

Do ‘Retention of Title’ clauses protect the seller in Finnish bankruptcy proceedings?

Elina Pesonen and Pauliina Tenhunen look at how effective such clauses are in practice



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Finnish bankruptcy proceedings in general and Retention of Title clauses

Finnish bankruptcy proceedings are governed by the Finnish Bankruptcy Act (20.2.2004/120). The Bankruptcy Act was totally renewed and modernised in 2004, undergoing major changes compared to the previous Bankruptcy Code. The new Bankruptcy Act also slightly changed the legal state governing the handling of Retention of Title clauses in bankruptcy proceedings.

The purpose of bankruptcy proceedings is to liquidate the assets of the debtor for the benefit of the creditors and, ultimately, to share the surplus equally amongst the creditors whose claims rank equally. One of the leading principles in Finnish bankruptcy proceedings is the principle of ‘*pari passu*’, i.e. principle of creditors’ equality when distributing the assets from the bankruptcy estate.

Retention of Title clauses are clauses by which the title to property to be sold is retained by the seller until the purchase price has been paid in full. This kind of a provision is an exception to the general rule provided in Finnish legislation in the Finnish Sale of Goods Act, according to which the title to property is transferred to the buyer at the same time as possession.

The Bankruptcy Act assumes that third-party property is not part of the bankruptcy estate if it can be separated from the debtor’s property. Retention of title in bankruptcy situations is expressly provided for in Chapter



5(7) of the Bankruptcy Act, which is applicable to movable property subject to the seller’s rights protected retention of title or withdrawal clauses.

Can Retention of Title clauses be void in bankruptcy?

Retention of Title clauses are not binding in bankruptcy situations if the clause has been agreed after the right of possession has already been transferred to the buyer, i.e. the debtor. In such situations, the property is part of the bankruptcy estate just like the buyer’s other property. This is due to the fact that, if the clause is agreed afterwards, this would in practice mean favouring the seller at the expense of other creditors.

In addition, Retention of Title clauses are ineffectual against bankruptcy estates if the

buyer, despite the Retention of Title clause, has the right to further transfer the property, link it to other property or otherwise dispose of the property as if being its owner. For example, it would not be possible for the buyer to pledge property or further transfer it in a way that would maintain the validity of the original seller’s retention of title against a third-party buyer. Whether or not the buyer has actually used such rights does not matter. The buyer’s right to do so alone is enough. This basically means that Retention of Title clauses concerning all kind of property, such as inventories, to be linked to the buyer’s property would be considered null.

Foreign suppliers, in particular, should also bear in mind that Finnish law is applicable to the bankruptcy of a Finnish buyer. This being the

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case, contractual clauses stating that the Retention of Title is subject to the law of some other jurisdiction are not valid in Finnish bankruptcy proceedings especially if the sold assets are situated in Finland.

Incorporating Retention of Title into contracts

It is important to pay sufficient attention to Retention of Title issues already when drafting contracts. First, Retention of Title must be incorporated into the contract. A unilateral notification that Retention of Title is being applied will not hold up. This being the case, Retention of Title must be agreed in the contract or, for example, in a binding order confirmation. If general terms and conditions are being applied and the Retention of Title clause is included in them, the seller should make certain that the general terms and conditions are properly disclosed to the buyer

and become part of the contract.

Second, the seller needs to give some thought to what rights the buyer is given to property sold under a Retention of Title clause. The seller should make sure that the buyer is not given permission to link goods subject to Retention of Title to other property or to otherwise dispose of it as if being its owner. This means that the effectiveness of Retention of Title clauses in bankruptcy situations is particularly questionable in relation to current assets.

In practice, contractual clauses should strictly stipulate that the buyer cannot dispose of the goods on his/her own behalf before the purchase price has been paid in full and the title has been transferred to the buyer. The seller can also consider other forms of collateral. Bank guarantees are certainly the most secure, but not nearly always a practical alternative for shielding oneself from a buyer's bankruptcy. ■



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