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Help, my buyer is insolvent! The unpaid seller's rights against the goods

A series of high-profile insolvencies in 2020 caused by the coronavirus pandemic, oil price crash and allegations of fraudulent activity has brought to the forefront the question of a seller's rights over goods when they are in transit to an insolvent buyer. While the seller might have a claim in damages or for the price, such claims will be unsecured and therefore of little to no value against an insolvent buyer.

We therefore consider in this article an unpaid seller's common law rights against the goods themselves under the Sale of Goods Act 1979 ("the Act") including the interplay of those rights with each of the sale contract and the recent changes to UK insolvency law.

The remedies under the Act

The rights of the unpaid seller are summarised at s.39 of the Act as:

- a) right to exercise a lien or withhold delivery;
- b) right to stop goods in transit; and/or
- c) right of resale.

A "seller" includes an agent who either indorses the bill of lading or is himself directly responsible for payment. A seller is "unpaid" when either (a) the whole of the price has not been paid or tendered; or (b) the condition under a payment instrument has not been met (i.e. a dishonoured letter of credit) or the buyer has become insolvent.

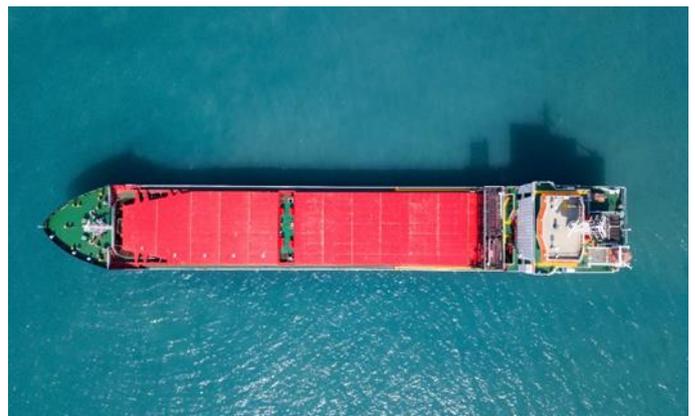
Insolvency

Buyer insolvency is the only ground on which an unpaid seller can stop the goods in transit and is one of three grounds for exercising a lien or withholding delivery of the goods.

The relevant test for insolvency is contained in s.61(4) of the Act, which provides:

"A person is deemed to be insolvent within the meaning of this Act if he has either ceased to pay his debts in the ordinary course of business or he cannot pay his debts as they become due"

This is a question of fact and evidence and a seller should not act on mere suspicion of insolvency, nor should it be tempted to rely on the definition of insolvency in the sale contract, which is irrelevant in this context. If the buyer is insolvent, the unpaid seller can exercise its rights immediately and does not have to wait until payment becomes due.



The right to a lien or to withhold deliver

An unpaid seller has the right to exercise a lien over the goods or, alternatively, a right to withhold delivery of them, until the price is paid or tendered. In both cases the seller must have actual possession of the goods.

Where there is a contract for the sale of a specified quantity of goods by instalments, it will be presumed to be an indivisible (or entire) contract so that the seller may exercise its lien over any part of the goods not yet delivered if any part of the total price is unpaid.

If, however, there are to be separate deliveries with a separate payment for each delivery then each delivery will be treated for the purposes of the seller's lien as if it were a separate contract, with the result that the lien can be exercised only over goods forming part of an instalment which has not been paid for.

Reserving the right of disposal

Since a right to a lien relies on possession, it will be lost if a seller parts with (actual or constructive) possession of the goods without reserving the right of disposal.

The starting point for determining whether a right of disposal has been retained is that property passes when intended to pass. So, where the bill of lading is deliverable to the order of the seller or its agent and is only endorsed to the buyer on payment, the presumption is that the right of disposal is reserved until payment is made.

However, the right of disposal can still be reserved where the bill of lading is made out to the order of (or endorsed to) the buyer. Examples of this are if a seller sends such a bill to its own agent with instructions to deliver it up to the buyer only against payment, or if it retains the bill itself until some condition is fulfilled by the buyer.

The right might also be waived in any number of fact-specific circumstances, including if a seller deals with the goods in a way which is inconsistent with the lien, such as taking security for the price in exchange for the goods or agreeing to a wrongful re-sale of the goods.

The right of stoppage in transit

The right to stop the goods in transit is only available where the buyer is insolvent.

The seller must take actual possession or give notice to the carrier that the goods should not be delivered to the buyer. The goods stopped can then be retained against the purchase price. The seller should be aware, however, that the carrier will also have a lien over the goods for unpaid freight, which will take priority over the seller's lien and will have to be discharged before the seller can take any further action.

The right of re-sale by seller

The seller has the right to resell the goods and pass a good title to a new buyer if: (a) it has retained property in them; (b) property has transferred to the buyer but it nevertheless retains physical possession of them; and/or (c) it has validly exercised its right to a lien or stoppage in transit.

The sale contract will be terminated on resale. However, the fact that the seller has passed good title to a new buyer does not automatically mean that the resale was permitted. If the resale was wrongful then the buyer may have a claim in damages against the seller for repudiatory breach of contract.



The effect of sub-sale by buyer

A seller's right to exercise a lien, withhold delivery, or stop the goods in transit is not affected if the buyer completes a sub-sale of the goods.

An important exception to this is where the buyer lawfully transfers the bill of lading to a sub-buyer or pledgee who takes it in good faith and for valuable consideration, in which case the seller's right is lost or (in the case of a pledge) made subject to that of the pledgee.

Impact of changes to UK insolvency law

The unpaid seller should consider whether it is restricted from exercising the remedies under the Act by virtue of UK insolvency law, including the changes recently introduced by the Corporate Insolvency & Governance Act 2020 ("CIGA"). The three main, permanent changes are:

- a) restriction on the rights of a party to terminate or do "*any other thing*" under a contract for the supply of goods and services in the event of counterparty insolvency (although note that certain "commodities contracts" are excluded

from this restriction, as to which see our previous [article](#));

- b) 20 (extendable to 40) day moratorium procedure for distressed but viable companies; and
- c) pre-insolvency rescue and restructuring regime.

If CIGA applies¹ then timing will be crucial where the unpaid seller is looking to exercise its rights against the goods. This is because CIGA prevents a seller from doing "*any other thing*" (which would include exercising a lien or stoppage) once the buyer has entered an insolvency period. Similarly, security (i.e. a lien) cannot be enforced during a moratorium. Therefore, the seller may have a very short period of time in which to exercise its remedies under the Act, being after the buyer has become insolvent within the definition in the Act, but before it has entered into an insolvency period under CIGA.

Interplay with contractual remedies

The remedies available under the Act arise by operation of the law but can be excluded or supplemented by the express agreement of the parties in the sale contract.

Most standard form commodity contracts include terms that entitle the seller to terminate or suspend deliveries if the buyer defaults in a prescribed way, including insolvency. The rights and remedies will differ from contract to contract and should be considered carefully. GAFTA (the Grain & Feed Trade Association), for example, permits the non-defaulting party to close out the contract upon the occurrence of a defined insolvency event and prescribes how the settlement price is to be calculated. Absent a complete contractual code for calculating loss, the seller will be entitled either to common law damages or an action for the price.

Retention of title ("RoT") clauses, which provide that ownership of goods delivered does not pass until payment is made, can also be an important tool for sellers in the event of an insolvency. However, sellers should be aware that:

- a) UK insolvency law prohibits the enforcement of RoT clauses during an administration or during the newly introduced moratorium;

- b) RoT clauses are difficult to enforce where goods are mixed or co-mingled with other goods such that it becomes difficult, if not impossible, to identify over which goods the seller has retained title; and
- c) some jurisdictions may not recognise a right of retention of title in the context of an insolvency.

Help, my buyer is insolvent!

The unpaid seller should always act with speed but not in haste. The remedies under the Act are important weapons but should be considered together with the contractual provisions and exercised with extreme caution, not least because getting it wrong could expose a seller to a claim by the buyer for losses suffered not only in relation to the goods but also under a sub-sale and/or charterparty. Finally, prevention is better than cure, so sellers should consider obtaining security (e.g. a parent company guarantee) and retaining rights of disposal through the bills of lading.

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¹ CIGA will apply if the insolvent buyer is registered in or has a sufficient connection with England or Wales, or if it receives an order from the English Courts recognising foreign collective proceedings under the Cross-Border Insolvency Regulations 2006.