



CONSIDERATIONS FOR SUPPLIERS OF GOODS

NOVEMBER 2020

INTRODUCTION

This note will cover two main topics of importance for the suppliers of goods. Firstly it will consider termination clauses in supply contracts. Following recent changes to UK insolvency laws, most suppliers (referred to hereinafter as a Seller) are now unable to terminate a supply contract because a customer (referred to hereinafter as a Buyer) has entered a relevant insolvency procedure. The changes stem from the Corporate Insolvency and Governance Act 2020 (the “Act”) which received Royal Assent on 25 June 2020 and came into force on 26 June 2020. This note considers the new provisions in more detail, the implications that they may have for BTHA members, what exclusions could apply and any practical steps that BTHA members can take to minimise the effect of these new changes.

Secondly, the note covers retention of title clauses (“**ROT Clauses**”) which are designed to ensure that a Seller retains ownership of the goods that it supplies until such goods are paid for. An ROT clause is only of any use if it is validly incorporated into the sale/supply contracts between BTHA members and their customers. This note considers the types of ROT Clause that are available to BTHA members, their effectiveness and what practical steps can be taken to ensure that they are validly incorporated. The note also considers the changes introduced by the Act as under the new regime a Seller may be prevented from enforcing a ROT clause on the Buyer’s insolvency making it crucial that such clauses are tightly drafted and can be triggered pre-insolvency on grounds such as the non-payment of invoices within terms.

PART 1- TERMINATION CLAUSES

1. PROHIBITION ON EXERCISING TERMINATION AND OTHER RIGHTS (IPSO FACTO CLAUSES)

The most significant change for BTHA members to be aware of is that as result of the new Act Sellers will be prevented from exercising a contractual right of termination (and doing “any other thing” as detailed below) arising as a result of the Buyer entering into a relevant insolvency procedure (this includes administration, administrative receivership, a company voluntary arrangement (“CVA”), liquidation, the new moratorium (discussed later) or a restructuring plan).

Whilst previously essential suppliers (e.g. suppliers of gas, electricity, water, communications and IT goods and services) were prevented from exercising contractual rights to terminate in insolvency situations, this has now been extended, subject to specified exemptions, to all suppliers, all contracts (regardless of date) and all types of insolvency processes. This means that the restrictions preventing termination on insolvency will apply to all supply contracts including those entered into prior to the Act coming into force.

Furthermore, upon a company entering into a relevant insolvency process, all other termination rights are suspended if they relate to a breach which occurred prior to the start of the insolvency procedure (including breaches concerning non-payment, as well as extending to breaches which are unrelated to the Buyer’s financial health). As a result, if the Buyer enters into an insolvency procedure, a Seller will not be able to rely on the non-payment of invoices prior to the company entering into the insolvency procedure as a ground for termination. It is therefore vital that BTHA members closely

monitor the financial positions of their customers and decide swiftly how to proceed should a right of termination arise.

Under the new Act, in addition to the restrictions in exercising termination rights, a Seller is also prevented from doing “any other thing” or allowing “any other thing to happen” based upon the Buyer entering insolvency proceedings. This has been deliberately widely drafted and will, for example, cover a requirement that there be an acceleration of payment of outstanding invoices and may even extend to ROT claims which are drafted so as to trigger only on insolvency (discussed in more detail in Part 2).

2. POSSIBLE PROTECTIONS AFFORDED TO SELLERS UNDER THE ACT

The Act does provide some protections to Sellers that could be relevant to BTHA members, including:

- the right to terminate the supply contract if consent of the insolvency office-holder of the Buyer is obtained;
- the right to terminate if court permission is granted. If continuing supply will cause “serious hardship” to the Seller, the Seller can apply to the court for permission to terminate. There is currently no guidance on what constitutes “serious hardship” but on the face of it, it is likely to be a fairly high threshold (and could be limited to circumstances where the Seller’s own solvency is threatened or where the Seller would have to expend significant costs to continue to supply which it might be unable to recover);
- the right for a Seller to terminate for a post-insolvency breach, i.e. a Seller will not be prevented from terminating if supply continues post-insolvency and that supply is not paid for; and
- the temporary exemption for small suppliers. Between 26 June 2020 and 30 March 2021 a Seller retains the right to terminate the supply contract upon the Buyer’s insolvency if the Seller is classed as a small entity at the time the Buyer becomes subject to a relevant insolvency procedure. A small entity Seller can be a company, a limited liability partnership or any other association or body of persons or an individual carrying on a trade or business. A Seller will be considered a small entity if it meets certain conditions. These are:
 - a Seller in its first financial year, is a small entity if it meets at least two of the following conditions:
 1. the Seller’s average turnover for each complete month is not more than £850,000.
 2. the aggregate amounts which would be shown in the balance sheet of the Seller is not more than £5.1 million.
 3. the average number of employees is not more than 50.
 - a Seller not in its first financial year, is a small entity if it meets at least two of the following conditions:
 1. the Seller’s turnover was not more than £10.2 million.

2. the Seller's balance sheet total was not more than £5.1 million.
3. the number of employees was not more than 50.

3. STEPS TO MITIGATE SELLER IMPACT

Practical tips to mitigate Seller impact

BTHA members can take action to mitigate the impact of the changes introduced by the Act by:

1. Reviewing the existing terms of supply:
 - Can invoicing occur more frequently with shorter payment periods?
 - Can the contract term or contract volume be reduced? A short contract term will ensure that a Seller is not locked into supplying the Buyer for a considerable period in any insolvency procedure. Furthermore, a lower volume contract carries less risk, but would need to be weighed up against the Seller's commercial objective of higher volume contracts.
 - Are the financial distress events triggering the right to terminate described sufficiently broadly to capture the new insolvency procedures?
 - Do the trigger events allow for the contract to be terminated before the prohibition on termination kicks in? It is important to note that the loss of the contractual right to terminate only applies once the Buyer enters into the relevant insolvency procedure. If the Seller becomes aware of a winding up petition or a notice of intention to appoint administrators having been filed, a Seller's right to terminate the supply contract could still be exercised at that point (providing a small window of opportunity). Terms should be checked to ensure that the termination clauses provide that the right to terminate would be triggered at these earlier stages and not just at the point when the Buyer enters into the insolvency process.
2. Keeping in contact with key customers, and looking out for warning signs of financial distress.
3. Considering periodic ongoing monitoring of the following:
 - Have customer accounts been filed on time?
 - Have any county court judgments been entered or winding up proceedings commenced?
 - Has there been an audit of stock segregation conditions at the customer's premises where the customer is holding goods that have not yet been paid for?
4. Incorporating "early warning" provisions. Whilst it is uncommon in standard terms

Practical tips to mitigate Seller impact

and conditions, more complex and sophisticated supply contracts can contain “early warning” provisions by which a Seller has visibility of its customer financial issues sooner rather than later and a process is triggered to allow the parties to agree a way forward.

5. Reviewing any ROT clauses and considering potential amendments (as discussed in Part 2 of this note).

4. POST- INSOLVENCY SUPPLY

If a Buyer has entered a formal insolvency procedure there are still options available to the Seller. Notwithstanding the Seller’s inability to terminate, the Buyer’s appointed insolvency officeholder may not actually want a continued supply, Therefore upon a Buyer entering into insolvency it would still be advisable to contact the insolvency officeholder to establish whether the Buyer still has a need for ongoing supplies. If the Buyer does not have the need for ongoing supplies then it could be agreed between the parties for the contract to be terminated.

It is important to note that if an officeholder does continue taking supplies, those new supplies should be paid for by the insolvency officeholder as an expense of the Buyer’s insolvency (and therefore ahead of other creditors) and as such, gives some comfort that, the Seller will receive payment for post-insolvency supply. Furthermore, as mentioned above, the Act does not restrict the right for a Seller to terminate for a post-insolvency breach, and therefore, a Seller can terminate the contract if it continues to supply post-insolvency and that supply is not paid for.

PART 2- ROT CLAUSES

1. TYPES OF ROT CLAUSE

(i) Simple clauses

A simple ROT Clause provides that the Seller remains the owner of goods it supplies until such goods have been paid for in full. In order to increase the effectiveness of such a clause, the following should also be provided for:

- **a right for the Seller to repossess the goods;**
 - This could be exercisable on a specified event, notably non-payment, or at any time. It is important to note, however, that following the entry into force of the Act, a Seller may not be able to enforce a ROT Clause upon the Buyer entering into a relevant insolvency procedure (see Part 1). As mentioned above, a Seller is not only restricted in exercising termination rights under the Act but also may not do “any other thing” which would otherwise be triggered by the insolvency procedure. Therefore an ROT Clause, depending on how it is drafted, could be caught by the Act if it gives the Seller an entitlement which is specifically linked to an insolvency event.

- As a result, and given that historically ROT Clauses have sometimes been drafted to become enforceable on the Buyer's insolvency only, it is important that BTHA members check to ensure that the ROT Clauses are capable of exercise pre-insolvency. However, even if ROT provisions are successfully triggered pre-insolvency, a Seller's ability to enforce them will still be circumscribed if the Buyer enters administration (as was previously the case) or becomes subject to the new Part A1 moratorium introduced by the Act (discussed in more detail below). If any BTHA member would like help with reviewing their supply of goods contracts to ensure their current wording is consistent with the new regime then the individuals at DLA Piper listed at the end of this article can assist with such.
- a requirement that the **Buyer mark the goods supplied as belonging to the Seller and store them separately**, so that they can be easily identified;
- **automatic termination of the Buyer's rights to deal with the goods supplied** (i.e. in the case of a toy shop to sell the goods to customers). As above, this could be exercisable on non-payment but should not be drafted to be exercisable only on the insolvency of the Buyer; and
- **a right for the Seller to enter the Buyer's premises** in order to repossess the goods (so that the Seller will not commit a trespass when doing so).

(ii) **All monies clauses**

One of the key limitations to a simple ROT Clause is that where the Seller has made a number of supplies to a Buyer and the Buyer has paid for some supplies but not others, the Seller must be able to match the specific goods held on the Buyer's premises against unpaid invoices. This is because as soon as the Buyer pays an invoice the ownership of the goods referred to on that invoice passes to the Buyer.

An all monies ROT Clause will provide that the Seller retains ownership to all goods supplied by the Seller whilst ever any sums are owed from the Buyer to the Seller. As such, it is not necessary with an all monies clause for the Seller to match goods in the Buyer's possession against specific unpaid invoices. Provided the Seller can show that the goods on the Buyer's premises were supplied by the Seller and that there are at least some sums outstanding from the Buyer to the Seller, the Seller can claim ownership of those goods.

It should be noted, however, that even where there is an all monies ROT Clause when a Buyer's account is paid in full title will pass. Therefore, where a Seller has substantial quantities of goods which are subject to a claim under such a clause, the position should be checked to see whether the account between the Seller and the insolvent Buyer has recently been cleared. If the account has been cleared, a situation will arise where title to those goods will have passed and the Seller may encounter considerable difficulty in identifying those goods supplied after the account was settled and where title to the goods has not yet passed. Therefore, if the Buyer's account is sometimes paid in full, even with an all monies clause, it is helpful to be able to link goods to specific invoices.

- (iii) There has been some conflicting case law as to whether an all monies ROT clause creates a charge which would be void unless registered at Companies House. The most widely held

view is that it does not create a charge however it is nevertheless prudent to ensure that an all monies clause is contained in a separate subclause so that it could be severed from the simple clause if necessary. **Proceeds of sale clauses**

If all the goods supplied by the Seller to the Buyer have been sold prior to the Buyer entering into the relevant insolvency event, the Seller will not be able to rely on either a simple or all monies ROT Clause to recover its goods or make a claim against the insolvency officeholder appointed in respect of the Buyer.

Attempts have been made by Sellers in the past to include in their ROT Clauses a right of ownership over the proceeds of sale in respect of goods that the Buyer has sold but not paid for.

Such clauses have very rarely been upheld by the courts and in recent years have (almost without exception) been held to be a charge against the Buyer's property which will have no validity against the Buyer's insolvency officeholder unless it is registered at Companies House. **Accordingly, proceeds of sale clauses should not be included in supply contracts unless they are drafted separately from a ROT Clause and specific advice has been obtained in relation to the clause's effectiveness. Such advice is outside the scope of this note.**

2. INCORPORATING AN ROT CLAUSE

A well drafted ROT Clause contained within standard terms and conditions is useless unless those standard terms and conditions are incorporated into the Seller's contracts with its Buyers. Accordingly, it is important to ensure that when a contract is formed with a Buyer the terms and conditions which govern that contract are those of the Seller and not the Buyer. Broadly speaking, there are two different scenarios to consider:

(i) Situations where there is an overarching trading contract or long term supply contract

A Buyer and Seller can agree a long term or overarching supply contract which states what terms will govern all orders and deliveries made during a set period. The Buyer will often have its own standard terms and conditions and an overarching supply contract should expressly state whose conditions apply. The Seller should therefore check the terms of such contract carefully and ensure that its standard terms and conditions are expressly incorporated into the contract with an authorised representative of the Buyer signing that contract to provide its express agreement that it is the Seller's terms and conditions that apply.

The Seller should also ensure that when the fixed term of the supply contract expires, new terms are agreed and entered into, which again expressly incorporate the Seller's terms and conditions. Furthermore, those BTHA members who enter into lengthy or open ended supply contracts should also consider undertaking periodic reviews of the terms to ensure that they are still appropriate given any legislative changes which have occurred.

(ii) **Where there is no overarching/long term supply contract in place**

Where there is no overarching contract which sets out what terms and conditions will govern the supply of goods by a Seller, each individual order and delivery of goods will be treated as a discrete and separate contract. The terms and conditions which govern these contracts are determined by the rules on formation of contracts, and in certain circumstances, terms may be implied by law.

In respect of the transfer of ownership of goods, the law assumes that, in the absence of evidence of an agreement to the contrary, ownership of goods passes on performance of the contract, which is usually deemed to take place when the goods are delivered.

In many cases rather than the terms and conditions of each order/delivery being negotiated, each party will simply send the other party standard documents (e.g. order forms, delivery notes and invoices) which make reference to their standard terms and conditions. This is often referred to as a "*battle of the forms*". The "*winner*" of the battle of the forms is the last party which states that its terms and conditions apply prior to performance of the contract (ie delivery of the goods) as this party's terms and conditions will be deemed to govern the contract (this is referred to as the "*last shot*" in the battle).

Accordingly, if the Seller receives an order from the Buyer which refers to the Buyer's standard terms and conditions, the Seller must take care not to accept this order without first stating that its own terms and conditions will apply. If the Seller simply delivers goods pursuant to an order which refers to the Buyer's terms and conditions, then the Seller will be deemed to have accepted the Buyer's terms and conditions. These will normally provide that title to the goods passes on delivery.

On receiving an order, Sellers should therefore respond by an acknowledgment of order which states that the Seller's terms and conditions apply.

Sellers should be aware that documents provided to the Buyer after delivery of the goods are likely to be treated as being "*Post contractual*" and cannot usually incorporate terms into a contract. This will apply in respect of delivery notes and invoices.

Beware course of dealings

Where a Buyer and Seller have a history of trading with each other, the terms on which they have previously contracted may be deemed to be incorporated into future contracts. This can work in favour of either the Seller or the Buyer, depending upon what terms and conditions have previously been incorporated. To avoid this, the Seller should ensure that its terms and conditions are expressly incorporated into each contract with the Buyer and, if possible, expressly agreed by the Buyer. We have set out in more detail how this can be achieved in the practical tips box below.

Practical tips on incorporation of terms

Members of the BTHA should follow the steps set out below when contracting with Buyers:

1. ensure that sales literature provided to the Buyer contains reference to the Seller's terms (including its ROT Clause). A Seller must be able to show that it has taken steps to bring its standard terms and conditions to the Buyer's attention. This should be done as soon as practicable, with a record kept that this has been done;
2. the following documents should all state that the Seller's terms and conditions apply and either contain a copy of the same or state where a copy of the Seller's terms and conditions can be found:
 - 2.1 the Seller's brochures, catalogues and other publications;
 - 2.2 quotation forms provided by the Seller;
 - 2.3 acknowledgment or confirmation of orders received by the Seller;
 - 2.4 delivery notes and invoices (although as stated above these are post contractual and may not effectively incorporate terms - they may, however be useful in establishing a course of dealing);
3. the Seller should make sure that those who deliver the goods are instructed not to sign any acknowledgments or notes stating that the Buyer's terms and conditions apply. The Seller should also make it clear to the Buyer that individuals who deliver goods on their behalf are not authorised to accept terms and conditions that would bind the Seller;
4. the Seller should closely monitor documents received from the Buyer. If the Buyer's orders (or other documents) refer to its standard terms and conditions applying, the Seller should ensure that the Buyer is notified prior to the goods being delivered that the Buyer's terms are not agreed and that the Seller's terms and conditions are to apply; and
5. the Seller may decide to directly engage with the Buyer where the Buyer seeks to rely on its own standard terms and conditions and raise the issue that these are not agreed. However, the Seller may decide to simply ensure that its standard conditions are the last set to be communicated to the Buyer prior to delivery of the goods.

3. THE EFFECT OF ADMINISTRATION AND A MORATORIUM

Ordinarily a ROT Clause gives the Seller the right to collect goods, held at the Buyer's premises, to which it has retained ownership, so that an alternative customer can be found for those goods. However, such clauses cannot be enforced during an administration or in the course of the newly introduced moratorium pursuant to Part A1 of the Insolvency Act 1986 (where restrictions broadly resemble the restrictions in place when a company is in administration).

A Part A1 moratorium can be put in force by the Buyer's directors filing papers with the court. The moratorium is overseen by a monitor, who must be a licensed insolvency officeholder. The moratorium will last for an initial period of 20 days, but this can be extended for another 20 days by the directors, or for up to a year with creditor consent or court approval.

In general, the position regarding ROT clauses in relation to the new moratorium is similar to the position in an administration, with the only noticeable difference being that in a moratorium a monitor cannot consent to the Seller taking possession of goods subject to a valid ROT clause, with court permission always being required.

In practice, where a Buyer is in administration, the administrator will often want to use goods supplied in order to realise funds for the Buyer's creditors, and may therefore refuse any request from a Seller to enter the Buyer's premises and repossess goods that it has supplied.

However, if the Buyer's administrator/liquidator sells goods that are subject to a valid ROT Clause, the Seller will have a claim in the Buyer's administration/liquidation (and/or against the administrator/liquidator personally) which is payable in priority to the Buyer's other creditors.

As such, if an administrator accepts the validity of a Seller's ROT Clause he or she will either allow for the Seller to collect goods to which it has retained ownership or pay for the same. If the administrator fails to do either of these then the Seller may have a claim against him/her personally.

4. ADDITIONAL POINTS TO NOTE

Sellers should be aware of the limitations of ROT Clauses and should take general steps to protect themselves in the event of the Buyer's insolvency such as:

- obtaining trade credit insurance;
- requesting a guarantee from the Buyer's directors/parent company;
- requesting letters of credit;
- reducing the credit terms available to a Buyer; and/or
- requiring some form of deposit or fund that is set aside or reserved, and which is regularly topped up, to be used if the Buyer faces financial difficulty.

Sellers may also wish to:

- conduct deeper due diligence on Buyers' financial position before entering into contracts;
- actively monitor customers' payment performance and financial position during the contract to try and obtain any early warning signs of financial difficulty;
- be ready to exercise contractual rights under the ROT clauses promptly if a Buyer starts showing signs of financial distress before formal insolvency proceedings are commenced; and

- as mentioned previously, review the contractual terms to ensure that the provisions protect the Seller as far as possible following the introduction of the Act.

Sellers should also be aware that whilst ever they retain ownership to goods supplied, the law implies that the Seller will remain responsible for the risk that such goods are damaged or destroyed. The Seller should therefore either ensure that its standard terms and conditions state that risk in the goods that it supplies passes to the Buyer on delivery or maintain its own insurance.

Practical tips on raising a ROT claim

Where a Buyer goes into insolvency or a moratorium is entered into, the Seller should take the following steps to notify the relevant insolvency officeholder and ensure that the goods subject to a valid ROT claim are identified:

1. Notify the insolvency officeholder appointed over the Buyer of its claim as soon as possible. The insolvency officeholder is likely to use the goods supplied by the BTHA member and it has the power to do so until it is notified of the member's claim; and
2. Arrange attendance at the Buyer's premises as soon as possible in order to identify goods held by the Buyer which were supplied by the member.

The insolvency officeholder will often ask the member to complete a "*retention of title questionnaire*" detailing its claim. This is likely to require the following information:

- what type of ROT Clause is claimed by the member;
 - how the member's ROT Clause is incorporated into contracts with the Buyer; and
 - details of the goods to which the member claims to have retained title.
3. The member should take great care in completing the questionnaire and should ensure that it has all of the relevant documents available which evidence that its ROT Clause is validly incorporated.
 4. The primary right for the member on proving its retention of title clause is for the goods held by the Buyer at the date of its insolvency to be returned to the member. However, if the insolvency officeholder has sold goods belonging to the member knowing that the member has ownership of the same, the member can seek payment from the insolvency officeholder in priority to the Buyer's unsecured and certain of its secured creditors. In some circumstances, the business of the Buyer may be sold in its entirety to a third party. Whilst sales contracts will specifically exclude goods to which the company does not have title, goods which were subject to the member's ROT Clause would most likely pass into the possession of the purchaser upon the sale completing. In such circumstances, the member should contact both the insolvency officeholder and the purchaser of the Buyer's business in order to assert its retention of title clause.

This note is intended as a general overview and discussion of the subjects dealt with. It is not intended to be, and should not be used as, a substitute for taking legal advice in any specific situation. DLA Piper UK LLP accepts no responsibility for any actions taken or not taken on the basis of this note. If you would like advice in respect of a specific matter or circumstances the following individuals at DLA Piper may be able to assist:



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