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"Romalpa" and Contractual Innovation

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Source: *Journal of Law and Society*, Vol. 42, No. 3 (September 2015), pp. 358-386

Published by: Wiley on behalf of Cardiff University

Stable URL: <https://www.jstor.org/stable/43862438>

Accessed: 25-12-2024 16:45 UTC

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Romalpa and Contractual Innovation

JAMES DAVEY* AND CLIONA KELLY**

Socio-legal studies have given relatively little attention to the mechanisms by which change occurs to the boilerplate that constitute modern contracts. Contrary to the impression left by neo-classical contract theory (and its descendant, Chicago School law and economics), contracts are not routinely revised to provide an optimal solution. As recent empirical studies show, change is sporadic, even within high-value contracts drafted by expert practitioners. Improvements to contractual form only arise after some external shock, which reveals the weakness in the prior norm. In the first application of this principle within the United Kingdom, the article considers the reputed rapid change in 'retention of title' clauses in sales transactions in the mid-1970s, and identifies the factors, and personalities, that led to such rapid legal innovation and change.

INTRODUCTION: BOILERPLATE AND CONTRACTUAL INNOVATION

Much has been written about reservation of title (RT) clauses in the last forty years, but relatively little about the mechanisms by which change occurs to the boilerplate that constitute modern contracts.¹ The vast majority of those articles and texts on RT clauses concerned themselves with the technical law, and the limits of RT clauses as seen in the litigated cases. In this field, the work of Sir Roy Goode is a useful exemplar. Notable as a well-respected

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1 See, however, O. Ben Shahrar (ed.), *Boilerplate: the Foundation of Market Contracts* (2007) and M. Radin, *Boilerplate: The Fine Print, Vanishing Rights and the Rule of Law* (2013).

commercial law scholar, but with connections to practice, Goode was creator of the Centre for Commercial Law Studies at QMW and consultant to Mishcon & Co.² Outside of these doctrinal studies lies a penumbra of fascinating interdisciplinary works. Most notable is Sally Wheeler's *Reservation of Title Clauses: Impact and Implications*, a socio-legal study of the extra-judicial enforcement of RT clauses across 259 disputes prior to publication in 1991.³

This article seeks to establish an additional branch of inquiry. We are not concerned directly with the law in the courts ('law on the page'), or with doubts about the practical enforcement of the rights ('law in action') but in the mechanism by which the change in legal culture occurred ('innovation in legal culture'). Most accounts of RT clauses describe a period of rapid transition in the mid-1970s, with frequent reference to Muir Hunter QC's simile of the clauses spreading 'like a dreadful weed'.⁴ John De Lacy⁵ contrasted the position in 1965 ('... in England conditional sale agreements are virtually unknown and such authority as there is may be regarded as turning on the facts of the particular agreement under consideration')⁶ with that in 1993 ('... it is stated that in the context of one administrative receivership alone about 400 retention of title claims had been made against the company').⁷

What remains contested is the trigger point for this sudden proliferation. For many, it is the Court of Appeal decision in the *Romalpa* case in 1976,⁸ for others it is the (unlitigated) insolvency of Brentford Nylons in February 1976.⁹ What is undoubted is the rapid replacement of one contractual norm with another. Prior to the mid-1970s, reservation of title clauses were largely unused in English commercial practice. Within a few years, the landscape had changed fundamentally, with such clauses becoming an integral part of the boilerplate of sales agreements. The puzzle is why the change in the

2 Lord Bingham writing in the Roy Goode Festschrift commented on Goode's significance in straddling academia and high end practice: Bingham LCJ, 'Professor Roy Goode' in *Making Commercial Law: Essays in Honour of Roy Goode*, ed. R. Cranston (1997).

3 S. Wheeler, *Reservation of Title Clauses: Impact and Implications* (1991). See, also, J. Spencer, 'The Commercial Realities of Reservation of Title Clauses' [1989] *J. of Business Law* 220 (empirical) and J. Snead, 'Rationalising Retention of Title Clauses with Insolvency Law' in *UCL Jurisprudence Rev. 2004*, ed. C. Campbell-Holt (2004) 288 (law and economics).

4 I. Davies, *Effective Retention of Title* (1991) 10.

5 J. De Lacy, 'Romalpa Theory and Practice under Retention of Title in the Sale of Goods' (1995) 24 *Anglo-Am. Law Rev.* 327, at 329 ff.

6 Citing R. Goode and J. Ziegel, *Hire Purchase and Conditional Sale* (1965) 100.

7 Citing *Lipe Ltd v. Leyland Daf Ltd* [1993] B.C.C. 385.

8 *Aluminium Industrie Vaassen B.V. v. Romalpa Aluminium* [1976] 1 W.L.R. 676; for example, R. Goode, 'The Modernisation of Personal Property Security Law' (1984) 100 *Law Q. Rev.* 234, at 248.

9 See, for example, Davies, op. cit., n. 4, p. 10. The Brentford Nylons insolvency is discussed below.

market was so rapid and so pervasive. The mechanisms for the passing of property in sales is clearly established in ss. 17–19 of the Sale of Goods Acts (1893 and 1979) as a series of defaults, largely controlled by the intentions of the parties, whether express or implied. As Snead noted of section 19: ‘This section is an embodiment of the “very basic contractual principle” that parties are free to contract as they will, subject only to vitiating factors such as fraud or deceit.’¹⁰ Moreover, case law recognized the efficacy of simple RT clauses as far back as *McEntire* in 1895.¹¹ It was always possible for parties to use simple RT clauses, but they did not (generally) do so in the United Kingdom even though the device was well established in other jurisdictions. Why then the sudden shift? What causes commercial practitioners, when initially anchored to one idea or way of doing things, to move away from that initial reference point? What paradigm shifts provoke widespread innovation in contract and commercial law?

In examining these questions, we reject the simplistic model of contract design reliant on individual wealth-maximizing actors seeking optimal atomized contractual positions. Instead, we apply the theory that contractual innovation mirrors technological development. This builds on the application of network theory to contract design, as developed in particular by Kahan and Klausner,¹² and on the development of this theory in recent work by Gulati, Scott, and Posner in the United States on innovation in contract design.¹³ Using these theories, we identify abrupt shifts in the market with the displacing of an existing standard (to which undue deference was given until its dominance is undermined) until a ‘tipping point’ is reached. Gulati et al. recognize that these shifts in the market are initially caused by an ‘external shock’ to the existing system – triggering a process by which a new norm then emerges. We suggest that this theory of the evolution of contracts is a good ‘fit’ with the adoption of RT clauses in contracts post-*Romalpa* and explains the shift to the new contract norm. Shifts in the market were triggered by the ‘external shock’ of the far-reaching and striking decision in the *Romalpa* case. As well as pointing to the vast potential of RT clauses as a means of protection from the insolvency of buyers, this decision was unusual in that it concerned a clause seemingly introduced by a foreign company, as opposed to being the result of a risky strategy by a lawyer or contracting party within the United Kingdom. An innovation was thus generated in an

10 Snead, op. cit., n. 3, p. 290.

11 *McEntire v. Crossley* [1895] A.C. 457.

12 See text and references at n. 39 below.

13 The project (which we refer to collectively as the Scott/Gulati project) has spawned at least three substantial publications since Winter 2012: M. Gulati and R. Scott, *The 3½ Minute Transaction: Boilerplate and the Limits of Contract Design* (2013); S. Choi, M. Gulati, and E. Posner, ‘The Dynamics of Contract Evolution’ (2013) 88 *New York University Law Rev.* 1; and M. Weidemaier, R. Scott, and M. Gulati, ‘Origin Myths, Contracts, and the Hunt for *Pari Passu*’ (2013) 38 *Law & Social Inquiry* 72.

‘incubation room’,¹⁴ protected from perceptions of the norm within the United Kingdom, and this may in part account for why the clause in question was complex and daring, as opposed to the simple clause, developed at a slow, cautious rate, that you would perhaps expect to see taken as a test case in the early days of a new innovation. Lawyers who subsequently considered using RT clauses then had the benefit of a ready-made interpretation of the clause and no one firm had to pioneer the clause; the clause thus brought with it significant network benefits, making its adoption easier.¹⁵ The ‘external shock’ was also caused by the political and economic landscape of the time, as *Romalpa* had as its backdrop an economic recession and the media attention on the Brentford Nylons insolvency scandal. Finally, we identify a further factor which we believe was crucial to the proliferation of RT clauses, namely, the influence of external third parties who may act as ‘mavens’, disseminating information and influencing the decisions of contracting parties. This not only provides a more compelling explanation of past shifts in markets, but is a fertile area for future empirical research.

In the first section of the article, we discuss how the process of contract formation does not meet the idealized vision of neoclassical theory but, rather, contracts are often mass produced and clumsily drafted. Innovative drafting is rare and not often rewarded within firms, so there is little incentive for creativity. With that in mind, in sections two and three we introduce theories which attempt to explain how contractual innovations *may* occur, noting the alignment between theories of contractual innovation and theories of technological innovation. In the fourth section we introduce our case study on RT clauses, with particular focus on the rapid increase in the use of these clauses in the years following the *Romalpa* decision and the Brentford Nylons scandal. In the final section we analyse the case study using the theories of contractual innovation and discuss how the evolution of RT clauses fits with network theory and, in particular, Gulati and Scott’s account of contractual innovation.

I. MODELLING CHANGE: THE ‘INNOVATION IN CONTRACT’ LITERATURE

In order to understand the process of contract innovation, we first need to debunk some myths of contract negotiation. As Feinman noted, the process of agreement of supply-chain contracts will not meet the idealized vision of neoclassical contract theory where:

14 F. Geels, ‘Technological transitions as evolutionary configuration processes: a multi-level perspective and a case-study’ (2002) 31 *Research Policy* 1257.

15 See the discussion on network benefits at n. 39 and n. 117 below.

[s]teely-eyed bargainers carefully calculated their interests in a particular exchange ... and embodied their transaction in an agreement that carefully defined the terms of performance and therefore could provide the basis for a determinate remedy in case of breach.¹⁶

The alternative view is that the structure of large law firms results in mass production of contracts; that 'law firms, legal products, and lawyers are all subject to the same laws of organization and innovation as the rest of the economy';¹⁷ and that 'lawyers should not be presumed to be all that different from assembly line workers'.¹⁸ Creativity in contractual drafting is not encouraged within the organizational structure of law firms, and lawyers have been shown to be unwilling to deviate from the norm.¹⁹ Bespoke contract design is not a high priority within routine commercial arrangements. 'Boilerplate' – the use of standard, non-negotiated terms – is rife. Nor is this restricted to 'mass market' consumer contracts:

... standard terms would appear to be no less widespread in contracts among the sophisticated. Notwithstanding their representation by able counsel, charged to craft comprehensive and detailed, but also particularized, contracts, such parties will commonly conclude agreements comprised heavily of traditional terms – contracting norms of a sort – rather than terms tailored to the distinct features of their particular bargain.²⁰

In addition, contract provisions are often sub-optimal, marked by 'the persistence of redundancy and the ubiquity of cumbersome, inartful, and sometimes imprecise drafting'.²¹ This may be in part a response to the multiplicity of potential future audiences of the contractual text.²²

The 'sausage-factory' production of contracts leads to a sharp division between the perceived high-powered litigators and less valued drafters and

16 J. Feinman, 'The Significance of Contract Theory' (1989–90) 58 *Cincinnati Law Rev.* 1283, at 1286.

17 B. Richman, 'Contracts Meet Henry Ford' (2011–12) 40 *Hofstra Law Rev.* 77, at 79.

18 *id.*

19 See C. Hill and C. King, 'How do German contracts do as much with fewer words?' (2004) 79 *Chicago-Kent Law Rev.* 889, 904; M. Kahan and M. Klausner, 'Path Dependence in Corporate Contracting' (1996) 74 *Washington University Law Q.* 347, at 355.

20 R. Ahdieh, 'The Strategy of Boilerplate' (2005–06) 104 *Michigan Law Rev.* 1033, at 1034.

21 C. Hill, 'Why Contracts are written in Legalese' (2001–2002) 77 *Chicago-Kent Law Rev.* 59, at 75.

22 A. Berg 'Thrashing through the undergrowth' (2006) 122 *Law Q. Rev.* 354, at 359: But if two companies enter into a complicated transaction, one of the main purposes in instructing lawyers to draft the contract is to ensure that its terms will be clear to those who have to deal with the contract in the future, and to the lawyers advising them, after the management who negotiated the contract have retired or moved on. The contract is therefore drafted so that it can be used by – it is addressed to – people who will have little of the background knowledge of the original management.

negotiators. Moreover, the division is not merely in approach but in source material and interest in doctrine. Gulati and Scott reported:

... neither one of us had seen much evidence of transactional lawyers engaged in a dynamic process of regularly reading cases and incorporating that learning into novel innovations in subsequent contracts. Some of the transactional lawyers we knew did not appear to have looked at a case in years. The task of reading cases seemed to be the province of the litigators, while the thinking about contract drafting remained with the transactional lawyers. In theory, the two groups might be specializing and transferring information across the artificial boundary that separated them. However, we had seen little evidence of interaction among transactional lawyers and litigators, let alone a process by which they collaborated in R&D on contract design.²³

This is not to suggest that individual lawyers are incapable of contractual innovation: confident lawyers with ‘more secure reputations’ are more likely to customize contracts,²⁴ and the work of Galanter suggested that the legal system favours ‘repeat players’, who act strategically over the long-term, over ‘one-shotters’ for whom a particular piece of litigation represents their sole experience of the issue.²⁵ The long-term perspective of the repeat player will include litigation and drafting strategies to develop the law to best suit their long-term goals. What the current evidence shows – consistent with Galanter – is that even repeat players will not seek to maximize the efficiency of the contractual document at all times, but only in response to some pressure to do so. Gulati and Scott’s interviews produced a consistent message: ‘the objective was to get the deal done, not to construct the perfect contract.’²⁶ This is consistent with a satisficing agenda, and may (at times) be boundedly rational.²⁷ Their expertise means that they can often have considerable traction on the shape of the new ‘default’ position. However,

23 Gulati and Scott, *op. cit.*, n. 13, p. 4. See, also, K. Adams, ‘Dysfunction in Contract Drafting: The Causes and a Cure’ (2014) 15 *Transactions: Tennessee J. of Business Law* 317, at 325–6. This is not to suggest that good practice does not exist in drafting, but that that is no systemic incentive to innovate.

24 M. Kahan and M. Klausner, ‘Path Dependence in Corporate Contracting’ (1996) 74 *Washington University Law Q.* 347, at 358.

25 M. Galanter, ‘Why The “Haves” Come Out Ahead: Speculations On The Limits Of Legal Change’ (1974–1975) 9 *Law & Society Rev.* 95.

26 Gulati and Scott, *op. cit.*, n. 13, pp. 87–8.

27 A. Vermeule, ‘Three Strategies of Interpretation’ (2005) 42 *San Diego Law Rev.* 607, at 610:

In many real world decisions, the set of options is itself (at least partially) the product of earlier decisions. One of the most important questions decisionmakers face is the extent of rational search: how many options, and how much information, should be sought out and considered before an ultimate choice is made? Here satisficing is coherent; as Herbert Simon emphasizes, satisficing is a constraint on further search for new information and new options. The satisficer searches only until finding a choice whose outcomes are good enough. By satisficing with respect to the particular decision at hand, the satisficer conserves time and other resources that may then be expended on other decisions.

outcomes in litigation and negotiation²⁸ will often depend on expertise and resources, rather than the 'law on the page' or in the contract.²⁹

This rather bleak perspective on the legal profession and drafting practices leads us to two questions regarding contractual innovation:

- (i) How does innovation in contract drafting occur?
- (ii) How are these changes / innovations then adopted on a wider scale so as to become standard provisions?

Numerous theories have been put forward to explain the inertia of lawyers and to suggest reasons why changes in commercial practice do nonetheless take place. In this article we focus on network theory as developed by Gulati et al. and suggest that these theories offer a plausible explanation of the change in contracting practice that resulted in the proliferation of RT clauses. In the following section we introduce these theories and show how they apply to contractual innovation in general. In later sections we move on to discuss their specific application in relation to RT clauses.

II. NETWORK THEORY AND CONTRACT INNOVATION

Developed in the context of technological innovations, in recent years network theory has been used to explain the spread of legal innovation, and to predict the success or failure of new legal regimes such as the Common European Sales Law.³⁰ The principal feature of networks is that 'the utility that a given user derives from [a network product] depends upon the number of other users who are in the same "network"'.³¹ Hence, the value of the network increases as the number of users increases. The classic example of this is the use of telephones. If only one person owned a telephone, then it would be a useless innovation; the value of a telephone is dependent on other people also owning telephones.³² The benefit of increased usage to all users on the network is referred to as a 'positive network externality' or a 'network effect', and network effects may be direct and indirect.³³

28 This extends to the 'ugly but expressive' (D. Campbell, 'Review Article: *Reservation of Title Clauses: Impact and Implications* by Sally Wheeler' (1992) 19 *J. of Law and Society* 488, at 491) hybrid concept of 'litigotiation', whereby legal rights are asserted as a part of the settlement process.

29 See S. Wheeler, 'Lawyer Involvement in Commercial Disputes' (1991) 18 *J. of Law and Society* 241.

30 See C. Kelly, 'The Proposal for a Common European Sales Law: Looking Beyond the Merits of Optional Instruments' (2013) 7 *J. of Business Law* 703.

31 M. Katz and C. Shapiro, 'Network Externalities, Competition and Compatibility' (1985) 75 *Am. Economic Rev.* 424, at 424.

32 The exact relationship between the number of users and the value of the network is referred to as Metcalfe's Law. In essence this provides that a tenfold increase in the size of the network leads to a hundredfold increase in its value. See C. Shapiro and H. Varian, *Information Rules: A Strategic Guide to the Network Economy* (1999) 183.

33 See Kelly, *op. cit.*, n. 30, pp. 705–7 for a discussion of network effects.

The difficulty with networks is that positive network effects can result in ‘excess inertia’ – a ‘socially excessive reluctance to switch to a superior new standard when important network externalities are present in the current one.’³⁴ Users may be reluctant to switch to a new product which has relatively few users in the early stages, and thus few network benefits, instead preferring to stick to an existing product which has network benefits, even if the existing product is in other ways inferior to the new product. This phenomenon, described as ‘standardization-by-sheer-force-of-numbers’,³⁵ has been used to explain the dominance of, for example, the QWERTY typewriter, despite the fact that alternative forms of keyboard exist.³⁶ This aligns with Geels’s theory of technological transitions:

Radically new technologies have a hard time to break through, because regulations, infrastructure, user practices, maintenance networks are aligned to the existing technology. New technologies often face a mismatch with the established socio-institutional framework.³⁷

This network analysis can be applied not only to different types of technology, but also to legal culture and practices,³⁸ and, importantly for our purposes, to contracts and contract terms. In the 1990s Kahan and Klausner took the lead in this particular field of analysis, arguing that the widespread use of contract terms by many firms confers network benefits on the users.³⁹ These network benefits include the availability of high levels of expertise as lawyers and accountants gain experience with the term, and also the availability of judicial interpretations of the term, which reduces uncertainty as to how the term is to be applied. In contrast, there will be little expertise and potentially much to lose⁴⁰ from a ‘new’ or innovative term which is not

34 J. Farrell and G. Saloner, ‘Installed Base and Compatibility: Innovation, Product Preannouncements and Predation’ (1986) 76 *Am. Economic Rev.* 940, at 940.

35 M. Katz and C. Shapiro, ‘Technology Adoption in the Presence of Network Externalities’ (1986) 94 *J. of Political Economy* 822, at 824.

36 P.A. David, ‘Clio and the economics of QWERTY’ (1985) 72 *Am. Economic Rev.: Papers and Proceedings of the Seventh Annual Meeting of the American Economic Association* 332. For a contrary view, see S.J. Liebowitz and S.E. Margolis, ‘The Fable of the Keys’ (1990) 33 *J. of Law and Economy* 1; S.J. Liebowitz and S.E. Margolis, ‘Network Externality’ (1994) 8 *J. of Economic Perspectives* 133.

37 F. Geels, ‘Technological transitions as evolutionary configuration processes: a multi-level perspective and a case-study’ (2002) 31 *Research Policy* 1257.

38 See A. Ogus, ‘The Economic Basis of Legal Culture: Networks and Monopolization’ (2002) 22 *Oxford J. of Legal Studies* 419, at 423.

39 See, for example, M. Kahan and M. Klausner, ‘Standardization and Innovation in Corporate Contracting (Or the Economics of “Boilerplate”)’ (1997) 83 *Virginia Law Rev.* 713; M. Kahan and M. Klausner, ‘Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases’ (1996) 74 *Washington University Law Q.* 347; M. Klausner, ‘Corporations, Corporate Law, and Networks of Contracts’ (1995) 81 *Virginia Law Rev.* 757.

40 Hill and King, op. cit., n. 19, p. 904 point out that ‘abiding by the norm will never engender criticism, but if there should be a dispute over the contract language later on, not having abided by the norm may very well be punished.’

used by many firms. Hence a commonly used but clumsy contract term with network benefits will often trump a 'better' contract term lacking these network benefits.⁴¹ Gulati et al. discuss the application of network theory to contract terms, distinguishing between 'horizontal' and 'vertical' network benefits. The latter kind of benefit relates to the value of the common use of a term to third parties, or the:

liquidity value of having uniformity across a market. The more widely a term is used, the greater its value as a standard form because pricing becomes easier. Thereafter, the difficulty of coordinating a move to new contractual language constitutes a barrier to innovation.⁴²

Network theory is of assistance to us in our efforts to understand contractual innovations as it offers an explanation of why users sometimes do move to a new standard, even in the face of an existing network or norm.⁴³ Certain factors greatly increase the chance of migration to a new standard and taken together can offer an explanation for such migration. First, predictions as to the success of a new network result in 'positive feedback'; hence a strong focus on the popularity of a new network product will, in itself, create a 'bandwagon' whereby the popularity of the product will increase.⁴⁴ Positive expectations can thus 'tip' the market in favour of a new network.

Coordination is another key feature of the transition to a new network. Farrell and Saloner refer to the problem of 'symmetric inertia', where firms prefer the new technology yet do not make the change for fear that nobody else will change, and that the new technology will not prove popular enough to replace existing network benefits with new network benefits.⁴⁵ New networks are more likely to succeed where the move to the new network is coordinated or where a 'big player' makes the first move or encourages others to do so. For example, Kahan and Klausner have commented on how underwriters have significantly influenced firms' contracting choices, and how these intermediaries have the ability to affect a high volume of contracts.⁴⁶

Finally, compatibility of the new innovation with the old system facilitates migration to the new system, as it is not necessary to entirely overhaul or abandon the old system; this is described as an 'evolutionary' strategy by Shapiro and Varian.⁴⁷ This mirrors Geels's theory of technological transitions, as he points out that new technologies often appear first

41 Hill, op. cit., n. 21, p. 70; Kahan and Klausner, op. cit. (1996), n. 39, pp. 352–3; J.S. Johnston, 'The Influence of the Nature of the Firm on the Theory of Corporate Law' (1993) 18 *J. of Corporate Law* 213, at 242.

42 Gulati and Scott, op. cit., n. 13, p. 79.

43 For the argument that standards can change despite strong network effects see Liebowitz and Margolis, op. cit. (1990) and op. cit. (1994), n. 36.

44 Shapiro and Varian, op. cit., n. 32, p. 181. See, also, Katz and Shapiro, op. cit., n. 31.

45 J. Farrell and G. Saloner, 'Standardization, Compatibility, and Innovation' (1985) 16 *RAND J. of Economics* 70, at 72.

46 Kahan and Klausner, op. cit. (1997), n. 39.

47 Shapiro and Varian, op. cit., n. 32, p. 191.

as 'add-ons' or hybridization.⁴⁸ However, a new network may be adopted, even where it is not compatible with existing networks, if it offers a 'revolutionary' change; that is, if the new product is 'so much better than what people are using that enough users will bear the pain of switching to it'.⁴⁹ Of course, in this situation, other factors will also come into play in promoting the use of the new product or system; context is key.

III. INNOVATION, TECHNOLOGIES, AND MARKET PARADIGM SHIFT: FITTING NETWORK THEORY TO BOILERPLATE

Theories which seek to explain contractual innovation have tended to suffer from a lack of empirical evidence. This is starting to change, as evidenced by the work done over the last six years on the impact of negotiating process on contractual boilerplate by a research group based on the east coast of the United States. Led chiefly by Robert Scott and Mitu Gulati, this project has sought empirical and interview-based evidence on the negotiation and agreed form of sovereign debt contracts, with a focus on those administered in New York and London. The sum total of these agreements would run into many billions, and might be thought to represent the pinnacle of high-end contracting. Each party (whether state or underwriter) will have access to substantial expert advice, both legal and fiscal. The contracts are relatively simple, and have not evolved markedly over several hundred years. Despite this, **most of these contracts contain a clause (the '*pari passu*' clause) that is generally recognized as having no clear agreed meaning and no obvious contractual benefit, but which carries a marked litigation risk.** The clause was apparently borrowed from corporate lending agreements and stipulates that a creditor shall be treated as of equal rank to all other creditors in liquidation.⁵⁰ In the corporate environment, this would have potential benefits to the creditor. With sovereign debt, there is no liquidation, only default, and so the clause loses its value to the creditor. It is possible that it had some beneficial usage when such clauses were first included in sovereign debt bonds (possibly as early as 1870), although none of the practitioners interviewed for that project seemed to have a clear idea of what that might have been.⁵¹ It is obvious that in a modern sovereign debt contract such a statement has no obvious *prima facie* advantage to the parties, and recent litigation showed it posed a potential risk.⁵² After one research lunch, Scott and Gulati admitted defeat in their search for an easy answer:

48 F. Geels, 'Technological transitions as evolutionary reconfiguration processes: a multi-level perspective and a case-study' (2002) 31 *Research Policy* 1257, at 1271.

49 Shapiro and Varian, *op. cit.*, n. 32, p. 195.

50 Gulati and Scott, *op. cit.*, n. 13, pp. 8, 113–14.

51 *id.*, pp. 111–12.

52 *Elliott Assocs.*, No. 2000QR92 (Ct. App. Brussels, 8th Chamber, 26 September 2000). See Gulati and Scott, *id.*, ch. 4. For the contrary view that the *pari passu*

[T]he two of us realized that we could not suggest a plausible answer to why the clause had neither been improved nor, better yet, just deleted. The failure to revise a contract term that, owing to an aberrant interpretation, now carried a nontrivial litigation risk was inconsistent both with the theoretical models of how sophisticated contract drafters behaved and with the dynamic model of case law serving as the basis for contract drafting and innovation.⁵³

This led to a substantial empirical project, which spawned two distinct lines of data: interviews with key market participants (mostly lawyers) and the data set of contractual documents collated over several hundred years. In this piece we draw largely from their work on the second source of data, and consider the way in which established norms are broken and replaced with fresh ‘standard’ terms.

In seeking to understand the process of contractual boilerplate (as stagnation), and the limits of change in contractual terms, Gulati and Scott sought to measure at least ten possible explanations.⁵⁴ Some of these were based on rational assumptions of behaviour and others on non-rational heuristics. For the purposes of this article, we focus on one substantial component in the mix: the benefit measurable by network theory. This theory is developed by Choi, Gulati, and Posner, demonstrating that contract evolution goes through three stages:

[S]tage one when a particular standard form dominates in the absence of external shocks; stage two when there are external shocks and marginal players experimenting with deviations from the standard form; and stage three when a new standard emerges.⁵⁵

So, when the established norm is subject to some ‘external shock’ that undermines its dominance, the gap is filled by innovation from fast-moving smaller businesses. Finally, a new equilibrium is established when large-scale users adopt a new standard. This model of change is best represented graphically. Figure 1 shows the distribution of sovereign debt contracts between two competing sets of boilerplate – the standard Ireland 1967 terms and the innovative Mexico 2003 variant:

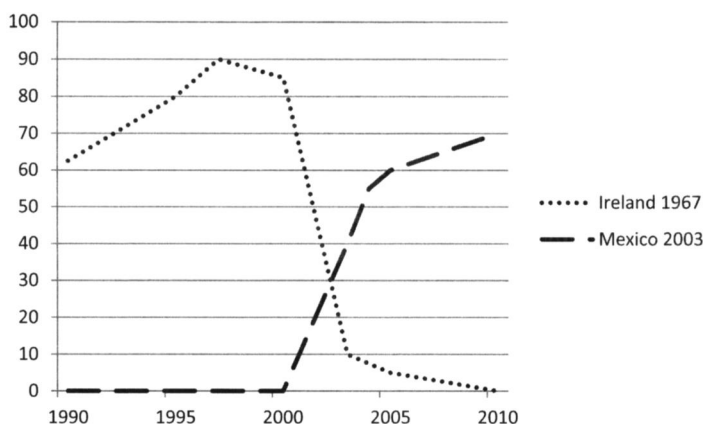
clause has an important function, see M. Wright, ‘The *Pari Passu* Clause in Sovereign Bond Contracts: Evolution or Intelligent Design?’ (2011) 40 *Hofstra Law Rev.* 103; R. Cohen, ‘Sometimes a Cigar is Just a Cigar: the Simple Story of *Pari Passu*’ (2011) 40 *Hofstra Law Rev.* 11.

53 Gulati and Scott, *id.*, p. 5.

54 In order of discussion these were: 1. Learning Externalities; 2. Network Externalities; 3. Negative Signalling; 4. Penalty for Remedial Measures; 5. Satisficing; 6. Contract Routines; 7. Nervous Nellies and Herd Behaviour; 8. Free Riders; 9. Endowment Effects (and Related Cognitive Biases), and 10. One Can’t Fix what One Doesn’t Understand.

55 Choi et al., *op. cit.*, n. 13, p. 1.

Figure 1⁵⁶



It is the ‘S-shape’ of the Mexico 2003 form that is particularly instructive. This is what network theory would predict for the market development of a new technology.⁵⁷ The old standard (the Ireland 1967) was already in decline as new variants were introduced even before the Mexico 2003 form gained prominence. This is due to an external shock, here the 1995 Mexican debt crisis.⁵⁸ The Mexico form is not therefore in direct competition with the Ireland 1967 form, as such; that old standard has already lost substantial position in the market. Put simply, there is a lag between the displacement of the old standard caused by an external shock and the rise of a new standard. That represents the period in which smaller players seek to innovate and gain market share.

An important development found in Choi et al.’s explanation of contractual innovation – and one which we have hinted at already – is that contract innovations are said to arise ‘not only from high-volume intermediaries but also from marginal players’.⁵⁹ These are both ‘minor in terms of the issuers and in terms of their lawyers’.⁶⁰ These marginal players are more likely to be involved in the early stages of innovation but their actions may not be noticed; it is only when bigger players such as dominant law firms or, in the case of Choi et al.’s study, industry groups or the IMF begin to ‘play a key role in promulgating the innovation’ that the new standard will accelerate. Referring back to the example of the Ireland 1967 form and the new Mexico 2003 form, Choi et al. conclude:

⁵⁶ This is a simplified version of the table at id., p. 28.

⁵⁷ A. Sood and G. Tellis, ‘Technological Evolution and Radical Innovation’ (2005) 69 *J. of Marketing* 152, at 153.

⁵⁸ Choi et al., op. cit., n. 13, p. 20.

⁵⁹ id., p. 8.

⁶⁰ id., p. 22.

In the wake of heated debate over [the process for handling sovereign default] ... in 2002, the four new models – Mexico 2003, Brazil 2003, Uruguay 2003, and Turkey 2003 – quickly began to dominate the scene. Two features of these four new models are interesting. First, they all showed up in 2003. This represents the point at which the dominant Ireland 1967 model exited from the New York market. Second, the models in stage three that appeared in 2003 were from the high-volume issuers and their high-volume lawyers, unlike what we saw in stage two. These four models are, we surmise, the big players competing to be the authors of the new dominant design.⁶¹

However, even marginal players are said to need an external shock, or some external factor, before they begin to experiment in stage two. This then has much to tell us about the nature and process of legal change in the contents of agreements. Not all of this is revelatory, but it does deepen our understanding of the mechanisms at play. We now move to our case study in which to test this conjecture: the apparently sudden shift in contractual behaviour regarding reservation of title clauses in the United Kingdom.

IV. CASE STUDY: THE ADOPTION OF RETENTION OF TITLE CLAUSES

A retention of title clause, or reservation of title clause, is a clause in a contract for sale that provides that even though the buyer may have possession of the goods, the seller retains ownership of the goods until the buyer has paid for them.⁶² The major advantage of such clauses is that they offer an unpaid seller protection in the event of the insolvency of the buyer – the goods do not form part of the buyer's assets for the purposes of the insolvency proceedings. The clause effectively places the seller of goods, who would otherwise most likely be an unsecured creditor, outside of the scheme of distribution in insolvency, and the seller can take back his goods,⁶³ even if another creditor claims to have a charge over them. There is thus no 'priority conflict' between the seller and the secured creditors.⁶⁴ Moreover retention of title clauses are generally drafted in such a way that the buyer is still free to make use of the goods,⁶⁵ but without the incon-

61 *id.*, p. 25.

62 This is a summary of the operation of retention of title clause. For more detail on their operation and effect see, for example, J.N. Adams and H. McQueen, *Atiyah's Sale of Goods* (2010, 12th edn.) 467–78; L.S. Sealy and R.J.A. Hooley, *Commercial Law: Text, Cases & Materials* (2009, 4th edn.) 452–70; E. Baskind et al., *Commercial Law* (2013) 255–64.

63 When an administrator is appointed under Schedule B1 of the Insolvency Act 1986, a seller is unable to repossess any goods held under a retention of title agreement without permission from the administrator or consent from the court.

64 M. Bridge et al., 'Formalism, Functionalism and Understanding the Law of Secured Transactions' (1998) 44 *McGill Law J.* 567, at 636.

65 Although there is no guarantee that a retention of title clause will be effective in every such situation, for example, where the goods are manufactured into other

venience of having to register a charge. Unsurprisingly, liquidators and other creditors will often object to retention of title clauses, as they take away from the resources of the insolvent buyer and reduce the amount that is left for other creditors.⁶⁶ Liquidators argue that the clause is essentially a charge, which, as it is unregistered, is void against a liquidator or creditor.⁶⁷ This argument has succeeded in some instances and not in others.

1. *The Romalpa decision*

Reservation of title clauses are sometimes called 'Romalpa' clauses, after the leading case of *Aluminium Industrie Vaassen BV v. Romalpa Aluminium Ltd.*⁶⁸ *Romalpa* was the first modern decision on reservation of title, and led to a dramatic increase in the use of reservation of title clauses. The clause in question was quite complex, and the case is notable for the Court of Appeal's particularly far-reaching interpretation of the clause in question. This was not a timid entrance for reservation of title clauses, with parties simply testing to see if a simple retention of title clause would succeed and a court reluctant to interfere with the distribution of resources in insolvency. It was, rather, a bold statement of the possibilities that such clauses could offer sellers looking to maximize their position in the event of insolvency.

In *Romalpa* the plaintiffs, a Dutch company, had sold aluminium foil to the defendants, an English company, subject to a complex reservation of title clause. This clause provided, among other things, that if the buyer were to manufacture the aluminium supplied, or mix it with other materials, then the seller would be the owner of the new manufactured goods. The buyer was to keep these goods for the seller 'in his capacity as fiduciary owner' and was to store them in such a way that they could be recognized as such. Finally, the buyer was entitled to sell these goods on to a third party within the normal course of business but, if the goods were not paid for, was to hand over to the seller any claims the buyer had against this sub-buyer.

The defendant buyers became insolvent before paying for the aluminium foil, and this clause was sufficient to allow the sellers to claim a quantity of unsold foil held by the receiver. However, a difficulty arose in relation to a

goods: see *Borden (UK) Ltd. v. Scottish Timber Products Ltd.* [1981] Ch. 25; *Re Peachdart Ltd.* [1984] Ch. 131. The construction of a clause may mean that a company can continue to deal with the goods subject to an RT clause despite their insolvency until the time at which the seller chooses to exercise his or her right to repossess them: *Bulbinder Singh Sandhu (trading as Isher Fashions UK) v. Jet Start Retail Limited (in administration)* [2011] EWCA Civ 459.

66 It has been noted, however, that retention of title clauses rarely affect unsecured creditors as the insolvent buyer's remaining assets are usually claimed by preferential creditors, for example, by banks through the recovery of their registered charges: *Report of the Review Committee on Insolvency Law and Practice* (1982; Cmnd. 8558; chair, K. Cork), at paras. 234 and 1600.

67 See Companies Act 2006, s. 874.

68 *Romalpa*, op. cit., n. 8.

quantity of aluminium foil which had been sold on to a third party before the original seller had been paid. The sub-buyer would have obtained good title to the goods under section 25(2) of the Sale of Goods Act, thus extinguishing the seller's rights over the goods. The seller could not therefore claim the goods themselves, but instead claimed an interest in the proceeds of the resale, basing the claim on a right to trace the proceeds of sale.⁶⁹ The Court of Appeal upheld this claim, holding that when the buyer lawfully sold on the aluminium, he had a duty to account for those goods in accordance with the normal fiduciary relationship of principal/agent or bailor/bailee.

Thus, the first modern case on retention of title clauses established not merely that these clauses were effective in their simplest form, but that even when goods were sold to a third party, a far-reaching claim to the proceeds of this resale could also be effective. Subsequent cases may have shed doubt on whether such claims would always be effective,⁷⁰ but *Romalpa* certainly introduced the potential of reservation of title clauses with a big bang.

2. The impact of the Romalpa decision

Although it is difficult to assess the impact of the *Romalpa* decision some 37 years after the fact, and nigh on impossible to determine the number of sales contracts containing retention of title provisions,⁷¹ there is evidence of a surge in both the use and complexity of retention of title clauses post-*Romalpa*, in the late 1970s and early 1980s. This is not to say that RT clauses were unknown before *Romalpa*⁷² but, rather, that their potential as a means of additional security for the seller was still underestimated.

Leading commercial law textbooks in the years leading up to *Romalpa* include brief discussions on conditional sales.⁷³ These very general discussions recognize that imposing a condition to be fulfilled before the property passes will effectively prevent the property from passing, with, for example, Tony Guest commenting that 'the condition most frequently encountered in such a reservation is the payment or tender by the buyer of the price.'⁷⁴ There is no discussion of the benefits of including an RT clause, in particular, the priority it would afford a seller in the event of the buyer's insolvency. A reader with no knowledge of reservation of title would be left

69 Based on the principle in *In re Hallett's Estate* (1880) 13 Ch.D. 696.

70 This is principally due to the difficulty of establishing that the seller/buyer relationship was truly fiduciary: see, for example, *Re Andrabell Ltd.* [1984] 3 All E.R. 407 and *Compaq Computers Ltd. v. Abercorn Group Ltd.* [1991] B.C.C. 484.

71 Wheeler states that there is 'no practical way of accurately determining the number of suppliers who purport to include some sort of reservation of title provision in their sales documentation': Wheeler, op. cit., n. 3, p. 5.

72 See B. Collier, *Romalpa Clauses: Reservation of Title in Sale of Goods Transactions* (1989) 2–3.

73 See, for example, P.S. Atiyah, *The Sale of Goods* (1975, 5th edn.) 154–5, 224–5.

74 A.G. Guest (ed.), *Benjamin's Sale of Goods* (1974) para. 384.

somewhat underwhelmed as to its potential use as a means of security; paradoxically, the same reader would also be unaware of the possible limitations of RT clauses, or of the issues they raise with regard to the existing insolvency regime. Reservation of title simply appears to be a non-issue, or at the very most a peripheral feature of a sales contract.⁷⁵ Similarly, in the aftermath of *Romalpa* Roy Goode commented that although reservation of title was 'known to English law for a very long time', such clauses had 'been mainly confined to instalment sale and hire purchase agreements'.⁷⁶ Moreover, any RT clauses tended to be simple rather than complex, focusing on the original asset rather than on the proceeds of sale.⁷⁷ Beale and Dugdale's empirical research of sales contracts in engineering firms in the mid 1970s also indicates that while 'some standard conditions' of contracts provide that property in goods shall not pass until the seller is paid, the more common action was to carry out a credit check before offering to sell on credit without security or, if there was a risk of non-payment, simply to refuse credit or to provide for stage payments, for example, by insisting on payment upon delivery.⁷⁸

This lack of innovation regarding reservation of title can be contrasted with the position elsewhere, in particular in Germany and the Netherlands where the use of RT clauses and claims to proceeds was routine.⁷⁹ Pennington suggests that the increasing use of reservation of title in Germany in the nineteenth century was because bank loans for buyers were less readily available than in England, so sellers were forced to extend credit to buyers.⁸⁰ It is no surprise that the *Romalpa* case itself concerned a clause inserted by a Dutch supplier,⁸¹ and that the Brentford Nylons scandal (discussed below) similarly concerned the supply of goods by an overseas supplier.⁸²

75 Although it should be noted that there was recognition of the need for reform of personal property security law, with the *Consumer Credit: Report of the Committee* (1971; Cmnd. 4596; chair, G. Crowther) as early as 1971 recommending reform based on Article 9 of the United States Uniform Commercial Code. See Goode, *op. cit.*, n. 8.

76 R. Goode, 'Reverberations of *Romalpa*' *Times*, 11 May 1977, 25. See, also, Prior's comment that although the use of such clauses is not 'presently common practice' in the United Kingdom, it is 'by no means unknown': R. Prior, 'Reservation of Title' (1976) 39 *Modern Law Rev.* 585, at 585 ff.

77 Goode, *id.*

78 H. Beale and T. Dugdale, 'Contracts between businessmen: Planning and the use of contractual remedies' (1975) 2 *Brit. J. of Law and Society* 45, at 52.

79 Goode, *op. cit.*, n. 76. It has also been commented that this was the practice in Sweden and Denmark: Prior, *op. cit.*, n. 76, p. 585.

80 R. Pennington, 'The *Pactum Reservati Dominii* in Twentieth Century Europe' (1977) *Acta Juridica* 257. See, also, the discussion of German law in the Irish case of *Re Interview Ltd* [1975] *Irish Reports* 382, at 392.

81 The contract in *Romalpa* contained a clause stating it was to be governed by Dutch law, but as neither party invoked Dutch law, it was decided according to English law: see R. Fentiman, 'Foreign Law in English Courts' (1992) 108 *Law Q. Rev.* 142, at 149.

82 'Suppliers threaten legal action over Brentford Nylons' *Times*, 2 March 1976.

Moreover, there appears to have been awareness in the United Kingdom of the fact that such clauses were used across Europe.⁸³

Although we do not currently have access to sales contracts from the years immediately after *Romalpa*, contemporaneous accounts of the change in legal culture exist. Roy Goode was particularly vocal on the impact of the decision,⁸⁴ and famously said that ‘it is doubtful whether any case decided this century has created a greater impact on the commercial world than *Romalpa*.’⁸⁵ In terms of the practical impact *Romalpa* had on commercial practice, he stated:

In the wake of *Romalpa*, suppliers all over the country began to include reservation of title clauses in their contracts, stamp ‘*Romalpa*’ on their invoices and assert proprietary claims to the goods on the buyer’s bankruptcy.⁸⁶

Romalpa clauses were said to ‘have now become so common in this country as to present a serious threat to the smooth running of business.’⁸⁷ Other contemporaneous literature backs up this contention that in the aftermath of *Romalpa* there was an increased use of retention of title clauses.⁸⁸ Furthermore, Goode commented that not only had such clauses become more common, but ‘encouraged by *Romalpa*, sellers [developed] more extended clauses which are sometimes extremely elaborate.’⁸⁹ Thus, sellers started to develop clauses which claimed not only title to the original goods but also any products and proceeds of sale, as well as including ‘current account’ clauses.⁹⁰

83 See, for example, J.H. Farrar and N.E. Furey, ‘Reservation of Title and Tracing in a Commercial Context’ (1977) 36 *Cambridge Law J.* 27, at 32: ‘So far, reservation of ownership does not seem to be widely used in the United Kingdom ... It is, however, widely used in the E.E.C.’

84 See, for example, Goode, op. cit., n. 8; R. Goode, *Proprietary Rights and Insolvency in Sales Transactions* (1985).

85 Goode, op. cit., n. 76.

86 Goode, op. cit., n. 84, p. 90.

87 Goode, op. cit., n. 76.

88 See, for example, Pennington, op. cit., n. 80, p. 258, commenting that in England it is only ‘in recent years’ that retention of title clauses ‘have come into widespread use in imitation of European practice’; M. Kerr, ‘Modern Trends in Commercial law and Practice’ (1978) 41 *Modern Law Rev.* 1, at 9, commenting that there has been a ‘sudden upsurge in interest in the reservation of title in goods by sellers until payment has been received’; Davies, op. cit., n. 4, p. 10: ‘Since *Brentford Nylons* [in 1975] such clauses have become prolific in commercial contracts to the extent that Muir Hunter QC told delegates at the Touche Ross Insolvency Conference in November 1980 that there was a proliferation of reservation of title clauses like a “dreadful weed”.’

89 Goode, op. cit., n. 84, p. 82.

90 A ‘current account’ clause provides that the goods supplied remain the property of the seller until all sums due to the seller (not just the payment for the goods in question) are paid. For many years there was considerable doubt over whether this type of clause would be effective, as it could mean that for as long as the buyer had

Such empirical evidence that exists, while limited, appears to back up Goode's claims of a rise in both the use and complexity of reservation of title clauses. In a small scale study of 35 businesses, conducted by Julie Spencer in the late 1980s, 59 per cent of respondents said that they included reservation of title clauses in their contracts.⁹¹ This study further demonstrated that businesses using these clauses did not just use simple retention of title clauses, but also proceeds of sale clauses, current account clauses, and clauses claiming manufactured goods.⁹² When asked when they had first included a reservation of title clause in their conditions of sale, answers ranged from 1976, the year *Romalpa* was decided, to 1986, with 71 per cent of those who used reservation of title clauses indicating that they had only included the clause since 1980. Spencer opines that the greater influence of *Romalpa* from 1980 might be due to the 'substantial increase in the annual number of insolvencies since 1980.'⁹³ However, court decisions continued to have an influence, with a new surge of businesses using a clause, or adapting an existing clause, after the decision in *Clough Mill Ltd* in 1984.⁹⁴

This is not the first time it has been suggested that prevailing economic conditions accelerated the process by which suppliers adopted reservation of title clauses. De Lacy states that with the economic downturn it was 'hardly surprising that parties began to re-evaluate their contractual relations and the expectations contained therein'⁹⁵ and, in 1978, Kerr stated that while concept of reservation of title 'is old and well-known' it had been 'brought to the fore by economic instability'.⁹⁶

3. The Brentford Nylons scandal

A further factor which contributed to the impact of the legal decision in *Romalpa* was the media attention afforded to the Brentford Nylons 'debacle'⁹⁷ around the same time as the *Romalpa* decision. Brentford Nylons was a large textile manufacturer which specialized in the manufacture of cheap nylon shirts and light household furnishings such as sheets and curtains. The company originally sold its goods by mail order, but moved to a new business model whereby it sold from stores. The difficulty with this

any debt outstanding the property in the goods would remain with the buyer. However, in *Armour v. Thysson* [1990] 3 All E.R. 481, the House of Lords upheld such a clause, basing its judgment on the parties' intentions as expressed in the contract. See R. Bradgate, 'Retention of Title in the House of Lords: Unanswered Questions' (1991) 54 *Modern Law Rev.* 726.

91 Spencer, op. cit., n. 3, p. 221.

92 id., pp. 225–9.

93 id., p. 222.

94 *Clough Mill Ltd v. Martin* [1984] 3 All E.R. 982; Spencer, id., pp. 222–3.

95 De Lacy, op. cit., n. 5, pp. 338f.

96 Kerr, op. cit., n. 88, p. 9.

97 R. Goode, 'The Right to Trace and its Impact on Commercial Transactions – II' (1976) 92 *Law Q. Rev.* 528, at 548. See, also, Davies, op. cit., n. 4, p. 10.

was that it was ‘difficult if not impossible for any one manufacturer to provide a sufficient range of own-brand goods to attract custom in sufficient volume.’⁹⁸ In addition, the industry was moving from nylon manufacture to other types of materials, and the company incurred significant debt constructing a large new factory in Northumberland to facilitate a move to polyester cotton. All these factors were thought to put a strain on resources, and in February 1976 the company called in a receiver.⁹⁹ However, two of Brentford’s major creditors, a German fibre manufacturer and its main British supplier, both of whom were associated with a large Dutch fibre company, almost immediately threatened the receiver with an injunction to stop the sale of £5 million worth of raw materials which had been supplied to Brentford Nylons but which had not been paid for.¹⁰⁰ They claimed that the stock had been sold subject to a reservation of title clause and thus still belonged to them. The dispute was settled through private negotiations rather than taken through the courts, supposedly because of the number of jobs that would have been lost if production was forced to cease due to an inability to use the raw materials.¹⁰¹ This case appears to have provoked reactions from several quarters, with, for example, the Institute of Chartered Accountants commencing an enquiry to assess the implications of this type of clause and to see how widespread its use was.¹⁰² Thus the Brentford Nylons scandal represented the ‘law in action’ illustration of the effect of reservation of title clauses, and would have added to the public consciousness of the impact of insolvency. This scandal, combined with the economic conditions of the time, no doubt added to the impact of *Romalpa*.

98 P. Ollerenshaw, ‘Innovation and Corporate Failure: Cyril Lord in UK textiles 1945–1968’ in *History of Insolvency and Bankruptcy from an International Perspective*, eds. K. Gratzner and D. Stiefel (2008) 158.

99 ‘Receivers take over at Brentford Nylons’ *Times*, 24 February 1976.

100 ‘Suppliers threaten legal action over Brentford Nylons’ *Times*, 2 March 1976.

101 ‘Fibre makers in pact with Brentford Nylons Receiver’ *Times*, 6 March 1976. The Brentford Nylons story did not however end there, as the government subsequently offered Lonrho, an international trading group with large textile interests, a loan of £5 million to purchase Brentford Nylons and save jobs. (‘Government offers Lonrho £5m loan to save 1,600 jobs at two Brentford Nylons factories’ *Times*, 25 June 1976. This was despite the fact that the Department of Trade had recently conducted a controversial investigation into Lonrho’s activities in Africa and parts of its report had been forwarded on to the police. Lonrho and, in particular, its head Tiny Rowland, was later cleared of any charges but the company and its leaders remained controversial: ‘Tiny Rowland, African Giant’ BBC News, July 26 1998, at <<http://news.bbc.co.uk/1/hi/world/africa/139596.stm>>.

102 *Times*, id. (6 March).

4. *The relevance of the judicial retreat from Romalpa*

It is sometimes argued that the impact of the *Romalpa* decision has been overstated,¹⁰³ based solely on the fact that in subsequent cases where suppliers have attempted to rely on clauses drafted based on *Romalpa*, the courts have distinguished *Romalpa* on rather shaky grounds and refused to follow it.¹⁰⁴ However, the point being made here is that the case had reverberations for commercial practice and contractual innovation, regardless of whether subsequent court decisions diminished the effectiveness of proceeds of sales clauses. Wheeler has pointed out that the enthusiasm for including these clauses in sales contracts was not diminished by subsequent adverse case law:

It would be incorrect to think that drafters of reservation of title clauses do not attempt to assert ownership of new products and trace proceeds of sale of original goods and new products despite seemingly adverse case law and the practical difficulties of setting up concepts like fiduciary relationships in a commercial context.¹⁰⁵

The impact of *Romalpa* is also sometimes rejected on the basis that in practice such clauses are rarely litigated or enforced. It is true that actual legal decisions on reservation clauses are few and far between, but the limited empirical evidence that does exist shows that given the correct circumstances and proper drafting, reservation of title clauses, particularly 'simple' reservation of title clauses,¹⁰⁶ are enforced and have effect.¹⁰⁷ The difficulty with enforcement appears to occur mostly when a clause is poorly

103 See, for example, De Lacy, op. cit., n. 5, p. 327:

At the time the case was decided such a statement would undoubtedly have been an accurate reflection of popular commercial sentiment. However, from today's perspective it appears to be an embarrassing largesse, more reflective of a 'pious hope' than a judgment upon the beginning of a commercial revolution. It will be seen that far from having a great impact upon commercial law the case has fallen by the wayside and has all but been overruled by the courts of first instance.

104 See, for example, *Re Andrabell and Compaq Computers*, op. cit., n. 70. See, however, the recent case of *Caterpillar (NI) Ltd v. John Holt & Company (Liverpool) Ltd* [2013] EWCA 1232 which appears to be more in keeping with the *Romalpa* decision, although it related to a different issue (the ability to sue for the price of goods under s. 40 of the Sale of Goods Act 1979) and has been criticized: S. Cogley and J. Richmond, 'Retention of Title' *Law Society Gazette*, 11 November 2013.

105 Wheeler, op. cit., n. 3, p. 33.

106 See S. Worthington, *Proprietary Interests in Commercial Transactions* (1996) 8 (although this does not seem to be based on empirical evidence).

107 See, for example, Spencer, op. cit., n. 3, pp. 229–31. Although this study is rather inconclusive and a little unclear on this issue, 30 per cent of respondent suppliers stated that their claims had generally been successful. Accountancy firms were somewhat more pessimistic on the likelihood of the success of claims but, again, answers seem to have been quite varied as between a small number of firms.

drafted,¹⁰⁸ where there is a lack of evidence that the goods claimed were in fact the subject of a contractual provision for retention of title,¹⁰⁹ and where the supplier of goods does not move fast enough to put a receiver on notice of his retention of title claim.¹¹⁰ Worthington has made the point that retention of title devices fail where 'the substance of the parties' agreement triumphs over the form used to define property ownership.'¹¹¹ Wheeler, in contrast, has focused on the importance of the negotiating powers of the parties involved in determining whether or not the clause is enforced.¹¹² Moreover, the lack of enforcement of clauses says nothing about their existence, or about the number of claims made in relation to them.¹¹³ The focus of this article is not so much on the issue of whether or not these clauses are *enforced* but, rather, on the impact the *Romalpa* decision had on commercial practice and innovation, in the sense that there was a sudden, noticeable increase in the number of contracts including complex reservation of title clauses after the decision. Whether or not these clauses are ultimately enforced is essentially irrelevant to this issue.

Thus, within 10 years of *Romalpa*, there appears to be a new, stable position of using a reservation of title clause to supply goods on credit terms. The insolvency risk is now shared in a more complex fashion than before. If the reservation of title clause is effective, then the supplier will recover the goods, although this may well provide less than full recovery of the profit obtainable through payment of the contract price.¹¹⁴ Often the supplier will have traded the 'book debt' owed by the purchaser to a second finance house, and it will now hold the risk of enforcing the *Romalpa* clause. Moreover, the purchaser's financiers will not be able to look to those apparent assets to meet any outstanding indebtedness to it. It is vital to those creditors that they are able to properly price the credit being offered, as either unsecured or secured incoming assets. However, there remains a substantial risk of a reservation of title clause not being enforced in practice to full effect, if at all. The information costs of verifying each incoming shipment would prohibit dealing with credit management on an ad hoc basis. This is a multi-dimensional co-ordination game, reaching beyond the immediate parties to the sale contract. The additional dimension comes in

108 See, for example, *Re Bond Worth Ltd.* [1980] 1 Ch. 228 where an attempt to retain 'equitable and beneficial ownership' was held to be a charge.

109 Goode, *op. cit.*, n. 84, p. 90.

110 See E. Bailey and H. Groves, *Corporate Insolvency Law and Practice* (2007, 3rd edn.) paras. 11.51–11.54 for the steps a supplier should take in the event that he or she has a retention of title claim.

111 Worthington, *op. cit.*, n. 106, p. 10.

112 S. Wheeler, 'Lawyer Involvement in Commercial Disputes' (1991) 18 *J. of Law and Society* 241.

113 De Lacy, *op. cit.*, n. 5, pp. 329 ff: in the context of one administrative receivership alone, about 400 retention of title claims had been made against the company.

114 See, for example, Wheeler, *op. cit.*, n. 112, and Spencer, *op. cit.*, n. 3.

the likely chain (and web) of such deals, as raw materials are traded, processed, branded, and presented to retail customers.

It is thus evident that *Romalpa* had a serious impact on the commercial world, in that there was an increase in the number of sellers including reservation of title clauses in their contracts, and clauses drafted were more complex and detailed. The question that the article poses is why *Romalpa* had such an impact, when reservation of title clauses were already known in the commercial world. It now moves on to use theory of the evolution of contract innovation to suggest why these clauses were ignored or left on the periphery until the dramatic shift in practice brought about by *Romalpa*.

V. ANALYSIS: CONTRACTUAL INNOVATION AND THE SPREAD OF RETENTION OF TITLE CLAUSES

Applying Galanter's typology¹¹⁵ to sales contracts, the contracting parties may be expert repeat players in some areas (such as duties relating to delivery, or non-legal recovery of the price) but are likely to be closer to 'one-shotters' in respect of insolvency issues. The insolvency practitioner and the finance houses involved indirectly are much more likely to be familiar with the process of business failure, but are not contracting parties. In the case of the banks, they can influence the contractual position by imposing formal or informal controls on the flow of credit, such as differential pricing for credit where the goods are subject to an RT clause. Obviously, the insolvency practitioner would not have been in a position to influence the contract as drafted, but as Wheeler demonstrated, has considerable practical influence on the contract as enforced.¹¹⁶ In the following sections we discuss whether network theory can explain the spread of RT clauses.

1. *Network theory and the spread of retention of title clauses*

Network theory tells us that the widespread use of a contract term brings with it indirect network benefits, in particular, the availability of judicial interpretations of the clause, high levels of user expertise and knowledge of how the clause works in practice, and vertical network benefits making pricing easier.¹¹⁷ In Gulati and Scott's study, parties felt greater confidence in clauses which were widely used – even if they had not been tested in litigation.¹¹⁸

115 Galanter, op. cit., n. 25.

116 Wheeler, op. cit., n. 3.

117 Gulati and Scott, op. cit., n. 13, p. 79.

118 id., p. 87.

Of course, if the buyer becomes insolvent, the chances of a seller retrieving unpaid for goods is not increased merely because other sellers also have RT clauses. However, the argument being made here is that, as with other contract clauses, there are horizontal and vertical network effects associated with increased use of RT clauses owing to increased expertise and knowledge on the effect and interpretation of the clause. The network effects are here more important when the contract is formed – which is the stage we are focused on in this article – rather than at the implementation stage.

A new or innovative contract term will not at first have these benefits and thus poses a risk; a risk which is more pronounced in the generally conservative world of the law firm, where the status quo is preferred to innovation.¹¹⁹ A difficulty thus arises in introducing a new term – somebody has to be the first to take a risk and introduce the term, and potentially years of uncertainty could ensue as to the exact meaning and implications of that term before it is tested in court.

The *Romalpa* decision is striking because it immediately provided this new innovation (that is, a complex RT clause claiming the proceeds of sale) with one of the major network benefits associated with well-known existing contract terms, namely, the existence of a judicial interpretation of the term. An English firm did not have to ‘pioneer’ the term and take the risk that it would not be of effect in an English court; instead a foreign supplier, assuming that Dutch law would apply, inserted it into their contract and inadvertently took the risk of receiving an unfavourable judgment on behalf of English suppliers. A further network benefit, the availability of some knowledge as to how these clauses would work in practice in the event of insolvency, was provided both by the *Romalpa* case and by the Brentford Nylons insolvency. The latter was widely reported in the press and would have demonstrated to British suppliers that retention of title clauses can produce results for suppliers.¹²⁰

Network theory further suggests that compatibility with the existing regime can aid uptake of a new innovation. The development of RT clauses appears to support this. RT clauses were compatible with the existing contracts – no major changes to the structure or form of the contract were necessary, at least in the immediate aftermath of *Romalpa*.¹²¹ The contract was still a contract of sale, as opposed to an instalment method of supply such as hire purchase or some conditional sales. This would have facilitated

119 See n. 19, above.

120 Later judicial interpretations threw doubt on *Romalpa*, meaning many proceeds of sale clauses were redundant. However the clause could still remain in the contract without doing any harm, especially if you had a separate simple RT clause which could be severed from an unenforceable proceeds of sale/manufactured goods clause. On the persistence of redundant terms, see Hill, op. cit., n. 41.

121 Later case law indicates that some changes to the overall contract were necessary: see, for example, *Re Andrabell*, op. cit., n. 70.

the change to include such clauses. However, the difficulty with this aspect of network theory is that although it certainly contributes to the explanation of why RT clauses were adopted, it does little to explain why the change happened at that particular point in time, and not previously. To answer this question, we again look to the *Romalpa* case as a turning point in the history of contractual drafting. A new network may be adopted, even where it is not compatible with existing networks, if it offers a 'revolutionary' change; if the new product is 'so much better than what people are using that enough users will bear the pain of switching to it.'¹²² The *Romalpa* case provided this revolutionary change, offering innovative benefits which did not exist before hand. Retention of title clauses were no longer useful only where goods were unchanged and unsold before the buyer became insolvent; now they had potential to protect a supplier even when the buyer had manufactured goods from the products and sold the goods on.

Two other factors play a role in the rise of new networks: the phenomenon of positive feedback and the existence of a coordinating force with the ability to influence contracting choices. In the case of retention of title clauses it is not immediately clear where this coordination came from, as law firms are not as a rule coordinated. We suggest that expert academic practitioners played a vital role as communicators of the message that the *Romalpa* decision was not one to be ignored, and made crucial predictions as to the likelihood that suppliers would increasingly use these clauses. Thus for example, Prior stated:

Vendors of goods and materials can be expected to incorporate, into their standard conditions, *Romalpa* type provisions and company secretaries will certainly be looking to their lawyers to achieve this.¹²³

Similarly, comments in the aftermath of *Romalpa* to the effect that there has been a 'sudden upsurge in interest' in reservation of title clauses,¹²⁴ or that they are in 'widespread use',¹²⁵ not only represent a comment on the *existing* commercial practice, but greatly affect the *future* state of things, and can, in and of themselves, increase the use of retention of title clauses. Nor were these comments limited to academic journals – Goode's article in the *Times* in 1977, in which he stated that *Romalpa* clauses 'have now become so common in this country as to present a serious threat to the smooth running of business',¹²⁶ could feasibly have increased the use of the clause by suppliers. Equally, the initiation of investigations into reservation of title clauses by the Institute of Chartered Accountants could simply have added to the idea that they were becoming increasingly popular.¹²⁷ This is arguably

122 Shapiro and Varian, op. cit., n. 32, p. 195.

123 Prior, op. cit., n. 76, p. 589.

124 Kerr, op. cit., n. 88, p. 9.

125 Pennington, op. cit., n. 80, p. 258.

126 Goode, op. cit., n. 76.

127 See *Times*, op. cit. (6 March), n. 101.

backed up by the fact that although these comments about the purported popularity of retention of title clauses were all made in the 1970s, the empirical evidence by Spencer shows that many businesses did not start incorporating retention of title clauses until a few years later.¹²⁸ Using Malcolm Gladwell's analysis of the spread of ideas, discussed below, these expert commentators and market leaders who spread the word about this new innovation can be viewed as the 'Mavens' of commercial law.

Traditional network theory can thus tell us that *Romalpa* represented a revolutionary innovation which came complete with its own network benefits, in particular, a judicial interpretation of the clause. Although lacking an official sponsor, the clause was promoted by a significant number of academics, all of whom predicted its ultimate success to the point that that success became increasingly likely. Choi et al. have recently drawn on network theory to put forward a new theory of contract evolution,¹²⁹ and it is this development to which we now turn.

2. Gulati and Scott and the spread of Romalpa clauses

The empirical evidence from which Gulati and Scott drew their theory did not lend itself to a simple overarching explanation. Ultimately, their explanation relies on a mixture of rational and less than rational behaviours. They were able to identify a series of genuine constraints on lawyers involved in negotiating, drafting, and advising on sovereign debt contracts.¹³⁰ Many of these resolved down to financial pressures to perform the task quickly and cheaply. However, there were also concerns about the signal it would send to other contracting parties in suggesting an alteration to the standard form, even if that would ultimately improve the quality of the boilerplate. These are rational responses to the irrationality of other players in the market.¹³¹ However, this circularity of approach (each firm failing to innovate so as not to 'stand out from the crowd') extended to irrational behaviour even when the possible financial and reputational advantages from identifying and resolving a potential problem would outweigh the negative signals.¹³²

Ultimately, Gulati and Scott describe a momentarily stable system, maintained in balance largely by the belief in the status quo by lawyers and their customers. One forceful external jolt, and this would often be a judicial decision or similar, would then disrupt the balance and set the scales swinging once more.

This analysis fits in with the above explanation of the explosion of retention of title clauses in the sense that both rely on an external trigger – a

128 Spencer, op. cit., n. 3, p. 222.

129 Choi et al., op. cit., n. 13.

130 Gulati and Scott, op. cit., n. 13, ch. 6.

131 id., pp. 80–3.

132 id., ch. 7.

‘revolutionary’ strategy in the case of networks, an ‘external shock’ or ‘tipping point’ in the case of Choi et al.’s theory. In fact, the reference to a ‘tipping point’ is one which is often found in the network theory literature. This brings us full circle to the explanation of why reservation of title clauses took off in the late 1970s and 1980s: the *Romalpa* case, complete with poor economic conditions and the media attention given to the Brentford Nylons scandal, caused an external shock which had a ripple effect through the commercial and legal community.

(A) 第1階段：合同條款的模板和收斂

(a) Phase 1: Boilerplate and convergence of contract terms

Prior to 1974 there appears to be a settled tradition in favour of not reserving title in sales contracts. Rather, purchasers sought credit from their financiers and used those monies to obtain goods on cash terms. This provided immediate payment to the supplier, and the purchaser’s financiers took the risk that the materials supplied would not be processed profitably due to insolvency. The financiers involved commonly took a ‘floating charge’ on the book assets of the company to obtain preference over unsecured creditors in insolvency.¹³³

(B) 第2階段：外部衝擊和第一個過渡階段

(b) Phase 2: External shocks and the first transition phase

The understood positions of the parties in this game are disrupted by the combined shocks of economic decline, and the evidence of this in the Brentford Nylons and *Romalpa* insolvencies. The shock comes from the unpaid seller having an effective claim (at least on these facts) to the unprocessed materials and the proceeds of sale of processed materials. In the familiar game of musical chairs that is business failure, the debenture holders found they had no seat when the music ended. This fundamentally changed the rules of the game.

The insolvencies in Brentford Nylons and *Romalpa* were not isolated incidents at a time of economic decline. Their significance derives from their ‘other-worldly’ nature. The established order of priority in insolvency was disrupted by the reservation of title clauses. These are alien for at least two reasons. First, in both cases they were incorporated as a result of cross-border trade, and the adoption of non-British norms as to the passing of property. In *Romalpa* and Brentford Nylons the suppliers are Dutch. We do not currently have access to the Brentford Nylons supply contracts, but the *Romalpa* clause was not designed to bring about a change in English law. It was Dutch in origin, and expected to be enforced under Dutch law. This is, then, change by mutation rather than deliberate innovation. This is not unusual. Many technologies that have led to dramatic market shifts have

133 R. Goode, ‘Twentieth Century Developments in Commercial Law’ (1983) 3 *Legal Studies* 283, at 291.

been inadvertent: Viagra, stainless steel, and Saccharin are all reputedly 'happy accidents'.¹³⁴

The more legal cause of their 'otherness' is the source of the broader effects in *Romalpa*: the equitable origin of the tracing remedy used by the unpaid seller to go beyond the goods supplied and makes claims over the proceeds of sale. This usage of equitable principles in commercial law was thought sufficiently significant to deserve a double-length article by Roy Goode in the *Law Quarterly Review*.¹³⁵ Following a shock to the system of this magnitude, Choi et al. predicted that the initial reaction will be limited within large, established enterprises which will adhere to the prior standard. They asserted that the immediate innovation will arise within smaller organizations which will seek market share by experimenting with innovative forms. These will not displace the established norm immediately. Rather, as with technologies generally, these adaptations will need to be adopted by established market players in order to gain traction. The significance of this predictor is that it appears to be a good fit for the rise of the *Romalpa* clause. We do not have the kind of empirical data used by Posner, Gulati, Scott, and others in their wide-ranging project. Nonetheless, the fit between the contemporaneous account of the spread of *Romalpa* clauses (and the many variants of such clauses) is significant.

What is missing from the Scott/Gulati account is an explanation of how these forms spread throughout the market. We believe that it can be significantly improved by the addition of a further element: the 'Maven' of Malcolm Gladwell's book *The Tipping Point*.¹³⁶

3. Boilerplate: mavens and tipping points

The spread of knowledge throughout a community is part of the staple research diet of marketing, consumer behaviour, communication and political science.¹³⁷ Malcolm Gladwell, in his book about the epidemiology of ideas (*The Tipping Point*) discusses the importance of certain individuals in the spread of knowledge. He refers to such individuals as 'Mavens', from the Yiddish for a trusted source of information. Within the academic literature, market mavens are defined as:

134 Development stories are often contested, but see: Viagra, at <<http://www.sildenafilakaviagra.com/history-of-viagra>>; Stainless Steel and Harry Brearley, at <http://www.bssa.org.uk/about_stainless_steel.php?id=31>; Saccharin, at <<http://science.discovery.com/famous-scientists-discoveries/10-accidental-inventions.htm>>.

135 R. Goode, 'The Right to Trace and its Impact on Commercial Transactions – I' (1976) 92 *Law Q. Rev.* 360 and Goode, *op. cit.*, n. 97.

136 M. Gladwell, *The Tipping Point: How little things can make a big difference* (2002).

137 L. Feick and L. Price, 'The Market Maven: A Diffuser of Marketplace Information' (1987) 51 *J. of Marketing* 83, at 85.

individuals who have information about many kinds of products, places to shop, and other facets of markets, and initiate discussions with consumers and respond to requests from consumers for market information.¹³⁸

Their motivation for this is mixed, but in the commercial sphere it is likely that:

individuals may transmit information as part of an implicit contract in which the information receiver pays for the information by providing information or other rewards to the giver. That is, a market maven may provide general information to individuals who, in turn, give information to the maven, perhaps on specific topics about which they are particularly knowledgeable.¹³⁹

The crucial difference between this type and other ‘opinion leaders’ (‘individuals who acted as information brokers intervening between mass media sources and the opinions and choices of the population’)¹⁴⁰ is the social aspect, the face-to-face dissemination of the information.

We speculate that company secretaries became aware of the *Romalpa* decision through two distinct pathways. First, awareness was raised through the reports in the financial and general media attention surrounding the Brentford Nylons and *Romalpa* insolvencies. The first-instance decision of *Mocatta J* was not reported (in the Law Reports) until the appeal was heard in 1976, but Roy Goode was clearly seeking to raise wider awareness of the issue through substantial pieces in the *Times* and elsewhere. This fits within the ‘opinion leader’ bracket. We suspect that the types of clauses that could be drafted to assimilate the *Romalpa* decision into commercial practice formed a substantial part of his practice.¹⁴¹ Secondly, as a consultant to Mishcon, and creator of the specialist Centre for Commercial Law Studies, Goode was actively involved in communicating significant legal change to London’s commercial law firms. In return he obtained significant financial support from the City to support academic work. As a contemporary noted he ‘devoted great energy and ingenuity to this task at which he proved to be outstandingly successful’.¹⁴² He was therefore acting as the personal conduit for change to be recognized and adaptations to be suggested. This brings him within the ‘maven’ class, as a trusted guide to a fluid situation, where many possible courses of action could have been pursued.

138 id.

139 id.

140 id., at p. 84.

141 Within 8 months of the *Romalpa* decision in the Court of Appeal, Goode’s speculations on the broader implications of the decision were published: Goode, op. cit., n. 97, pp. 547–52.

142 G. Zellick, ‘Roy Goode and Queen Mary College’ in Cranston (ed.), op. cit., n. 2, p. xix.

CONCLUSION

The Gulati/Scott project has important lessons for legal theorists and practitioners alike.¹⁴³ The combined application of law, economics, and psychology suggests that changes in contractual boilerplate arise in a similar fashion to developments in other forms of technology. This is confirmed by their iterative study of the global sovereign bond market. Contracts, then, are not some special class of creation. Contract designers are not the efficiency-seeking maximizers of fiction, but satisficing individuals who resist change. When change does come, it is when players are forced to face the limitations of their original design by some outside event. Our choice of contractual form is 'sticky' but we can be persuaded to set a new benchmark by external influences and events.

This provides an explanation for the reputed explosion of reservation of title clauses in the United Kingdom during the mid-1970s. The twin external shocks of the *Romalpa* case and the Brentford Nylons insolvency showed the weakness of securing loans to manufacturers by looking to their stock and current account balances. Yet these external shocks were not deliberate – they were the accidental application of continental European practice within the English legal system. As with many technological developments, the improvement arose by accident and not design.

What is missing from the Gulati/Scott account is a mechanism by which the shock is propagated through the market. In a diffuse environment such as commercial sales transactions, change might normally be slow and haphazard. As Gulati and Scott reported, those involved in contract design did not give the impression of closely following the latest precedents.¹⁴⁴ We suggest that key individuals – here, Sir Roy Goode – carried the message from academia to practice, in exchange for influence and sponsorship. We cannot yet claim demonstrated proof of the Gulati/Scott model in the United Kingdom. That awaits further empirical study. However, the close correlation between the account of rapid change and the model described is surely more than mere coincidence.

It is by understanding the mechanisms of change that we (as a society) are better able to map, and potentially influence, the efficient design of contracts. It is clear that even highly-paid and skilled practitioners cannot be expected to routinely self-assess the efficiency of their creations, without some external influence or prompting. The challenge now is to ensure that practitioners are appropriately incentivized to reflect on agreements, even where no disputes arise. This represents a substantial research agenda for contract law.

143 On the implications for elite legal practice, see R. Moorhead 'Securities lawyers and sticky contracts: innovation and elite law', at <<http://lawyerwatch.wordpress.com/2013/09/29/securities-lawyers-and-sticky-contracts-innovation-and-elite-law/>>.

144 See text to n. 23, above.