Retention of Title Clauses: Good in Theory

Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liquidation) and anor
High Court of Australia, May 2000

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Retention of Title Clauses in sale agreements are designed to secure payment of the purchase price of goods sold. Many clauses now purport to give sellers quite esoteric rights in support of their basic aim (to retain title in the goods sold) by providing special remedies where the goods themselves cannot be recovered.

The so-called 'Romalpa clauses' have always attracted some controversy. The High Court of Australia has recently considered the effectiveness of one such clause. On 11 May 2000 in Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liquidation) and anor, the court dismissed an appeal from the Court of Appeal of New South Wales brought by Associated Alloys Pty Ltd ('Associated').

FACTS

Associated sold steel to Metropolitan Engineering and Fabrications Pty Ltd ('Metropolitan'). From about 1987, its invoices for the steel included retention of title provisions. The appeal concerned three invoices issued for steel delivered to Metropolitan between August and October 1995. Two of these contained a Romalpa clause.

Metropolitan did not pay Associated the full amount owing under the invoices, but used the steel supplied under those invoices, as well as additional steel, in the fabrication of pressure vessels, heat exchangers and columns for supply to Lucky Goldstar. Metropolitan went into liquidation. Associated remained unpaid for its steel and sought to rely on its retention of title clause to gain priority over unsecured creditors in the liquidation of Metropolitan.

THE CONTRACT PROVISION

Although the retention of title clause contained five sub-clauses, only the first and fifth are relevant here. The first provided that property in the invoiced goods (the steel) would not pass to Metropolitan until it paid the relevant invoices in full.

The fifth sub-clause provided:

In the event that [Metropolitan] uses the goods/product in some manufacturing or construction process of its own or some third party, then [Metropolitan] shall hold such part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for [Associated]. Such part shall be deemed to equal in dollar terms the amount owing by [Metropolitan] to [Associated] at the time of the receipt of such proceeds.

The steel was used in a manufacturing process and could no longer be identified separately. Therefore, Associated could not rely on the first provision to recover its steel. Instead it relied on the fifth paragraph as the relevant provision in such circumstances.

THE DISSenting JUDGMENT OF JUSTICE KIRBY

Justice Kirby found that the clause was either void for uncertainty, or only operated as creating a charge over undifferentiated book debts of Metropolitan.

He considered that the agreement (if it was a charge) should have been registered with the ASIC under the Corporations Law. As it had not been registered, it was void as against the liquidator of Metropolitan and therefore Associated had to rank as an unsecured creditor in the liquidation. He agreed with the NSW Court of Appeal and dismissed Associated's appeal.

Justice Kirby considered that courts should accept that contracts do provide for the transfer of title to goods. However, in his view, the courts should not allow 'retention of title' clauses to defeat or postpone the interests of other creditors in cases
of insolvency, unless the interest asserted by such clauses is registered as a charge under the Corporations Law.

THE MAJORITY DECISION

The majority judges (Gaudron, McHugh, Gummow and Hayne) said that the first part of the clause described subject-matter of commercial value, namely 'proceeds', and the second operated to confer an interest in those proceeds. However, they held that goods resulting from 'a manufacturing or construction process of a third party' (such as Lucky Goldstar) were not 'proceeds' subject to the clause.

The court then had to decide whether the 'proceeds' were limited merely to funds comprised of payments made by Lucky Goldstar to Metropolitan, or whether the term included debt obligations owed by Lucky Goldstar. They held that the 'proceeds' were the moneys received by Metropolitan only. This allowed the clause to operate with certainty.

In the majority view, a trust could be created if the subject trust property was identified to be a proportion of proceeds received by Metropolitan. Here the clause was sufficient to constitute a trust of future acquired property. It was therefore not a charge within the meaning of s.9 of the Corporations Law and its registration with the ASIC was not required. That being the case, Associated could rely on the clause against the liquidator of Metropolitan.

The court said that Parliament had selected the criteria for operation of the registration provisions for the Corporations Law and found that this arrangement was not subject to those provisions. The majority judges refused to destroy or impair property rights (such as these) by themselves supplementing the list of interests specified by Parliament for registration.

They accepted that non-registration of such agreements creates practical difficulties for persons, such as financial institutions, who wish to assess the credit-worthiness of persons such as Metropolitan. They said that this was a matter for Parliament and pointed out, in passing, that such provisions arguably reduce a seller's commercial risk, which might in turn result in lower prices.

Ultimately though, Associated failed because it could not demonstrate actual receipt of the future acquired property that was to become the trust property. Had Metropolitan in fact received all payments from Lucky Goldstar for the products made by Metropolitan from Associated's invoiced steel, then the inference could have been drawn that Metropolitan had received 'the proceeds' from the Lucky Goldstar in respect of each of Associated's invoices. However, only part payment had been received from Lucky Goldstar and as a result that inference could not be drawn.

The court found, in effect, that while the clause created a trust, no identifiable 'proceeds' ever became the subject of that trust. Accordingly, the majority also dismissed the appeal.

CONCLUSION

In this instance the court majority, had the evidence been sufficient, would have maintained rights derived from a retention of title clause in a sale contract against a liquidator, thereby achieving the ultimate purpose of the clause (securing payment for the seller of goods). However, it also illustrates well the difficulties associated with making such clauses work in practice.

Finally, it should always be remembered – and the court specifically warned – that 'the text and scope of clauses which have come to be ... described [as Romalpa clauses] are not uniform. Such clauses will require particularised application of the relevant principles of law and equity to the construction and operation of the text of each individual clause'.

The problem with complex Romalpa clauses has always been to put the theory into practice. This case provides a classic example of the difficulties. ■

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