.

The importance to creditors
According to the Sale of Goods Acts in the different states, ownership of goods passes “when intended”. In most instances, this is when the customer takes possession of the goods. This means that when goods are purchased on credit, ownership of the goods would normally pass to the customer before payment has been received.

RoT clauses prevent ownership from passing until payment is received, even if possession has been transferred to the customer.

This means that if the purchaser cannot (or does not) pay for the goods or becomes insolvent, ownership of the goods remains with the supplier who can reclaim possession of the goods.

The type of RoT clause utilised will impact upon the supplier’s rights in respect of the goods. This is exemplified by the following real case examples.

Gaining unrestricted access – no trespass clause
Real case example
We acted on behalf of a wholesale seafood supplier. Frozen seafood products were supplied to a restaurant at a hotel. The restaurant did not pay its bills and was having financial troubles. Our client sought to collect its goods, but the restaurant owners refused them access.

Our client had a “no trespass” clause in the credit agreement and was able to rely on this clause to gain access to the premises and repossess the goods.

The act of entering onto someone else’s property without permission is trespass, irrespective of whether there is a good cause.

Effectively drafted RoT clauses include an access provision to permit suppliers to enter onto private property and collect the goods supplied under unpaid invoices. Without such a clause, a supplier’s RoT entitlements would be ineffective practically, because the supplier would have no entitlement to enter onto private property to reclaim goods which they hold title to.

Attacking proceeds of sale
Real case example
We acted on behalf of a manufacturer and wholesaler of camping equipment. One of the customers of our client was a camping store. The store was getting into financial trouble and the directors sought to liquidate the stock by selling it on an online auction site. Our client found out that this was happening.

Even though the camping equipment had already been sold, we were able to exercise our client’s rights against the sale proceeds, force the online auction site to treat them as being held on trust for our client and have the sale proceeds remitted back to our client.

The relevant clauses incorporated what are referred to as “tracing” provisions. They stipulate that sale proceeds from the goods supplied are deemed to be held on trust for the supplier.

Even if the sale proceeds are not held separately, a well-drafted clause will allow the supplier to trace the funds into the customer’s bank account.

The supplier must be able to prove that at least some of the current monies held in the customer’s bank account were generated from the sale of the goods under the RoT clause.

If the money is paid into an overdraft
account, the ability to trace is inapplicable, as the money is a payment to the bank.

**Keeping track of the goods**

**Real case example**
We acted on behalf of a large timber supplier. The customer was a timber yard who went into administration. Our client went into the timber yard to repossess their goods. The goods were all wrapped in plastic, and normally would have had a tag on the plastic identifying our client’s business name. All of the tags had been removed and the directors of the company smugly suggested that RoT did not apply as the goods could not be identified.

Our client opened the plastic packaging and was able to point to printed serial numbers on the timber which were unique to our client’s business (because they were allocated for internal inventory management and were cross-referable in our client’s computer system).

Our client was able to exercise the RoT claim.

For a seller to be able to effectively rely on a RoT clause, it is important that they are able to specifically identify the goods supplied as those subject to the unpaid invoice.

With an ‘all monies’ or ‘tracing’ clause, the seller must show that the goods in the buyer’s possession were in fact supplied by the seller, and not by anyone else.

Our client’s ability to identify goods by reference to their serial numbers meant the difference between recovering the goods, and being left with a bad debt.

**Recovering all goods, despite part payment – all monies clause**

**Real case example**
A clothing manufacturer supplied a company with goods for their retail shop. The retail company went into receivership. The manufacturer claimed moneys due and payable under a number of invoices. They had an ‘all monies clause’ within their contract and were able to recover the goods (even those which related to paid invoices), as title to the goods did not pass until all monies due and outstanding were paid.

These clauses also retain title to goods that have been supplied under paid invoices. This clause states that title or ownership of goods does not pass to the customer until all indebtedness is paid. This is the case even if some invoices have been paid. Any of the goods supplied are able to be collected, whether they are related to the unpaid debt or not.

When the indebtedness of the customer is reduced to nil at any time, the supplier loses their rights to repossess the goods, as the title to the goods will have passed to the customer.

Goods that the supplier attempts to collect under unpaid invoices that arise at a later stage must be properly identified by the supplier as goods having been supplied under the unpaid invoices, or after the account was nil. The goods...
supplied prior to the nil account may not be collected.

Where transactions are recorded in a number of agreements, an all monies clause should be drafted to supersede any inconsistent intention that may exist within the other agreements forming part of the transactions.

How the Personal Property Securities reform can affect your RoT clauses

The Personal Property Securities Act 2009 (Act) was enacted by the Commonwealth Government in December 2009 and comes into effect in May 2011. It provides for a national regime for the registration of security interests over personal property. It is important for creditors to recognise the impact of the legislation on RoT clauses to ensure they are well prepared for the changes.

Under the Act, a RoT clause is deemed to be a security interest to which the Act applies. This means that a RoT clause is still valid, but will be subject to priority rules and the requirements of the Act.

Where a supplier provides goods on credit and subject to a RoT clause, the supplier should register their interest on the PPS Register to ensure they do not risk losing their priority over the interest. If a supplier does not register their interest, they will have an unperfected (unregistered) security interest. A perfected (registered) security interest may defeat an unperfected interest if the interest is granted by the buyer to a third party.

The Act also applies in circumstances where the buyer has been supplied goods subject to a RoT clause, and subsequently becomes insolvent, is declared bankrupt or wound up. In the case of bankruptcy or liquidation, the interest vests in the bankruptcy trustee or liquidator, and will make void any unperfected (unregistered) security interest.

To ensure that suppliers do not lose priority over goods supplied to buyers on credit, it is imperative that they register their security interest under the PPS legislation.

FAQs – Retention of title claims

Where are these clauses used?

RoT clauses are usually in writing, and located in a credit application within the standard credit supply terms. They may also be printed on the invoices and statements. To be enforceable, they must be clearly communicated to and accepted by the customer before the goods are supplied.

How does a supplier repossess their goods?

As the RoT clause ensures the goods still belong to the supplier, they are entitled to repossess the goods. It is imperative that the RoT clause is well written to ensure successful recovery of the goods. A well written RoT clause should state that the supplier has the right to enter the customer’s premises for the purpose of recovering the goods if they are not paid for within a stated period of time. This is important as, without such a provision, it may be difficult to re-take possession of the goods, it may cause delay or amount to trespass on the property of the customer.

How are the goods identified by the supplier?

The onus is on the supplier to prove that the particular goods are theirs, and were supplied under the specific invoice that remains unpaid. Suppliers may use invoice numbers or identification marks to match certain goods with particular invoices.

What if the goods cannot be identified?

If the goods are unable to identify the goods under two separate invoices, and one of the two is unpaid, the supplier must identify the goods under the unpaid invoice or they risk losing their right to repossess the goods.

What happens if the goods have been on-sold?

In order to retake the goods, they must be in possession of the customer. If the goods have been on-sold to a third party, possession would have passed to that third party and the goods cannot be collected. This may occur during normal trading.

What happens if the goods have been used or improved?

The goods must be identifiable and be able to be separated in order to be collected. If the goods have been used or improved due to the process of manufacturing, the improved good, or the newly manufactured item may not be able to be recovered. This may occur where:

- the goods supplied are part of, or affixed to, another item; or
- the goods have been mixed into, or applied to, another item.

The goods may be recoverable if they have just been attached to another item, their identity remains intact and they are able to be separated easily without damage. If the goods are unable to be separated, or their identity no longer remains, they generally cannot be recovered.

Plan of action – increase the enforceability of your rights

With due care in ensuring RoT clauses are drafted well, and diligence in protecting interests through registering them, creditors can increase the enforceability of their rights should the need arise.

- Implement a well drafted RoT clause into the terms and conditions of trade.
- Ensure that the type of RoT clause is appropriate for the nature of the product
- Register their interests to protect their position (as soon as the PPS legislation comes into effect).

One overlooked technicality can be the difference between retaining goods or losing them forever. To ensure that your goods and bottom line are best protected, always seek advice from a specialist legal provider or call 1300 757 534 for further information.

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