

# Bonus Question 1

Natureally plc sells leather to various garment makers on terms that require payment 30 days after delivery. About 50% of its sales are to regular customers and the rest are to 'one-off' customers. Some of its customers resell the leather, whereas other customers use it in the manufacture of jackets and other garments which are then stored or sold.

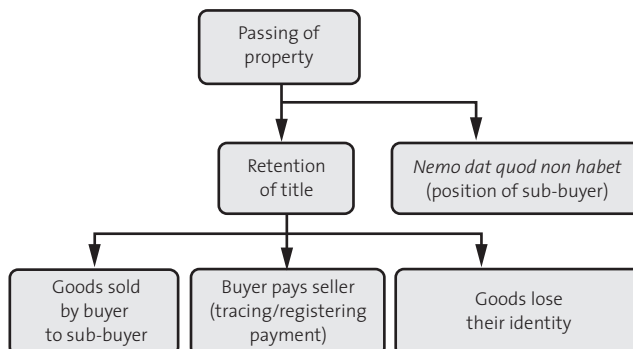
- Advise Natureally plc on why it ought to consider incorporating a retention of title clause into its standard terms of sale and what protection such a clause might provide.

## How to Answer this Question

The question invites an explanation of the purpose of retention of title clauses and a discussion of the effects and effectiveness of them. You should approach the question as follows:

- ❖ explain the purpose of retention of title clauses;
  - ❖ deal with the passing of risk;
  - ❖ state the requirements for an effective clause;
  - ❖ explore the limits on effectiveness without being registered where:
- (a) the buyer sub-sells the goods (and can the seller take an interest in the proceeds of the sub-sales?);
  - (b) the buyer pays for the goods (and what if he only makes part-payment or if the buyer owes other money to Natureally plc?);
  - (c) the goods lose their identity.

## Applying the Law



How the law relates to passing of property in this question is illustrated here.

## ANSWER

The reason why Natureally plc ought to consider incorporating a retention of title clause into its standard terms of sale is to protect itself against the risk of one of its customers becoming insolvent and hence going into liquidation before the customer has paid Natureally plc for the leather supplied. Without a retention of title clause or some other form of security, Natureally plc would in that event be a mere unsecured creditor of the insolvent buying company and would be lucky to get more than a small proportion of the debt owed to it. The purpose of a retention of title clause would be to put Natureally plc in a stronger position in the event of the buyer going into liquidation – that is, if the goods had not been paid for, to enable Natureally plc to retake possession of the goods (Natureally plc's goods) and to do so irrespective of how many other creditors the insolvent buyer might have.

### PASSING OF RISK

Before dealing with the effectiveness of a retention of title clause to protect Natureally plc, a warning should be given about the passing of risk. A retention of title clause, when it works, will result in title (that is, ownership, or what the **Sale of Goods Act 1979** terms 'property') being retained by Natureally plc (that is, not passing to Natureally plc's buyer) for some considerable time after delivery. However, by **s 20(1)** of the **Sale of Goods Act**, the goods will, unless the contrary is agreed, remain at the seller's risk until the property in them passes to the buyer. Thus, Natureally plc would be well advised, when including a retention of title clause in its conditions of sale, either to include also a clause stating that the goods will be at the buyer's risk from the moment of delivery, or else to see that Natureally plc is covered by its own insurance for loss or damage caused after delivery by accident, act of God or act of a third party.

### EFFECTIVENESS WITHOUT BEING REGISTERED

By a properly drafted retention of title clause, Natureally plc can ensure that it retains property in the goods supplied until one of three events occurs. As soon as one of these events occurs, property will pass (that is, Natureally plc will lose title to the goods). Those three events are: first, that the goods are sold by the buyer and property passes under that contract to the buyer's sub-buyer; second, that the buyer pays Natureally plc; third, that the goods, although still unsold by the buyer, lose their identity on becoming incorporated in something else. The point is that, until one of these events occurs, Natureally plc will have *retained* title to the goods and will be able, on the buyer going into liquidation, to retake the goods, thereby enforcing its rights of ownership. Such a right does not have to be registered as a charge, because the requirement (in **s 860** of the **Companies Act 2006**) to register applies only to charges *created* by the buying company. Thus, both the Court of Appeal (in *Clough Mill v Martin* (1985)) and the House of Lords (in *Armour v Thyssen* (1990)) have held that retention of title clauses are enforceable without being registered.<sup>1</sup> Attention will now be paid in turn to each of the three possibilities that will cause Natureally plc to lose ownership in the goods even where there is a retention of title clause.

<sup>1</sup> Referring to examples supports and strengthens your analysis; it also demonstrates your knowledge.

## BUYER SELLS THE GOODS

Natureally plc may think that it would be wise to retain title until the goods have been paid for and to ensure that if they have not been paid for, Natureally plc still retains title even if the buyer sells the goods. This, however, would be unrealistic. It is very likely that Natureally plc's buyer needs to be able to sell the goods in order to maintain its own cash flow and thereby to be able to settle its debts, including those owed to Natureally plc. On the other hand, if that buyer were unable to pass on good title to a sub-buyer to whom it sold the goods, it would be very unlikely to be able to find willing sub-buyers. In any case, even if the retention of title clause were to purport to retain title for unpaid goods even after they had been sold on to a sub-buyer, there is always the risk that the sub-buyer, if unaware of the retention of title clause, would claim nevertheless to obtain title by virtue of one of the exceptions to the principle *nemo dat quod non habet* – in particular, the one in **s 25(1)** of the **Sale of Goods Act 1979**. Therefore, a sensibly drafted retention of title clause will authorise the buyer to sub-sell the goods (see *Aluminium Industrie v Romalpa* (1976)) so that the buyer in sub-selling the goods will, vis-à-vis the sub-buyer, be selling as a principal and, vis-à-vis Natureally plc, be selling as an agent of Natureally plc.<sup>2</sup> Technically, of course, Natureally plc would not lose ownership and the sub-buyer would not acquire ownership until, according to the terms of the sub-sale, property passes from the buyer to the sub-buyer.

If then, as seems inevitable, Natureally plc is not to retain ownership after the time when property is to pass to the sub-buyer, is there any way that Natureally plc can continue to protect itself against the subsequent insolvency of the buyer? The answer, confirmed by the decision in the *Romalpa* case, is that an appropriately worded clause *may* give Natureally plc an interest in the proceeds of sale received by the buyer from the sub-buyer. For such a result to be achieved, the clause will need to make it clear that in having possession of and sub-selling the goods, the buyer is agent of, bailee of, fiduciary of and selling for the account of the seller. Then, if the buyer has kept any such proceeds of sale in a separate account, Natureally plc will, in priority over the buyer's other creditors, be able to take those proceeds of sale to satisfy the outstanding debt due to Natureally plc. If the proceeds have been mixed by the buyer with other monies, then Natureally plc may be able to trace according to the equitable principles of tracing (*Re Hallett's Estate* (1880)). It is important that the clause complies with the requirements set out above. Even then, there is uncertainty surrounding clauses aimed at securing to the seller (here, Natureally plc) an interest in the proceeds of sub-sales by the buyer. Some of this uncertainty was exposed in *Pfeiffer GmbH v Arbuthnot Factors* (1988), where the clause authorised the buyer to sub-sell and required the buyer to pass on to the seller all the buyer's rights under those sub-sales contracts, requiring this to be done up to the amount of the buyer's indebtedness to the seller. It was held in the High Court that this was a charge created by the buyer and was void because it was not registered under the **Companies Act**. There

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2 Even if no express provision is made in the contract allowing the buyer to resell the goods, courts are likely to imply such a term, especially when commercial parties are involved. See *Four Point Garages v Carter* (1985) and *Fairfax v Capital Bank* (2007).

were two significant distinctions between the clause here and that in *Romalpa*. First, the clause providing that the buyer in sub-selling was doing so for the account of the seller was expressly limited to the amount of the outstanding debts owed by the buyer to the seller. Second, it failed expressly to state that the buyer was, in selling the goods, a fiduciary of the seller. One possibly significant uncertainty in all of this is that in *Romalpa*, the one case where a seller has successfully claimed an interest in the proceeds of sub-sales, the decision rested on a concession made by counsel for the buyer's receiver, namely, a concession that the relationship of seller and buyer was that of bailor and bailee. Advice to Natureally plc is therefore to include in the contractual retention of title provisions a clause which deals with the proceeds of sub-sales and satisfies the requirements indicated above, but to recognise the uncertainty over its legal effect, if not registered as a charge created by the buyer.

### BUYER PAYS NATUREALLY PLC

For those customers of Natureally plc that are 'one-off' customers, the clause need retain title only until the purchase price has been fully paid. The effects of such a clause were set out in *Clough Mill v Martin* (1985) (partly *ratio* and partly *obiter*). If the buyer goes into liquidation before paying for the goods, then Natureally plc can retake the goods. Natureally plc can then resell the goods itself, since they are its property. If Natureally plc sells them for more than the original price that the buyer had agreed to pay, then Natureally plc will make a profit which it would not have made if the buyer had paid for the goods before going into liquidation; Natureally plc will be entitled to retain that profit. If Natureally plc is able to resell the goods only for a lower figure than the buyer had agreed to pay, then Natureally plc will have a claim for damages against the buyer for the consequent loss; however, Natureally plc will be unlikely to recover much of that loss, in respect of which it will be merely an unsecured creditor of the insolvent buyer. If, at the time when the buyer had gone into liquidation, the buyer had paid *part* of the purchase price to Natureally plc, and if Natureally plc, having repossessed the goods, is able to sell them for the same price that the buyer had agreed to pay, Natureally plc will be under a duty to refund the buyer's part-payment. If, however, Natureally plc has been able to resell the goods only at a lower figure than the buyer had agreed to pay, then Natureally plc will be able to deduct that loss from the amount of any refund.

For Natureally plc's regular customers,<sup>3</sup> the clause should, in the interests of Natureally plc, be an 'all liabilities' clause; it should retain title until the buyer has satisfied all his liabilities to Natureally plc, whether arising under this or any other contract. That such a clause can be effective was confirmed by the House of Lords in the Scottish case of *Armour v Thyssen* (1990), and it is not thought that the law is any different in this respect in England. Indeed, the reasoning in that case would seem also to legitimise a clause which retains title to Natureally plc until all debts owed to Natureally plc by the buyer or by any subsidiary or associated company of the buyer have been paid.

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3 A logical structure is the first step towards gaining a good mark. You need to present your arguments in an organised manner, don't jump. This is a good example of how to achieve this: the discussion of issues involving 'one-off' customers is followed by the discussion relating to the regular customers.

## GOODS LOSE THEIR IDENTITY

It has been established in various cases that a retention of title clause will cease to be effective once the goods have lost their identity by becoming incorporated in something else. This usually occurs in the buyer's manufacturing process, for example, resin becoming incorporated in chipboard (*Borden v Scottish Timber Products Ltd* (1981)), or pieces of leather becoming incorporated into handbags made by the buyer (*Re Peachdart Ltd* (1984)).<sup>4</sup> It seems that Natureally plc cannot retain title to the leather once that leather has been used in the manufacture of other products, such as jackets, trousers, etc. It seems unlikely that the leather (unlike the engines in *Hendy Lennox v Grahame Puttick Ltd* (1984)) could be incorporated in something else without losing its identity. Thus, Natureally plc cannot protect itself where the leather has been incorporated in something else in the buyer's manufacturing process, without registering a charge created by the buyer over the manufactured product.

## CONCLUSION

Natureally plc would be well advised to include retention of title provisions in its contracts, which, if carefully drafted, should serve to give some security against the risk of the buyer becoming insolvent. Without being registered as a charge, those provisions should be effective in the case of unmixed goods and, possibly, the proceeds of sale of unmixed goods.

### Common Pitfalls

Students need to categorise the goods in order to ascertain where property in the goods is vested so that risk can be considered.

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4 The inclusion of concrete examples demonstrates your knowledge and understanding of the relevant legal rules and also substantiates your analysis.