

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani
November 2008

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

What is a lien?

A lien is a right that entitles a party to retain assets in its possession as security for the payment of money. There are essentially three types of liens:

- legal liens
- equitable liens
- statutory liens.

The liens that are of primary interest to parties operating in the logistics industry, and with which this article exclusively deals, are legal liens. Legal liens generally exist by operation of law, but can be extended by contract or even created by contract.

Particular liens and general liens

A legal lien, whether existing by operation of law or created by contract, can be either a particular lien or a general lien.

- A particular lien allows a creditor to retain possession of an asset until the debts that have arisen in relation to that particular asset have been paid.
- A general lien, on the other hand, gives a creditor the right to retain all of a debtor's goods in its possession until all monies owing to the creditor have been paid.

How liens arise

Particular liens can arise automatically by operation of law in two circumstances:

- where someone has a quasi-public calling under which they have certain duties to the public in relation to goods, as in the case of a common carrier
- where someone improves goods by their skill and labour.

General liens can arise by operation of law from customary practice in particular industries.

Liens, whether general or particular, can also be expressly created by contract.

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

The standard terms and conditions of the Road Haulage Association, the Freight Transport Association, the British International Freight Association and the United Kingdom Warehousing Association all contain standard provisions imposing a general lien over customers' goods. Even if such terms and conditions are not used in a particular transaction, it is arguable that general liens are industry-standard and therefore arise in the sector by operation of law.

It is accordingly important for customers of logistics services' providers to understand that, because liens may arise automatically by operation of law in the logistics sector, if they don't want liens to exist in their dealings with providers, then their contracts with providers must expressly exclude them.

Registration is not required

Liens are neither charges nor mortgages and are accordingly not registrable under the Companies Act 1985 (and will not be registrable under the Companies Act 2006, when the sections dealing with registration of charges come into force).

The primary purpose of registration of a charge is to protect the rights of creditors who take security over assets that are not in their possession by giving "notice to the world" of the existence of the charge. Because a legal lien, by definition, relates to assets in the possession of the creditor, the creditor has control over the assets and can prevent the assets from being sold without its knowledge. Registration of a lien would accordingly provide little, if any, additional protection, so statute does not provide for it.

Possession

A legal lien requires the goods under lien to be in the possession of the creditor. Issues may arise for a logistics service provider if, as is often the case, its direct customer is not the ultimate owner of the goods.

If an ultimate owner has given an intermediary, such as a freight forwarder, an express or implied power to deposit goods with, for example, a warehouse, then a lien granted by the freight forwarder to the warehouse would generally be effective, even if the freight forwarder were not the owner of the goods.

This would not be the case if the warehouse knew that the ultimate owner had imposed on the freight forwarder an express restriction prohibiting it from entering into a contract whereby a lien was established.

Ultimately, each case will depend on its individual facts.

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

When to enforce a lien

It is critical that the debt secured by a legal lien is payable before the lien-holder is obliged to deliver the goods. Retaining possession of a customer's goods in expectation that the customer will not make payment when due is not a valid exercise of a lien.

The logic for this is simple. A lien is a right to retain goods in a party's possession as security for a payment. But if that possession is no longer lawful at the time when payment becomes due – for example, because an obligation to deliver the goods has already arisen – then the law will not recognise the lien, even though the creditor is in actual possession of the goods.

This can be a problem where the lien-holder has granted the customer a period of grace, such as the customary 30 days, for payment of invoices. If the creditor begins an insolvency process during that 30-day period, then the insolvency process will have commenced before the payment is due and, accordingly, before the lien has become enforceable. It is for this reason that contracts invariably contain provisions whereby, upon the commencement of an insolvency process or other analogous event, all of the debts of the relevant party become immediately payable.

A prudent logistics provider should also consider – particularly in the current economic climate – including provisions in its standard terms whereby it can unilaterally change a customer's payment terms if it is concerned about the customer's financial position.

Right of sale

A lien is a right that entitles a creditor to retain assets in its possession pending payment of a debt. It is important to note that a lien is only a right of retention, and not a right of sale. In the absence of an express contractual right of sale, the courts will not generally give an order for the sale of goods held under a lien, except in cases where goods are perishable or where there is some other reason why a quick sale is desirable.

Accordingly, it is common practice to include an express right of sale in any contract under which, or in respect of which, a lien may arise. The standard terms and conditions of the main professional bodies in the logistics sector, detailed above, generally contain express rights of sale pursuant to liens (although the United Kingdom Warehousing Association is an exception to this).

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

However, they provide that the supplier must give the customer “reasonable” or 28 days’ written notice in the case of non-perishable goods before exercising the right. This can cause problems when the need to act quickly arises.

Enforcement of the right of sale

A legal lien and any related power of sale will be effective in establishing a priority in respect of most forms of insolvency process. In particular, a lien will be effective against a receiver (which expression, for the purposes of this article, includes an administrative receiver) or liquidator.

When selling goods, a lien-holder must nevertheless act fairly and in good faith, meaning that it must enter into a real and independent bargain, and it must take reasonable steps to obtain a proper price for the goods.

In the event of the exercise of the right of sale after the appointment of a liquidator or receiver, the most practical solution (and certainly the safest, in terms of obtaining a proper price for the goods) will be for the lien-holder to try to negotiate a deal with the liquidator or receiver itself for release of the goods to them against payment of the debt by them. Any such deal will be particularly attractive to the liquidator or receiver if the value of the goods greatly exceeds the amount of the debt.

Debtors in administration

The greatest problems with the enforcement of liens arise in relation to debtors that go into administration (not to be confused with an administrative receiver being appointed over a company’s assets).

Moratorium

Under statute, once a company goes into administration, a moratorium is imposed during which no steps may be taken to enforce security over the company’s property except with the consent of the administrator or with permission of the court. It is critical to note that “enforce security” in this context relates to the actual enforcement of the lien itself, being the retention of the goods, and not just to a contractual right of sale.

Accordingly, a lien-holder that is ordered by a company administrator (as opposed to a receiver or liquidator) to deliver up goods in its possession and held under a lien must either do so or else seek a court order allowing it to retain possession, and certainly cannot exercise a right of sale.

Liens in the domestic logistics industry

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

When the court will grant an order

In determining whether to grant an order permitting enforcement of a lien during the administration of a company, the courts will grant one if it is unlikely to impede the achievement of the purpose of the administration (which is generally to try to save the company or ensure that its business is sold as a going concern) or if it would be inequitable to prevent the security being enforced. Otherwise the court will balance the interests of the lien-holder against the interests of the other creditors, but will try to prevent the administration procedure from prejudicing the secured creditors.

Protection through terms and conditions

A lien-holder has no influence over what form of insolvency process its creditor goes into. While a lien might be effective against a receiver or liquidator, it is not effective against an administrator. A lien-holder will often have advance warning of a customer being in financial difficulties. However, if the lien-holder's contract requires it to give reasonable or 28 days' written notice before exercising a right of sale, it might in practice be unable to exercise the right before an administrator is appointed, even if some form of insolvency process has appeared imminent for some time.

To protect against this, a prudent operator in the current market might consider changing its standard terms and conditions to enable it to exercise the right of sale without notice to the customer in the event that it reasonably believes that its customer is about to enter into some sort of insolvency process. This protection might enable a lien-holder to exercise its right of sale before an administrator is appointed, with the consequential suspension of the right to enforce the lien or exercise a right of sale.

Nigel Kotani
Partner – LLC Law

If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.