

## Romalpa thirty years on – still an enigma?

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### Introduction

A reservation of title (ROT) clause is a “contractual agreement according to which the seller retains title to the goods in question until the price has been paid in full.”<sup>1</sup> It is a concept of remarkable simplicity, commonly used in the United Kingdom. The rationale for the widespread use of such clauses is clear. They are not geared to the “halcyon days of solvency”<sup>2</sup> but are intended as “queue jumping devices,”<sup>3</sup> aimed at protecting the seller in the event of a buyer’s insolvency.

Although recent reforms have attempted to improve their lot,<sup>4</sup> on insolvency the position of the unpaid seller is usually hopeless. Whilst reports of the complete demise of insolvency law have proved to be exaggerated,<sup>5</sup> the doctrine of *pari passu* today remains an “illusory ideal.”<sup>6</sup> Preferential creditors and floating charge holders still take precedence, leaving little for the unsecured creditors. Put bluntly, sellers of goods, as unsecured creditors, receive a “raw deal”.<sup>7</sup>

A successful ROT clause however, gives the seller a proprietary right. This accords him super-priority status over all other creditors. He is no longer left “waiting for Godot”<sup>8</sup>, the goods are still his and he can claim them back. It is this close *nexus* with insolvency which makes ROT a “difficult and complex area....encompassing the law relating to sales of goods, bailment, agency, trusts, mortgages and charges and the principles of tracing.”<sup>9</sup> The law in the UK is based on one extraordinary case and its aftermath.

*Aluminium Industrie Vaassen B.V v Romalpa Aluminium*<sup>10</sup> has been described as “the most important decision in commercial law this century”<sup>11</sup>. It introduced the concept of ‘extended reservation of title’ into English law. Although *Romalpa* still stands, the last 30 years have seen a steady erosion of many of the principles laid down by the Court of Appeal. The reasons behind this judicial response, particularly with regard to the proceeds clause, lie at the heart of this article. Equally important is the strange reticence which has been shown to the issue of legislative reform. It has been claimed

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<sup>1</sup> Directive on Combating Late Payment in Commercial Transactions Art 2 (3)

<sup>2</sup> *Aluminium Industrie Vaassen B.V. v Romalpa Aluminium* [1976] 1 W.L.R. 676 per Roskill LJ.

<sup>3</sup> Belcher, Beglan. Jumping the Queue JBL (1997)

<sup>4</sup> Enterprise Act 2002. Abolition of crown preference. Top slicing.

<sup>5</sup> Goode, R. The Death of Insolvency Law. (1980) 3 Co law 123

<sup>6</sup> Jeremie, J. Lazurus Arisen CompLaw 1995 16(4) 99-101

<sup>7</sup> *Borden (UK) Ltd. v Scottish Timber Products Ltd.* [1981] Ch.25 per Lord Tempelman

<sup>8</sup> Godot never comes.

<sup>9</sup> Insolvency Law and Practice. Report of the Review Committee. Chairman Sir Kenneth Cork

<sup>10</sup> *Aluminium Industrie Vaassen B.V. v. Romalpa Aluminium* [1976] 1 W.L.R. 676

<sup>11</sup> R.Goode Proprietary Rights and Insolvency in Sales Transactions 3<sup>rd</sup> Edition (Sweet & Maxwell)

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that *Romalpa* represented “the chickens coming home to roost,”<sup>12</sup> with English commercial law “paying the price for a century’s statutory inertia.”<sup>13</sup>

Numerous committees over the last 35 years have advocated reform as part of a general scheme of registration for security interests. It is almost inexplicable that only extremely limited legislative reform has taken place.<sup>14</sup> As well as analysing the current state of the law in the UK, comparisons with two other jurisdictions will be made. Particular emphasis is placed on the ingenuity of the German courts in developing the necessary framework to allow ‘proceeds clauses’. In the U.S.A attention is principally focussed on Article 9 of the Uniform Commercial Code, an astonishing piece of legislation which altered the entire conceptual basis of proprietary security interests. It is submitted that the UK’s approach to reservation of title is not founded on sound legal principle. It is however, an inevitable consequence of very particular underlying political, economic and (above all) business considerations.

### **Romalpa - Cat among the pigeons**      Romalpa - 鴿子中的貓

Possibly due to the influence of the principles of Roman law,<sup>15</sup> the historical development of the ROT clause is most marked in continental jurisdictions. The *concept* of reservation of title itself however, is not alien to English law. In 1895, the House of Lords considered it merely another illustration of *laissez-faire* freedom of contract. If the contract showed that the parties intended title would not pass, there was “*no rule or principle of law which prevents its being given effect.*”<sup>16</sup> This early judicial approval and the equally accommodating provisions of the Sale of Goods Act<sup>17</sup> would appear to be fertile ground for the development of ROT. It is surprising therefore, that prior to 1976 the ROT clause was virtually unknown. Although conditional sale devices such as hire-purchase were commonplace, the novelty of ROT was that it enabled the buyer to deal with the goods ‘as his own.’

In England, ROT began with *Romalpa* and as a consequence, the phrase “*Romalpa Clause*” entered the English legal dictionary. *Romalpa* concerned the sale of aluminium foil. The defendant buyer went into liquidation still owing the plaintiff seller £122,000. The plaintiff sought to rely on the now infamous Clause 13:

“The ownership of the material to be delivered by A.I.V. will only be transferred to purchaser when he has met all that is owing to A.I.V., no matter on what grounds.”

It was successfully argued that this clause enabled recovery of the unsold foil, still in the buyer’s possession, valued at £50,000. Even more dramatically, Moccotta J. (and the Court of Appeal) considered the parties to be in a fiduciary relationship. This

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<sup>12</sup> Goode. Reverberations from *Romalpa*. The Times (1977)

<sup>13</sup> Ibid.

<sup>14</sup> Insolvency Act 1986

<sup>15</sup> Pennington (1978) ICLQ

<sup>16</sup> *McEntire v Crossley* [1895] AC 457

<sup>17</sup> S.17, S.19 SGA (1979). both provisions were also in the 1893 Act

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enabled recovery of £35,000 in *proceeds* of sale, using the equitable<sup>18</sup> doctrine of tracing established in *Re Halletts Estate*.<sup>19</sup> Astonishingly, the proceeds clause itself was *implied* into the contract to give it business efficacy. Clause 13 only referred to the proceeds from the sale of products manufactured from the foil.

The impact of this decision and its subsequent affirmation by the Court of Appeal was remarkable. Firstly, most lawyers were astonished to discover that the right to trace is available for both unauthorised *and authorised* dispositions.<sup>20</sup> The legal surprise was dwarfed by the seismic shock felt by the banks, whose floating charges had been devalued overnight. Within months, new accounting procedures were introduced. These involved a “*substance over form*”<sup>21</sup> approach, reflecting the very real possibility that goods subject to a Romalpa clause could no longer be considered part of a company’s assets.

Fuel was added to the fire by the controversy surrounding the so called ‘Brentford Nylons affair’. This occurred shortly after *Romalpa*, but before its affirmation in the Court of Appeal. The case was never litigated and consequently is rarely referred to in legal journals. In the national press at the time however, it was headline news. The company ‘Brentford Nylons,’ a household name in clothing “*aimed at the cheaper end of the market*”<sup>22</sup>, had gone into receivership. Highly significantly, the official receiver was a Mr Kenneth Cork (as he was then). Mr Cork was initially optimistic that the company could remain viable and 2,500 jobs could be saved. This aim appeared to be thwarted when two suppliers threatened legal action to enforce their rights under similar clauses to those used in *Romalpa*. Although no details were ever disclosed, it was widely reported that Mr Cork had been compelled to strike a deal. Brentford Nylons were able to continue trading and the company was subsequently sold to Lonrho. It was rumoured that the two suppliers had agreed not to pursue a court action in return for priority status as creditors.

Unsurprisingly, the issue of Retention of Title became a top priority of the Insolvency Law Review Committee which, ironically, was chaired by Sir Kenneth Cork. No doubt alerted by the widespread publicity, traders immediately sought to take advantage of this newfound security. A great variety of clauses were incorporated in documents of sale and the “*progeny of Romalpa*”<sup>23</sup> were soon before the courts. Broadly speaking, there are four different types of ROT clause:

The ‘simple’ clause, whereby the seller retains title to the unchanged goods which are still in the buyer’s possession; the ‘manufactured goods’ clause, whereby the seller retains title to the goods even after they have undergone a manufacturing process; the ‘proceeds clause’, whereby the seller is entitled to the proceeds of a sale of the goods to a third party; and finally the ‘all monies’ clause under which the seller retains title to the goods until all the debts owed by the seller to the buyer are extinguished. The subsequent hostility of the judiciary can be gauged with reference to any modern

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<sup>18</sup> There is also tracing at common law.

<sup>19</sup> (1880) 13 Ch.D. 696

<sup>20</sup> R.Goode Proprietary Rights and Insolvency in Sales Transactions (3<sup>rd</sup> ed Sweet & Maxwell)

<sup>21</sup> Belcher *supra*, n 3.

<sup>22</sup> Quigley, D. The Times February 24<sup>th</sup> 1976

<sup>23</sup> McCormack G. Reservation of Title. 2<sup>nd</sup> ed. 1995 Sweet & Maxwell.

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precedent book. A prudent solicitor can nowadays only (safely) recommend the use of a “simple” or “all monies” clause.

Although there are clear *dicta* from the Court of Appeal<sup>24</sup> suggesting that manufacturing clauses are possible, “the practical outcome of a series of cases has put it beyond doubt that “extended” title reservation clauses will not work.”<sup>25</sup> This article is principally concerned with ‘tracing of proceeds’ clauses which have been “particularly vulnerable”<sup>26</sup> to judicial attack. In this jurisdiction *Romalpa* is the only successful example to date.

### **The legal debate**

“We have found this a difficult and complex subject.”<sup>27</sup> (Cork Report (1982))

This telling admission, by such an august body, is a reflection of the “maze, if not the minefield”<sup>28</sup> of case law which has sprung up since *Romalpa*. It has been asserted that the authorities speak ‘with forked tongues’ making any meaningful analysis of the legal principles governing proceeds claims a “complete waste of time.”<sup>29</sup> There is force in this claim as much of the case law is incoherent, inconsistent and illogical. More pragmatically, it is now almost impossible to “conceive of the circumstances”<sup>30</sup> in which a proceeds claim can succeed. It is however necessary to consider the general nature of the post-*Romalpa* legal debate in order to fully understand the underlying policy issues. The focal point of much of the case law has been the statutory requirements governing the registration of security interests or “rights in property that can be exercised to secure a payment or debt.”<sup>31</sup>

In contradistinction with many other jurisdictions, there is no “general concept of a security interest in England.”<sup>32</sup> Traditionally, the law recognises only four types of consensual security: pledges, contractual liens, charges and mortgages.<sup>33</sup> These devices are all “clearly differentiated”<sup>34</sup> from title retention. This distinction is of paramount importance. English Law requires that certain charges<sup>35</sup> be perfected by registration. Failure to do so relegates the charge holder to the status of an unsecured creditor.

Most of the case law is concerned with the s.395 Companies Act (1985) but similar statutory provisions also exist elsewhere.<sup>36</sup> Although in many ways “economically

<sup>24</sup> *Clough Mills v Martin* [1985] 1 WLR 111 per Goff LJ

<sup>25</sup> Bridge, McDonald, Simmonds & Walsh. 44 McGill L.J. 567

<sup>26</sup> Bourbon-Select, C. (2005) 20(9), 419-425 JIBLR

<sup>27</sup> Insolvency Law and Practice. Cork Committee 1982

<sup>28</sup> *Compaq Computers v Abercorn Group Ltd* [1991] BCC 484

<sup>29</sup> *McCormack supra*.

<sup>30</sup> McCormack *ibid*.

<sup>31</sup> The Reform of the Law of Security Interests Aubrey Diamond Current Legal Problems. 1988

<sup>32</sup> Bridge *supra*.

<sup>33</sup> R.Goode Commercial Law. (Sweet & Maxwell) 2004 Also Millet LJ Re Coslett.

<sup>34</sup> Bridge *supra*.

<sup>35</sup> Confusingly, the term charge is often used generically to include mortgages.

<sup>36</sup> Bills of Sales Act 1882

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and financially identical in effect”<sup>37</sup> to a charge or a mortgage, there is no statutory requirement for ROT clauses to be registered. It has been successfully argued however, that ROT clauses are in fact “sham devices”<sup>38</sup> masquerading as equitable charges. In *Re.Bond Worth*<sup>39</sup> Slade J. went so far as to claim:

“... any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt....  
**must necessarily be regarded as creating a mortgage or charge.”**

This sweeping statement of principle has been heavily criticised. *Prima facie*, taken to its natural conclusion, it infers that *all* unregistered retention of title clauses must be ineffective upon the insolvency of the buyer. This completely ignores not only the *statutory*<sup>40</sup> freedom of contracting parties to decide when title passes, but also the clear authority of the House of Lords.<sup>41</sup> In 1895, when invited to take a similar substance over form approach, their Lordships *still* concluded that title had not passed, looking instead to the true intention of the parties and the terms of the Bills of Sales Act.<sup>42</sup>

In the case of *simple* ROT clauses (which purport to retain title to the unchanged/unmixed goods still in the possession of the buyer) it is now settled law that no charge is created.<sup>43</sup> It had been claimed that the charge is created by the contract itself, a contract to which the buyer is a party.<sup>44</sup> This view has been considered untenable for the simple reason that title to the goods never leaves the seller.<sup>45</sup> Providing full legal title remains with the seller, the buyer simply does not have the capacity to create a charge. “As a matter of legal theory, a person cannot charge a legal estate that he does not have.”<sup>46</sup> Although the logic in *Clough Mill* has a beguiling simplicity, this approach has not been carried over to extended clauses.

The problem centres on the exact nature of the relationship between the two parties. The ‘legendary concession’ in *Romalpa* that the companies were fiduciaries was critical. The **orthodox view is that a fiduciary relationship is essential for tracing in equity.**<sup>47</sup> There appears to be no logical basis for this restriction however and it has been argued that the House of Lords should *“put this fallacy firmly to rest.”*<sup>48</sup>

“讓這個謬誤牢牢地安息下來。”

There *is* a doctrine of tracing at common law developed from the decision in *Taylor v Plumer*.<sup>49</sup> Although it now seems to be acknowledged that *Taylor v Plumer* in fact

<sup>37</sup> Diamond *supra*.

<sup>38</sup> Atiyah. The Sale of Goods

<sup>39</sup> *Bond Worth Ltd, Re.* [1980] Ch. 228

<sup>40</sup> S.17,S.19 SGA

<sup>41</sup> *McEntire v Crossley supra*

<sup>42</sup> (1882)

<sup>43</sup> *Clough Mill v Martin* [1985] 1 W.L.R. 111

<sup>44</sup> *Tatung (UK) Ltd v Galex Telesure Ltd* [1989] 5 BCC 325

<sup>45</sup> Diamond A. The Reform of the Law of Security Interests [1988] CLP

<sup>46</sup> *Abbey National Building Society v Cann* [1991] 1 AC 56 per Lord Oliver

<sup>47</sup> *Re Diplock* [1951] AC 251

<sup>48</sup> Goode. Commercial Law. (3<sup>rd</sup> ed. 2004 Lexis-Nexis)

<sup>49</sup> (1815) 3 M & S 562

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involved *equitable* tracing,<sup>50</sup> common law tracing is well established albeit through an historical accident. Common law tracing does *not* require a fiduciary relationship. In the context of ROT it does not appear to have been argued in the courts. Given the large number of post *Romalpa* decisions, this appears to be a startling omission. There are two possible reasons. Tracing at common law is limited by the need to keep the assets separate. Any mixing of the proceeds of sale with funds already in the buyer's bank account would defeat the claim. For the same reason any mixture of the goods in a manufacturing process would also be fatal. Alternatively it could be argued that the fiduciary element has significance beyond the right to trace. It may be the only way that the seller and buyer will not be deemed to be in a debtor/creditor relationship, making a charge construction almost inevitable.

On occasions the courts have gone to go to great lengths to find a fiduciary relationship. In *Bristol & West Building Society v Mothew*,<sup>51</sup> Millet LJ candidly observed that he had:

“...been concerned to circumvent the *supposed* rule that *there must be a fiduciary relationship or beneficial interest before resort* may be had to the equitable rules.”

This permissive approach has been notably absent in the post *Romalpa* case law. The courts have firstly struggled with classification. *It must be acknowledged that much of the confusion stems from Romalpa itself.* At first instance Moccotta J. considered there to be a bailment whereas the Court of Appeal argued in terms of agency. In *Bond Worth*, Slade J. raised doubts on the purported bailment construction. Relying on the Privy Council decision in *South Australian Insurance Co. Ltd v Randell*<sup>52</sup> he concluded that under a bailment, the buyer was under an obligation to return the “*very goods to the seller.*”

Although a separate line of authority does appear to support a different point of view,<sup>53</sup> the bailment argument was dealt a further blow in *Hendy Lennox* and in *Re Andrabell*. These judgements clearly state that even if the parties were acting as bailor/bailee this does not necessitate a fiduciary relationship. In *Clough Mill v Martin*, Goff LJ adopted a more robust approach, stressing that the precise nature of the relationship was unimportant:

“In performing this task, concepts such as bailment and fiduciary duty must not be allowed to be our masters, but *must rather be regarded as the tools* of our trade.”<sup>54</sup>

This approach, whilst possibly overly simplistic, does have certain attractions. The term fiduciary is clearly “*incapable of comprehensive definition.*”<sup>55</sup> Furthermore, although the law has classed many different types of relationship as ‘fiduciary’

<sup>50</sup> *FC Jones & Sons v Jones* [1997] Ch 159 per Millet LJ

<sup>51</sup> *Bristol & West Building Society v Mothew* [1998] Ch 1

<sup>52</sup> (1869) LR 3 PC 101

<sup>53</sup> *Re Smith* (1879) Ch D 566

<sup>54</sup> *Clough Mill v Martin* [1985] 1 W.L.R. per Goff L.J.

<sup>55</sup> Law Commission. Consultation Paper No.142 Shareholders Remedies

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(trustee/beneficiary, director/company, solicitor/client, mother/child), the categories are not closed. Strictly speaking there was no need to classify the relationship between the buyer and seller under a *Romalpa* clause within any *existing* fiduciary class. There appears to be no reason why a *Romalpa* clause cannot create a *sui generis* fiduciary relationship. Strangely this does not seem to have been argued before the courts. Despite the inherent flexibility of equity, the courts have found the fiduciary relationship elusive:

“The idea that a fiduciary relationship existed but that the buyer was free to deal with the proceeds of sale as he wished, unless and until he became insolvent, is difficult to reconcile with traditional ideas of a fiduciary.”<sup>56</sup>

很難與受託人的傳統觀念相協調

The view has also been propagated that a fiduciary relationship, with its “*defining feature of loyalty*,” is inconsistent with a commercial agreement between parties dealing at arms length.<sup>57</sup> In the cut throat world of commerce, companies look after their own interests. Although this argument has force, in practice the courts have found little difficulty in inferring fiduciary relationships in the context of the *Quistclose* trust.

In *Hendy Lennox*<sup>58</sup> the clause failed because there was no express obligation on the buyers to store the goods in such a way that they were clearly the property of the buyer. There was also no mention of a ‘fiduciary owner’. In *Re Andrabell*<sup>59</sup> the clause failed because the buyer was able to claim the profits from the sale, whereas in *Romalpa* the effect of the clause was to give the profits to the supplier. This aspect of *Romalpa* is surely one of the most confusing. It is submitted that as yet, no satisfactory explanation has been provided. If a proceeds clause is considered to be a restitutionary claim, it is arguable that in this respect the *Re Andrabell* clause makes more sense. In such a scenario there is no “undeserved windfall” for the seller and the excess profits could be paid to the other creditors. On the other hand, if the seller *does* still have full ownership rights over the goods, he is entitled to take the full payment. The question of unjust enrichment simply does not arise. This approach is clearly supported by the reasoning of the House of Lords decision in the leading authority on equitable tracing.<sup>60</sup>

One of the most extraordinary post *Romalpa* judgements was given in *Highway Foods International Limited, Re* (1995).<sup>61</sup> The deputy high court judge, Mr Edward Nugee Q.C., followed the trend in distinguishing *Romalpa* by finding that the proceeds clause constituted an unregistered charge. The case was however complicated by a further ROT clause which had been included by the *buyer* when the goods had been sold on to a third party. It was held that the original seller *was* entitled to the return of the goods from the third party. This clearly flies in the face of all the post *Romalpa* case law. Applying the Bond Worth reasoning, at the moment the goods were sold on, the reservation of title should have been extinguished and replaced by a charge. One

<sup>56</sup> Cooper, G. Columbia Business Law Review (1987) 17

<sup>57</sup> Panesar, P. ICCLR (2005) 16(12), 479-484

<sup>58</sup> *Hendy Lennox v Puttnick* [1984] 1 W.L.R. 485

<sup>59</sup> *Andrabell Ltd, Re* [1984] All E.R. 407

<sup>60</sup> *Foskett v McKeon* [1998] Ch 265

<sup>61</sup> [1995] 1 BCLC 209

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of the grounds given for this decision was that there had only been an agreement to sell between the buyer and the third party.

Even in this area of law it is very difficult to justify this decision on legal principle alone. It is however, a rare decision which appears to have done justice to the parties. The only alternative results would have given an undeserved windfall to either the receiver or the third party, neither of whom had paid for the goods. Possibly the most illuminating<sup>62</sup> judgement concerned a clause which had clearly been carefully drafted to take account of all the post-*Romalpa* case law:

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“Insofar as the dealer may sell or dispose of the Compaq products or receive any monies from any third party in respect of Compaq products, he shall strictly account to Compaq for the full proceeds thereof (such monies as the dealer shall receive) as the seller’s bailee or agent and shall keep a separate account of all the proceeds or monies for such purpose.”

Faced with this clause Mummery J. demonstrated the innate circularity of the whole debate. He simply reverted back to the purposive approach adopted by Slade J in *Bond Worth*:

“... any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt.... must necessarily be regarded as creating a mortgage or charge.”

It is submitted that to rationalise the modern attitude of the courts the following assumptions must be made: 1) Simple ROT clauses do not require registration; 2) Proceeds Clauses inevitably become charges at the moment the goods are sold on; and 3) The *distinguishing* of *Romalpa* is plainly disingenuous. The only possible conclusion is that the present judiciary consider it to be wrongly decided. Although it could be said that the courts are following the equitable maxim of “*looking to intent rather than form*”<sup>63</sup> it has been noted that much of the arguments (particularly about fiduciaries) has been highly “*redolent of formalism.*”<sup>64</sup>

In many ways the logic of *Romalpa* is clearly not beyond reproach. It is astonishing that the only tracing (proceeds) claim to succeed in English law was implied into the contract. The exact nature of the fiduciary relationship was never determined. (Clause 13 coined the “*unhappy term*”<sup>65</sup> – “*fiduciary owner*”). Nevertheless it is submitted that criticism of Moccotta J.’s first instance decision has been overly harsh. Here was a judge, sitting alone, confronted with four different types of ROT clause, the validity of which had never been tested in any English court. Although he chose to extend the concepts of bailment and equitable tracing further than their conventional limits, this was done to honour the contractual obligations of the parties. Furthermore, as far as legal form is concerned, based on the existing law at the time, there is no definitive answer as to whether the *Romalpa* tracing clause should have succeeded. *Romalpa*

<sup>62</sup> *Compaq Computer Ltd v Abercorn Group Ltd* [1991] B.C.C. 484

<sup>63</sup> Hanbury & Martin, *Modern Equity* 16<sup>th</sup> ed. Sweet & Maxwell, London 2001 at p.30

<sup>64</sup> McCormack *supra*.

<sup>65</sup> *Romalpa supra*. Per Roskill LJ.

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was a novel situation in English law. Moccotta J. was entitled to take a novel approach.

Given the inherent flexibility of English law, the weight of criticism based purely on legal (and equitable) principles is surprising. That peculiarly English invention, the floating charge and the conceptually uncertain *Quistclose*<sup>66</sup> trust are symbolic of the courts boundless ingenuity in “*championing security interests and their enforcement, sometimes even at the expense of logic.*”<sup>67</sup> The answer clearly does not lie in the substance over form argument. On the one hand a proceeds clause *does* serve the purpose of a security interest. To classify it as a charge however is to ignore its other ‘form’; a contractual agreement between two parties dealing at arms length, underpinned by statute. It is plain that the courts will not countenance a repeat of *Romalpa*. The rationale for this reluctance however must lie outside the legal textbooks.

### **The Jurisprudence of Romalpa**

Since the dawn of the modern company, with its limited liability and separate legal identity, there has been sympathy for the plight of the unsecured creditor:

“I have long thought ... that the ordinary trade creditors of a trading company ought to have a preferential claim on the assets in liquidation in respect of debts incurred within a certain limited time before the winding-up. But that is not the law at present. Everybody knows that when there is a winding-up debenture-holders generally step in and sweep off everything; and a great scandal it is.”<sup>68</sup>

Similar judicial hand-wringing was also evident even as the first chinks in the armour of *Romalpa* were being exposed:

“It is not therefore surprising that this court looked with sympathy on an invention designed to provide some protection for one class of unsecured creditors, namely unpaid sellers of goods.”<sup>69</sup>

However, contained within this very paragraph is one of the most cited policy reasons for the denial of *Romalpa*:

“There is no logical reason why this class of creditor should be favoured as against other (unsecured) creditors such as the suppliers of consumables and services.”

*Prima facie* this appears to be a strong argument. Retention of title, by definition, can only work with goods. It is of no utility to providers of services. A point rarely made is that it is also no use for *certain* goods. There is little benefit in reserving title to an

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<sup>66</sup> *Barclays Bank v Quistclose Investments Ltd* [1970] A.C. 567

<sup>67</sup> The Reform of English Personal Property Law Iwan Davies Legal Studies 2004, Society of Legal Scholars

<sup>68</sup> *Salomon v Salomon* (1897) AC 22 per Lord MacNaughten

<sup>69</sup> *Borden (UK) Ltd v Scottish Timber Products Ltd.* [1981] Ch.25 per Tempelman LJ

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ice cream.<sup>70</sup> For this reason, ROT clauses have been considered unfair and even immoral.<sup>71</sup> These objections however, appear to ignore the harsh realities of commercial life. The simple fact is that valid *Romalpa* clauses make no difference *at all* to the other unsecured creditors. They will receive no compensation in any event. Unless they react like Aesop's dog in the manger,

“...unsecured creditors will take no comfort from compelling a restitutionary claimant to join their ranks if preferred or secured creditors, or both, will, in any event, scoop the debtor's assets.”<sup>72</sup>

Concerns were initially raised both by the first instance *Romalpa* decision and particularly by the 'Brentford Nylons' saga, that ROT clauses (of all varieties) made the task of receivers impossible. “*It is regarded in the profession as a potential threat to receivership in any company that depends on a manufacturing process.*”<sup>73</sup> Similar issues came to the fore in *Leyland Daf v Automotive Products Ltd.*<sup>74</sup> The receivers were faced with nearly four hundred ROT claims. Two of the companies concerned refused to continue supplying Leyland Daf unless their combined debts of £758,955 were satisfied. At that time Automotive Products were the only company capable of providing the requisite products (brake cables). This prompted the receiver to bring an action under the EU's competition legislation, claiming that Automotive Products were abusing a dominant position.<sup>75</sup> The Court of Appeal dismissed the claim, holding that the ROT clause was a legitimate part of AP's bargaining power.

This appears to suggest that the concerns are not unfounded. To affect a sale of a struggling company, a receiver requires the company to continue trading long enough for him to identify a suitable buyer. This requires the remaining assets of the company to be kept intact. More cynical observers have suggested that the role of the receiver *was* in fact more encumbered by another problem. Prior to the enactment of the Enterprise Act (2002), a receiver could be appointed by the floating charge holders. Therefore, although *nominally* acting on behalf of all the creditors, the receiver was only answerable to the banks. This meant that the interests of the bank generally determined the time of any sale. The receiver was fully entitled to affect an immediate sale satisfying the bank's claim, even if a delay would have been beneficial to the remaining creditors.<sup>76</sup>

Plainly the most fundamental concern raised by *Romalpa* was that a “*proliferation of extended clauses would strike at the very heart of the system of credit.*”<sup>77</sup> This is a serious concern. Credit is the driving force of most western economies. It is often baldly stated that it is the banks whose interests are most affected by the *Romalpa* clause. Although this is correct in part, there were clear ramifications for other types of financial institution.

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<sup>70</sup> Example given by Brethertons solicitors. Commercial Law Website.

<sup>71</sup> Tribe J. Insolvency Law & Practice, Vol. 17, No.5, 2001

<sup>72</sup> Bridge, MacDonald, Simmonds & Walsh. 44 McGill L.J. 567

<sup>73</sup> Walters M. The Times. March 6<sup>th</sup> 1976

<sup>74</sup> [1993] BCC 389

<sup>75</sup> Article 86 EC (Now Article 82)

<sup>76</sup> *Re Charnley Davies* [1990] BCC 484

<sup>77</sup> McCormack *supra*.

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Concerns were expressed for the effect which Romalpa would have on agreements for factoring debt. This is a multi billion pound industry in the UK. Many companies 'sell their sales invoices' to financial institutions who take over the task of reclaiming the debt. The main advantages of such arrangements include the immediate access of up to 90% of the price of the goods sold and release from the costly and time consuming exercise of debt recovery.<sup>78</sup>

The fears of the factoring industry may well have been allayed by the decision in *Pfeiffer*.<sup>79</sup> Phillips J. held (obiter) that the rule in *Dearle v Hall*<sup>80</sup> applied. As the factor was the only party to have given notice of his interest, the *subsequent* factoring agreement took priority over the extended proceeds clause. **The Romalpa clause has been deemed to be unfair to the banks because, unlike the floating charge, it circumvents the registration requirement of the Companies Act (1985).** The very purpose of registration is to afford transparency to third parties. Therefore, when lending money to a company, a financial institution has no means of knowing whether any of the assets are subject to a ROT clause. This is particularly so in the case of 'proceeds clauses' where, after the goods are sold on, the assets will be in the intangible form of money.

The other closely related objection is that the ROT clause, if successful, confers a priority over the banks floating charge. Although these arguments have force, justifications exist for both the lack of registration and the super priority status. The ROT clause:

"...circumscribe the assets which can be used to give security; consequently there is no priority conflict between holders of restitutionary proprietary rights or title reservations and secured creditors."<sup>81</sup>

**The simplistic approach adopted in various judgements, that certain extended clauses are perfectly legitimate, provided they are registered as charges, is also deeply flawed.** Aside from the conceptual issues mentioned in the previous chapter, there are also intractable practical difficulties. If a proceeds clause really does constitute a floating charge, *in principle* it can be registered. There is however, no authority suggesting that this has ever happened. This is hardly surprising. Firstly, it is highly impractical for a seller to insist on the registration of a charge on every separate transaction. The registrar also requires information on exactly when the charge is created.<sup>82</sup> The law is unclear as to when an ROT clause becomes a charge. Even if the assumption is made that the charge is created at the moment of sale to a third party, there are still insurmountable difficulties. The seller is unlikely to have knowledge of the onward sale and will have no power to insist that the buyer registers the charge.

The *Romalpa* jurisprudence has been influenced by many of the issues discussed above. It would appear however, that some of these points are no longer relevant. The initial problems facing receivers were remedied by the **Insolvency Act (1986)**

<sup>78</sup> Information from Lloyds Bank & Royal Bank of Scotland Websites.

<sup>79</sup> *Pfeiffer Weinkellerei-Weineinkauf GmbH Co v Artbutnot Factors Ltd* [1988] 1 W.L.R. 150

<sup>80</sup> *Dearle v Hall* (1838) 3 Russ 1

<sup>81</sup> Bridge *supra*.

<sup>82</sup> s.403 1A (a) Companies Act 1985

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following the recommendations made in the Cork report. In any event the Enterprise Act (2002) has significantly altered the role of the receiver. **If the various *obiter dicta* can be relied on, factoring agreements may have priority over extended clauses.** The remaining objection of principle to the proceeds clause stems from its lack of registration. Bearing this in mind it is appropriate at this point to consider the situation in two other jurisdictions. In Germany, where there is also no requirement of registration and in the U.S.A, where legislation has revolutionised the whole area of law.

## Germany

It has been noted that there are some similarities between German and English law.<sup>83</sup> The historical development of ROT in Germany however, was very different. All the western European legal systems (apart from England) were dominated by the principles of Roman law until the sixteenth century. Under Roman law there was no reason to insert retention of title clauses into a contract. **The basic principle appears to be that “even if the seller had delivered the goods to the buyer, the seller retained dominium until the price was fully paid.”**<sup>84</sup>

In Germany, at some undefined point in time, this principle must have changed. The first codification of Prussian law in 1784 clearly states that ownership passes on delivery, irrespective of whether the purchase price has been paid.<sup>85</sup> However this was only a presumption which could be rebutted if the seller had “*expressly agreed to give credit*.”<sup>86</sup> This further provision facilitated retention of title.

The reasons for its rapid early development are essentially economic and relate to the availability of credit. In the early 19<sup>th</sup> century the UK was already the most ‘credit prone’ country in the world. In Germany meanwhile, the banking system was not sufficiently developed to cope with the increased demand of the industrial age. As a consequence, ROT developed as a cheap and simple alternative to borrowing money. Its status was greatly enhanced by a huge increase<sup>87</sup> in the use of ROT clauses in the harsh economic times following the First World War. Their widespread popularity has lasted to this day.

Originally ROT seems to have been used primarily for conveyances of land. When more appropriate devices were developed however,<sup>88</sup> its utility was soon spotted by dealers of movable goods. Although in many ways ROT represented a “*circumvention of various German statutes which only recognised a cumbersome form of bailment*”<sup>89</sup>, the enthusiasm with which it has been embraced by the German courts is illuminating.

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<sup>83</sup> *Re Weldtech* [1991] BCC 16 per Hoffmann J.

<sup>84</sup> Retention of Title to the Sale of Goods under European Law Pennington ICLQ 1978

<sup>85</sup> Prussian Allgemeines Landrecht, First Part, Title 7, s.58 and Title 10 s.1 and Pennington *Supra*

<sup>86</sup> Pennington *supra*. Allgemeines Landrecht Title 5 & Title 11

<sup>87</sup> Eigentumsvorbehalt und Abzahlungsgeschäft. Yale Law Journal No.4 Feb, (1932) 653-654

<sup>88</sup> Monti, Neuman & Reuter ICCLQ (1997) Vol 46 No 4 866-907

<sup>89</sup> Monti *supra*.

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Apart from an attempt by certain southern states to legislate against ROT in the early 19<sup>th</sup> century,<sup>90</sup> this judicial activism has been largely tolerated by the legislature. Since 1900 the sole statutory authority for retention of title has stemmed from a single provision of the German Civil Code:<sup>91</sup>

“If the seller of a movable has retained title until payment of the purchase price, it is to be presumed, in case of doubt, that the transfer of title takes place subject to the condition precedent of payment in full of the purchase price and the seller is entitled to rescind the contract if the purchaser is in default with the payment.”

Like s.19 Sale of Goods Act (1979), this appears, on a strict construction, to cover ‘simple’ clauses only. The German courts however, have extended the principle to cover all four main types of ROT clause. All of these are ‘insolvency proof’ and none require registration or notarisation. In Germany, reservation of title is clearly a powerful weapon. Unlike English law,<sup>92</sup> the intention of the parties is not paramount. The sale and the passing of property are governed by separate provisions of the Civil Code.<sup>93</sup> The contract of sale is governed by the *Schuldrecht* (or law of obligations). The passing of property however is governed by the *Sachenrecht* (or law “governing the relationship between people and goods”).<sup>94</sup> When a ROT clause is incorporated it operates on both *Schuldrecht* and *Sachenrecht*. From an English perspective the most interesting facet of the whole transaction is that despite the seller’s retention of title, the buyer *does* have a limited right to the goods even before the purchase price has been paid. What is even more remarkable is that this right (*Anwartschaftsrecht* or inchoate ownership) is a purely judicial creation. Although “*there does not exist a common opinion*”<sup>95</sup> the right resembles a proprietary right in that it can be transferred or pledged.

The success of the German courts in developing this right within the “*extremely formalistic*” confines of the BGB compares favourably with the English courts inability to find a fiduciary relationship, despite the flexibility of equity. Third parties buying in good faith *are* protected under 932 BGB:

“If a thing sold . . . does not belong to the disposer, the acquirer becomes the owner, if the thing is delivered to him by the disposer, unless he is not in good faith at this time.”

Retention of title is so commonplace in Germany that this protection has lost much of its efficacy. As it is highly likely that the goods will be the subject to a ROT clause a much higher degree of proof is required to establish a purchaser’s good faith. German companies *have* encountered difficulties enforcing ROT clauses in the UK. It appears that even an express choice of law provision nominating German law is of no

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<sup>90</sup> Monti *supra*

<sup>91</sup> BGB 455

<sup>92</sup> S.17 SGA 1979

<sup>93</sup> 433-513 & 929-936

<sup>94</sup> Monti, Neuman & Reuter ICLQ Vol.46 No.4 (1997) 866-907

<sup>95</sup> Rutgers. International Reservation of Title Clauses. (T.M.C. Asser Press, The Hague 1999)

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assistance. Although no *direct*<sup>96</sup> authority exists, it is assumed that ROT clauses, as proprietary rights, are governed by the *lex situs*. Even more fundamentally, the courts have refused to allow choice of law clauses to circumvent the registration requirements of the Companies Act 1985.<sup>97</sup>

Despite these inevitable problems of inter state trade, even the strongest *Romalpa* sceptic might well concede that ROT works well in Germany. Two hundred years of proceeds clauses have not prevented Germany from becoming the third largest economy in the world. It is an economy noted for its strong manufacturing base and high quality exports. The lack of registration and the generally super priority status of ROT simply do not create the same level of legal and academic concern in Germany. Any injustice to lending institutions is clearly considered incidental to the wider commercial good.

In England the development of such devices as the super lightweight floating charge and the judicial acquiescence of the *Quistclose* trust demonstrate the courts desire to protect the interests of the banking sector. In Germany the policy has been to support the seller of goods and the manufacturing industry. Whilst such a dichotomy exists there would appear to be no prospect of the German approach finding favour with the English courts. The proposals for reform in the UK have centred on legislation aimed at enabling sellers to protect their interests within a readily accessible system of registration. The jurisprudential template for all of these proposals originates from the United States of America.

### **The United States of America**

In the United States of America, the law relating to reservation of title is now governed by Article 9 of the Uniform Commercial Code. By any reckoning, the adoption of the U.C.C. represents an astonishing achievement. The brainchild of a group of legal theorists such as Karl Llewellyn and Grant Gilmore, it represented the complete codification of commercial law and its subsequent adoption by all fifty states in the union.<sup>98</sup>

Article 9 is regarded by many as “*the crowning achievement of the UCC project, and perhaps of the entire uniform law enterprise.*”<sup>99</sup> Fifty years on it is still considered by many to be a legislative triumph, particularly in relation to its “*logical and flowing treatment of security interests.*”<sup>100</sup> The central themes of Article 9 have provided the template for similar enactments around the globe. Although most of these have taken place in common law systems, the enactment of the provision in Louisiana has fulfilled Professor Diamond’s prediction that there appears to be “*no basic difficulty for a civil law system in adopting Article 9.*”<sup>101</sup> In the UK every major proposal for reform has been based on this model.

<sup>96</sup> *Trade Credit Finance No (1) Ltd v Bilgin* (2004) All ER (d) 47 provided a very strong *obiter*

<sup>97</sup> *Re Weldtech* per Hoffmann J.

<sup>98</sup> Louisiana (a civil law system) adopted the Article 9 in 1992

<sup>99</sup> Janger. Predicting when the Uniform law process will fail. 1998 Iowa Law Review

<sup>100</sup> Formalism, Functionalism and Understanding the law of Secured Transactions. Bridge, MacDonald, Simmonds and Walsh. 44McGill L.J. 567

<sup>101</sup> Diamond. The reform of the Law of Security Interests Current Legal Problems 1988

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Much of the appeal of Article 9 was that the law it replaced was considered to be a contradictory jumble of law and statute, understood neither by the lawyer or the businessman. A full analysis of pre-code American law is beyond the scope of this article; suffice to say the first draftsmen of the code pulled no punches in describing its deficiencies. *“The law may be described as closely resembling that obscure wood in which Dante discovered the gates of hell.”*<sup>102</sup>

Article 9 was revolutionary in that it effectively marginalised the concept of title when determining the proprietary rights to movable goods. Title was considered to be *“too theoretical and static a concept to be efficient.”*<sup>103</sup> Karl Llewellyn believed it was farcical to imagine that in the location of such an abstract concept could be determined by the perceived intentions of the contracting parties:

“Now, when the location of ‘the property’ in the wares goes far enough away from homely fact to need a lawyer to decide about it, but is supposed to be decided by the intentions of the parties who are not lawyers, this is not so good.”<sup>104</sup>

Article 9 was intended as a new pragmatic approach, reflecting the reasonable expectations of the contracting parties whilst remaining sensitive to the interests of third parties. At its heart lay the revolutionary concept of the unitary security interest. The code’s drafters believed that although there were various forms of security interest such as chattel mortgage, conditional sale, trust receipts and pledges, they all performed a similar *function*. It was therefore considered logical to apply a single set of regulations rather than separate rules governed by theoretical conceptions. The concept of retention of title in the USA, in one sense at least, has therefore ceased to exist. Article 2 states that:

“Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest.”<sup>105</sup>

An ROT clause therefore, creates a security interest in exactly the same way as a charge. It will be noted how closely this accords with the substance over form approach adopted by the English courts when deciding that proceeds clauses are disguised charges. To be effective, the security interest must be perfected by registration. The system has been described as ‘notice filing’. It differs from the system of registration for the Companies Act (1985) in several important respects. The registration does not have to relate to a specific transaction. It can cover all transactions between the parties over the next five years. Put simply, a ROT clause is capable of registration in America but not in England. The general rule is that those registering “first in time” will be granted priority. Retention of title clauses can nevertheless achieve an enhanced priority if they are registered as Purchase Money Security Interests (PMSI’s).

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<sup>102</sup> Gilmore, G. The Good Faith Idea and the Uniform commercial Code 15 Ga. L. Rev 605, 620 (1981)

<sup>103</sup> Tabac, W. The Unbearable Lightness of Title. Maryland Law Review. Winter (1991)

<sup>104</sup> Karl Llewellyn. Across Sales on Horse Back. 53 Harv. L.Rev. 725 (1939)

<sup>105</sup> U.C.C. Section 2-401 (1)

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A PMSI is a security interest designed to “*secure payment of the goods themselves and does not extend to other purchases.*”<sup>106</sup> This concept, which is not alien to English law, is clearly sufficiently broad to cover both simple and proceeds clauses. The special exemption from the ‘first in line’ rule is premised on the fact that the assets charged are effectively ring fenced. The new assets are “*cancelled by the debt for the price. The transaction is essentially neutral in character.*”<sup>107</sup>

The Uniform Code is not without its critics. Many commentators claim that even with its recent ‘restatement’ it has not kept up with the times, particularly with regard to security transactions in electronic form. There are also concerns<sup>108</sup> that the revised legislation does nothing to address issues of ‘distributive justice’. This relates to concerns that a further raft of creditors such as employees and ‘tort victims’ are unable to take advantage of Article 9. A similar suggestion to the recently enacted ‘top slicing’ provisions in the Enterprise Act (2002) was not included in the revised code.

Whilst these *are* legitimate concerns, such problems are also evident in the UK. Some claim that the worst defect of Article 9 is its attempt to move away from the concept of title - “*the pole star which had guided the development of property law into the twentieth century.*”<sup>109</sup> Grant Gilmore claimed that the unitary concept would cause a “*stench in the nostrils of legal purists.*”<sup>110</sup> This prediction appears belatedly to have become true. Over the past decade there have been a number of academic articles claiming that the purported abandonment of ‘title theory’ was conceptually unsound. The legislative designation of reservation of title as a security interest has been taken as an implicit acknowledgement that the concept of property remains intact.<sup>111</sup>

The recognition of devices such as the PMSI is another, often cited illustration of the durability of a proprietary right at odds with the unitary concept of a security interest. It is submitted that this entirely misses the point. The draftsmen of the code were fully aware of the conceptual differences between security interests and quasi securities such as ROT. Using the ultimate tool of statutory intervention was simply a method of ignoring form and recognising function.

Although Article 9 is plainly not perfect, it does demonstrate how ROT can be accommodated within a logically structured system of security interest regulation. There is no doubt that Article 9 places a bureaucratic burden on the seller of goods. It has been claimed that a “*total registration requirement for all retention of title clauses would be extremely onerous and burdensome.*”<sup>112</sup> These concerns appear to be exaggerated however, particularly in the light of modern advances in electronic filing. In any event such a burden appears to be a small price to pay for protection

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<sup>106</sup> Diamond *supra*.

<sup>107</sup> Diamond *ibid*.

<sup>108</sup> Janger *supra*.

<sup>109</sup> Tabac. The Unbearable Lightness of Title. Maryland Law Review. (1991) Md.L.Rev 408

<sup>110</sup> Gilmore *supra*.

<sup>111</sup> Schroeder. Death & Transfiguration: The myth that the UCC killed “property” Temple Law Review (1996)

<sup>112</sup> Tribe, J. Insolvency Law & Practice, Vol 17, No.5, 2001

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from the trustee in insolvency. As Article 9 appears to address many of the concerns expressed over the extended ROT clause in England, the reasons for the lack of reform deserve careful attention.

## Reform

Reform of this area of the law has been proposed for many years. The Crowther<sup>113</sup> committee proposed adopting a similar scheme to Article 9 in 1971. Although much of the report's proposals *were* enacted in the Consumer Credit Act (1974), the opportunity to reform the law of security interests two years prior to *Romalpa* was not taken. This was followed by the Cork report, which found the "absence of any provisions requiring disclosure of reservation of title clauses to be unsatisfactory and should be remedied as soon as possible."<sup>114</sup> There were submissions made that ROT clauses should be simply declared ineffective on insolvency. The committee felt however, that sellers were entitled to protect themselves and "it would be wrong to deny them the protection that they sought." Taking much the same stance as Crowther, it concluded that registration was the answer and the practical difficulties of establishing such a scheme were exaggerated. Nevertheless the only reforms which came out of Cork were restrictions on the use of ROT clauses in the Insolvency Act (1986). These included a 12-month moratorium on the enforcement of the clause during which time the administrator is entitled to deal with the goods in a manner "*inconsistent with the title of the supplier.*"<sup>115</sup>

This was followed by the Diamond<sup>116</sup> report which built on the previous proposals but suggested that simple ROT clauses did not require registration as they are "*not detrimental to other creditors.*"<sup>117</sup> The 2004 Law Commission Consultative Report found that there was evidence that the UCC and PPSA schemes "*are regarded as very successful.*"<sup>118</sup> Particular attention was paid to the Canadian province of Ontario, whose economy was considered comparable for its "*complexity and sophistication.*"<sup>119</sup> The major criticism raised by this scheme was that it should actually be *extended* to cover leases. Submissions were made that introduction of a unitary scheme meant that contractually agreed rights would be re-classified contrary to the expressed wishes of the parties.

Whilst recognising that this was correct, the Law Commission claimed that there were a number of advantages in such a re-classification. As it was considered that the law is "*already riddled with exceptions*"<sup>120</sup> to the *nemo dat* rule, the perceived problem of the supplier's loss of title to the goods was believed to be 'overstated'. In a side swipe at legal purists the report also stated that; "*What to lawyers may be a painful change*

<sup>113</sup> Report of the Committee on Consumer Credit (1971, Cmnd 4596)

<sup>114</sup> Insolvency Law and Practice. Report of the Review Committee. Para.1639

<sup>115</sup> McCormack *supra*.

<sup>116</sup> A Review of Security Interests in Property, A L Diamond (DTI,1989)

<sup>117</sup> Brown. Commercial Law. (Butterworths London 2001)

<sup>118</sup> Law Commission 176 2.129

<sup>119</sup> Law Commission 176 2.129

<sup>120</sup> Law Commission 176 Para. 2.108

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*to familiar conceptual structures may be precisely the practical relief that industry needs.*"<sup>121</sup>

The Report also tackled the issue of surplus. This area has caused a great deal of debate. One of the most unclear aspects of the post-*Romalpa* case law is whether the supplier is entitled to the return of the profits on top of the purchase price. Under an Article 9 type scheme, any profit would be returned to the debtor. Although this would also be a "major wrench to current concepts,"<sup>122</sup> it would bring much needed clarity to this area. On the basis of research, the Law Commission also concluded that 'retention title financiers' only wished to recover the sum owed and were not interested in any windfall. In this penultimate consultation paper it did appear that retention of title was finally going to be included in a new Bill regulating company security interests.

All such hopes were dashed in August 2005. Astonishingly, a full 35 years after the publication of the Crowther report, the proposal to include ROT within the Company Security Interests scheme was shelved because it "*merited further attention.*"<sup>123</sup> Opposition to the proposed legislation came from "*practitioners and the finance industry.*"<sup>124</sup> It is remarkable that the very organisations, on behalf of whom the courts are insisting that extended ROT clauses be registered, appear to be the major opponents to reform.

This unhelpful attitude bears a striking resemblance to the opposition of the U.S. banking sector in the early days of the Uniform Commercial Code. Although the "*influence of the banking industry has been widely noted in the drafting of each of these provisions*"<sup>125</sup> and despite many compromises and concessions made by the draftsmen, it is well documented that the American banks fought tooth and nail against the code's implementation. The most radical articles within the code (Article 4 and Article 9) were even branded "communist inspired."<sup>126</sup> For such an accusation to be made in 1953 gives a good indication of the vitriolic nature of the debate.

The banks' position was that there was no need for the code at all, preferring the existing patchwork of laws and their own self regulation. This view was memorably castigated by one of the early draftsmen as "*taking a good joke too far.*"<sup>127</sup> It is a measure of the extraordinary tenacity of the codes founders that full implementation of the code, from its first enactment in Pennsylvania to its adoption by Louisiana, took forty one years. The situation in the UK is clearly comparable. Resistance to change from "*banks and financial institutions to the chattel security systems presented by Article 9*"<sup>128</sup> probably stems from the fact that the banks are already extremely well protected through charges on book debts, floating charges and by the current judicial hostility towards the extended ROT clause.

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<sup>121</sup> Ibid.

<sup>122</sup> Law Commission 176 Para.2.110

<sup>123</sup> Law Com.176 *supra*

<sup>124</sup> *ibid*

<sup>125</sup> Rasmussen Louisiana Law Review (2002) 62 La.L.Rev 1097

<sup>126</sup> *Ibid*

<sup>127</sup> Kamp A. Buffalo Law Review Winter (2001) 49 Buffalo L.Rev 359

<sup>128</sup> Davies I. The new lex Mercatoria Jan (2003) ICLQ 17

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Such reforms have succeeded elsewhere. The Newfoundland Personal Property Security Act was enacted in 1999 which “*represented the culmination of similar enactments over the last 20 years in the common law states of Canada.*”<sup>129</sup> This legislation was also controversial and again strongly opposed by the financial institutions. Reform however *was* successfully achieved. One commentator gave a valuable insight into the drive for reform:

“PPSAs are not the product of a demand for change from the Canadian finance industry. They are the result of the conclusions on the part of a few practitioners, academics and government officials that modernisation of this area of Canadian Commercial Law would produce significant benefits for many Canadians. The North American experience illustrates that powerful interest groups can have a significant impact on the reform or otherwise of domestic secured credit law.”<sup>130</sup>

In the UK it is submitted that the only interest group with sufficient power to influence the legislation is the banks. As the banks already have:

“...obtained all the freedom it needs to make its position ironclad, it is therefore hardly surprising that they are not pressing for reform along the lines of Article 9.”<sup>131</sup>

The influence of the banking ‘lobby’ in the sphere of corporate insolvency has been described as “*phenomenal.*”<sup>132</sup> A recent example of this concerned the introduction of the Enterprise Act. In a last minute *volte face*, the government was persuaded that the “*brave new reforms would only affect debentures created after the coming into force of the new legislation.*”<sup>133</sup> The argument which prompted this astonishing about turn was based on the premise that banks are considered to be ‘persons’ for the purposes of the European Convention on Human Rights. It was contended that if previously created debentures were to fall within the ambit of the Act, this would breach the banks’ rights under Article 1 of the First Protocol. The ambit of Article 1 *has* proved to be very wide and it is a formidable provision. (Two recent decisions have stood the law relating to adverse possession on its head.)<sup>134</sup> Even so, the state does have wide powers of derogation and it is testament to the lobbying power of the banks that the government caved in so meekly.

On a final note it is instructive to consider the attempts at harmonising the disparate systems currently regulating ROT within the European Union. As much of the early litigation involved UK companies trading with our European partners (particularly with Germany), a pan European system of regulation would be highly appropriate. Such a system would also facilitate one of the EU’s most vaunted aims-The free movement of goods. If anything however, the EU’s attempts at reform have been slightly more inept than those in the UK.

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<sup>129</sup> Ibid.

<sup>130</sup> Iwan Davies. The New Lex Mercatoria Jan (2003) ICLQ 17

<sup>131</sup> Bridge, M. How far is Article 9 Exportable? The English Experience (1996) 27 Can.Bus.L.J.

<sup>132</sup> Stephen Davies QC Insolvency and the Enterprise Act (Jordans, Bristol 2003)

<sup>133</sup> Insolvency and the Enterprise Act 2002. Stephen Davies QC. Jordans.Bristol.

<sup>134</sup> *Beaulane v Palmer* [2006] Ch.79, *JA Pye Ltd v United Kingdom* (4403/02) [2005] 3 E.G.L.R.

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These attempts at reform have also had a remarkable side-effect. Almost laughably they have been used by the UK government as an excuse for delaying reform. “*Somewhat surprisingly, this distant prospect, which has not yet come to pass, was felt to preclude domestic legislative initiatives.*”<sup>135</sup> The Commission published a draft proposal for a directive as early as 1978, apparently unconcerned that the EC Treaty expressly states that it “*will in no way prejudice the rules in Member States governing the system of property ownership.*”<sup>136</sup> This recommended that ROT clauses (including the “*various complex forms of retention of title*”<sup>137</sup>) should be fully effective throughout the EU without any requirement of registration and notification.<sup>138</sup> This ambitious proposal was swiftly trimmed and a further proposal was published, limited to the validity of simple ROT clauses.<sup>139</sup> Sadly even this limited proposal for legal reform never reached the statute book.

There is a provision concerning ROT in the Late Payment Directive.<sup>140</sup> Although this Directive started life with reasonably clear substantive aims, “*difficult negotiations between the Council and European Parliament*”<sup>141</sup> have meant that the final version of Article 4 is a paradigm of obfuscation. Although the article does (ostensibly) enable the seller to enforce a simple ROT clause throughout the member states, it goes on to say that this validity is dependant on the “*applicable national provisions designated by private international law.*”<sup>142</sup> This means that the clause will still be governed by national law. Twenty eight years since the first European proposal for reform, the only European legislation governing Retention of Title will have absolutely no affect on UK law whatsoever.

## Conclusion

“The choice of what priority rules to generate is, ultimately, a political one because the choice has to be made as to who is most deserving. In Germany the banks are seen as least deserving. In Belgium (and France to a lesser extent) the opposite view is taken. In England the position is incoherent.”<sup>143</sup>

This statement goes to the heart of the problem. Over the last 30 years the courts have been forced to make a stark choice between two competing claims. On the one hand, the contractually agreed rights of parties dealing at arms length; on the other, the rights of third party creditors unaware of the ROT clause. The approaches taken in two cases, *Romalpa* and *Re Bond Worth*, exemplify the impossible task facing the courts. Clearly the views expressed by Goff LJ in particular and those of Slade J. are poles apart. Although the judgements in both cases are classics of their *genre*, neither

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<sup>135</sup> McCormack G. JBL 2002 Mar 113-142

<sup>136</sup> Art.295 TEU

<sup>137</sup> Latham P. Retention of Title. Recent Developments in Europe. JBL (1983)

<sup>138</sup> EC Working Paper III/872/79 Rev. 1

<sup>139</sup> Working Paper III/D/278/80

<sup>140</sup> Directive on combating late payment in commercial transactions 2000/35/EC

<sup>141</sup> Schulte-Braucks & Ongena, European Review of Private Law 4-2003 [519-544]

<sup>142</sup> Late Payment Directive *supra*.

<sup>143</sup> Monti, Nejman & Reuter *supra*.

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stands the test of detailed academic scrutiny. It seems that we are still waiting for a convincing judicial analysis either for *or* against the extended ROT clause.

In the absence of clear legal guidelines, the courts have made their decisions primarily on the grounds of policy. The approach has been conservative in the extreme. Historically, business has been dependant on the banks for credit to oil the wheels of commerce. The clear perception was that ROT clauses threatened to undermine the very protections for the banks which the courts had themselves fashioned. With this in mind it is possible to comprehend the courts stance more easily.

The rather parochial resistance to outside influence over ROT however, could fairly be described as blinkered. Although the United Kingdom has been a full member of the EU since 1972, even in *Romalpa*, a case involving Dutch and English companies, no comparative study was undertaken by the court. Roskill LJ came closest by casually commenting that it would be interesting to see how such a clause would be interpreted in Holland. It is possibly unfair to be overly critical of the courts. Their approach *has* been cautious and can plainly be considered to be unduly favourable to the interests of the financial institutions. However this is probably based on perceived conceptions that by protecting the banks they are acting for the wider commercial good.

The courts do not operate in a vacuum. The judiciary are well aware of the heated debate which has surrounded this issue over the last thirty years. The reluctance of the government to legislate, despite numerous promptings, can hardly be seen as an encouragement to adopt a different line. If there really is “*no major constituency pressing for change*,”<sup>144</sup> the courts may well feel that their restrictive approach is correct. Similarly, they could claim that the policy of ‘denying *Romalpa*’ is not contrary to the jurisprudence of Strasbourg. The concept of possession within Article 1 of the First Protocol is ‘autonomous’. It has therefore been held to be fully capable of encompassing rights held through an ROT clause. The early indications from the only reported case concerning ROT would appear to suggest however, that such “*interference with the possessions*” would be permitted.<sup>145</sup> In *Gasus-Dossier* the court gave great weight to the fact that the seller, by dealing in credit, was knowingly taking a commercial risk.

The resistance to reform in the UK has not been as well documented as the sustained assault made by the American financial institutions on Article 9. The tenor of the anonymous submissions to the Law Commission from “the financial institutions” however, clearly indicates a high level of hostility to any change in the law. A survey of the various Law Commission reports and also a significant number of academic articles indicates that there is a further highly influential group opposing change. Whilst opinion is clearly divided, a substantial number of legal practitioners are strongly resistant to adopting a system similar to Article 9. If such opposition to the re-classification of security interests is based on conceptual principles alone it can only be regarded as short sighted. This attitude has lead to the extremely uncharitable accusation that:

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<sup>144</sup> McCormack G, JBL 2002 *supra*.

<sup>145</sup> *Gasus Dossier-und Fordertechnik GmbH v Netherlands Series A*, No 306-B

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“...commercial figures working in the field of secured transactions have acquired a specialised body of knowledge and experience and there might be something of a fear that simplification and rationalisation of the law could threaten the livelihood of those who have learned to master the arcane rules.”<sup>146</sup>

Whatever the true reason for these objections, it is plain that all creditors, unsecured or otherwise, are not interested in legal niceties. They do not engage legal advice to ask questions such as: ‘When does title pass, or what constitutes a fiduciary relationship?’ Their sole concern is to protect their own interests by salvaging what they can from a doomed enterprise. Even in *Romalpa* itself, the most successful ROT claim in English legal history, the plaintiffs still made a loss of £35,000.

Much of the *Romalpa* case law must be viewed in its historical context. In recent years there have been major changes in UK insolvency law. Although attempts to reform the law of ROT have been a dismal failure, the position of unsecured creditors generally *has* been slightly improved. Correspondingly, the recent ground breaking decision of the House of Lords in *Spectrum*<sup>147</sup> concerning the categorisation of fixed and floating charges, has also slightly eroded the banks’ once unassailable position. Although the attitude of both judiciary and legislature has been profoundly unhelpful, the legacy of *Romalpa* continues to live on.

The law of ROT does now appear to be settled. Suppliers can be advised that proceeds and manufactured goods clauses will fail. Subject to its incorporation in the contract however, a simple clause will usually be effective. Perhaps more surprisingly the all monies clause<sup>148</sup> has also received high judicial approval. Although the route by which this point has been reached defies any meticulous analysis, this modern certainty is to be welcomed. ROT remains an invaluable tool for the modern businessman, both for its utility as a cheap method of granting credit and as an “*economic lifeline in times of recession.*”<sup>149</sup> Despite being denied the full benefits of the extended *Romalpa* clause, ROT devices continue to enable the seller of goods to “*pull himself up by his own bootstraps*”<sup>150</sup> and assert a modicum of control over his commercial destiny.

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<sup>146</sup> McCormack. J.B.L. 2002 (Portraying the views of Jacob Ziegler)

<sup>147</sup> In *Re Spectrum Plus Ltd* [2005] UKHL 41

<sup>148</sup> *Amour v Thyssen Edelstahlwerke* {1991} 2 AC 339

<sup>149</sup> Feld, J. Retention of Title, Seller v Receiver (1992) LSG Vol 89 No 25 Pg 8

<sup>150</sup> Goode. Legal Problems of Credit and Security. 3<sup>rd</sup> Ed. London Sweet & Maxwell 2003

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