UNCONVENTIONAL SECURITY DEVICES AND THEIR ENFORCEMENT ON INSOLVENCY

IWAN R DAVIES

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About the author

Mr Iwan Davies is a Senior Lecturer in Commercial Law at the University of Wales College of Cardiff. He has published extensively on commercial law and personal property rights.

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The passing of property under English law is an aspect of contract rather than conveyance (ss17 and 19 Sale of Goods Act 1979) and once property has passed, the relationship of buyer and seller becomes simply one of debtor and creditor. Other than certain proprietary remedies available under Parts V and VI of the Sale of Goods Act 1979 (the SGA) which usually cease on delivery, the seller's only remedy following the insolvency of the buyer is to prove in competition with other unsecured creditors. Nevertheless, through the apparently simple contractual mechanism of reserving title to the goods, the seller will adversely affect third party interests, especially those of the buyer's creditors, since he will enjoy a status equivalent to a secured creditor. The inclusion of property retention clauses in commercial transactions evident in finance leasing, hire purchase transactions and the Romalpa clause (AIV v Romalpa Aluminium Ltd [1976] 1 WLR 676) begs the question as to whether property passsage is a meaningful proposition as distinct from being an example of conceptualism.

It is not the case that property passage alone can adequately solve the narrow issues which arise in the context of sale and supply of goods. These issues include: who bears the loss if goods are destroyed without the fault of either party after the contract of supply is made but before delivery; whether the buyer has an insurable interest in undelivered goods; who takes the risk of the buyer or seller's insolvency? These questions pose utterly different policy considerations and they appear similar only if the discussion is pitched at the level of title passing. Indeed, the American Realist School of Jurisprudence regards the question of title passing to be a "silly issue" which cannot govern the modern commercial scene. In this vein, Professor Karl Llewellyn has written:

> "The reason why a one-lump Title is not determinable with certainty in sales cases is because Title is a static concept, a something which is conceived as continuing in somebody. The essence of the sales transaction is dynamic so that lump-title fits only in that rare case in which the economy resembles that of 300 years ago: where the whole transaction can be accomplished at one stroke, shifting possession along with title, no strings being left behind - as in cash purchase of an overcoat. But the contract of sale on credit, the shifting of goods to market via a factor, the shipment against draft, the instalment sale, the delivery or shipment on approval these are not one-stroke

> transactions ... They involve a period, often an extended period, during which matters are in temporary suspension or are in active flux between the parties; over considerable periods of time there is no such title in either party as the static picture of title suggests ((1937-38) 15 NYULR 159.)

The analysis favoured here is that the legal effects of the various stages in the process of the circulation of goods should be examined; all connected problems should be solved on their factual merits. Such an approach will involve unravelling practical problems including the conflicting rights of the creditors of the buyer and seller in addition to those of a bona fide purchaser.

The characterisation and systematisation of the legal relations at different points in the sales process is particularly pertinent in the context of retention of title clauses. This is especially so if the seller's right is categorised as "reserved" ownership since this would indicate that both parties have some kind of ownership. The emphasis on property reservation is that it allows the owner to seize the property should the debtor fail on one of his primary obligations. In a sense, virtually all extensions of credit give the creditor a contingent right to take the property of the debtor in order to limit the extent of the indebtedness, i.e. after a court judgment the creditor can "execute" or "levy" some of the debtor's property in order to satisfy the judgment. While the secured creditor has the right not enjoyed by the unsecured creditor to take property without the post default consent of the debtor and without going to court, this may not be so valuable outside liquidation, and even sometimes at liquidation, because a debtor's active objection will require the secured creditor to go to court as well.

Since the purpose of the property retention is only to ensure <u>priority</u>, the supplier is not essentially retaining the asset himself but rather the right to <u>use</u> the asset to gain repayment of the debtor's debt to him. Thus, Article Nine of the Uniform Commercial Code (the UCC) does not allow the secured creditor to keep the collateral without the consent of the debtor since the ultimate remedy is to sell the asset in the market place and use the cash in order to diminish the indebtedness. The secured creditor is not entitled to any value derived from its continued use so that, for example, in the Court of Appeal in <u>Clough Mill Ltd v Martin</u> [1985] 1 WLR 111, Robert Goff LJ said *obiter* that the seller should retain the title to the material as trustee upon trust for sale accounting to the buyer for any surplus achieved. This approach is anomalous in the light of s48(4) of the Sale of Goods Act 1979 which would appear to insist that a sale contract will be rescinded in this circumstance. The effect of this is that the seller in reselling is acting in his own capacity and should, therefore, be entitled to any profits which accrue on resale. This approach was confirmed by the House of Lords in Armour and Another v Thyssen Edelstahlwerke AG [1990] 3 All ER 481. Of course, where the transaction is categorised as creating a security interest for the seller, it is perfectly proper for the buyer to be entitled to any surplus gained on resale on the basis that property will have passed to him.

Undoubtedly, a tension exists between the creation of a security interest and retention of title which does not, strictly speaking, constitute a security interest since it does not arise by virtue of an assignment of a proprietary interest by way of mortgage or charge.

RETENTION OF TITLE: A TRIUMPH FOR LEGAL FORM?

Scottish law with its emphasis upon a unitary concept of ownership in which possession is central *(possession vaut titre)* is reluctant to recognise non-possessory security rights. Nonetheless, the SGA does make some attempt to deal with the Scottish dilemma vis à vis non-possessory security interests through the insertion of s62(4) of the 1979 Act which was a provision specifically drafted for Scotland but also applies to England. This states:

> "(4) The provisions of this Act about contracts of sale do not apply to any transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge, or other security".

The historical antecedent to the above section is the Scottish case of McBrain v Wallace (1881) 8 R 330. Here the view was taken that so long as the "sale" was correctly carried through, the arrangement's function as a security did not overturn the transaction. From this it follows that s62(4) applies to transactions where the sale is a complete sham, i.e. the owner purports to sell goods to a creditor in order to raise secured finance while retaining possession. Thus, the Scottish Law Commission in their Memorandum 25 observed that s62(4):

> "... is of importance since the introduction of the rule that property in sale might pass without delivery would otherwise have been possible by resort to transactions in the form of sale to circumvent the rule that a security over moveables may not generally be constituted without transfer of them." (Para 5:23)

In a similar vein, Lord Moncreiff held in Robertson v Hall's Trs (1896) 24 R 120:

> "[T]his [s 62(4) Sale of Goods Act 1979] is in effect a statutory declaration that a pledge of, or other security over moveables, cannot be created merely by completion of what professes to be a contract of sale. The form of the transaction is not conclusive, the reality of the transaction must be enquired into." (p.134)

It is important to guard against what Levin called "the intention fallacy" ((1925-26) 24 Mich LR 130). He was commenting on the position in the USA before the adoption by the federal states of the Uniform Conditional Sales Act 1918 which was the immediate precursor to the Uniform Commercial Code. At that time, the distinction between conditional sale and a chattel mortgage was very important, the latter, as in England, being void for non-registration. Levin observed through careful analysis of the cases that:

> "When the courts have spoken of *indicia* of intention, they were subconsciously seeking the *indicia* of a conditional sale or a mortgage as the case might be and not the *indicia* of intention." (p 141)

Such a phenomenon has also expressed itself in the Romalpa line of cases where intention is often linked with the business purpose of the transaction irrespective of the precise wording of the retention of title clause. An example of this can be seen in Vinelott J's approach in Re Peachdart [1984] Ch 131:

> "... it is impossible to suppose that ... the parties intended that until a piece of leather had been fully paid for the company would remain a bailee of each piece of leather comprised in the parcel throughout the whole process of the manufacture ... and that on the sale of a completed handbag the company would be under an obligation to pay the proceeds of the sale into a separate interest-bearing account and to keep them apart from their other moneys and not employ them in the trade." (p 142, emphasis added)

The difficulties involved in determining the "true intentions" of the parties anticipated in s 62(4) of the SGA were demonstrated recently in Welsh Development Agency v Export Finance Co Ltd [1992] BCC 270. The facts revolved around a company, Parrott Ltd, in which the Welsh Development Agency (WDA) was a principal shareholder. The company, by a debenture dated in October 1985, charged its book debts and other property and assets in favour of the WDA. By May 1989, the company was insolvent and the WDA appointed receivers under the debenture. The WDA claimed that by virtue of its charge, it was entitled to receive payment of all debts owed by overseas buyers in relation to goods exported to them by Parrot. However, the defendants (EXFINCO) claimed that it was entitled to the debts on the basis of its agreement with Parrot, namely, that the sale of goods by Parrot was done on the basis of an agency relationship for EXFINCO. The merits of the scheme for EXFINCO were as follows: First, debts due under the contracts to sell goods to overseas buyers would never have been the property of Parrot but belonged to EXFINCO as undisclosed principal so they would therefore not be subject to any prior floating charge over Parrot's debt or property; second, such a transaction would be a sale and not a secured borrowing and as a result, the transaction would involve "off balance sheet" accounting.

At first instance ([1990] BCC 393) it was held that the transaction amounted in substance to a charge and was void for nonregistration. This judgment was reversed by the Court of Appeal, which upheld the arrangement as a genuine agency agreement. This was so despite the fact that the parties had constructed the agreement in such a way as to avoid all contact between the financier and the overseas buyer. Furthermore, the manufacturer's mandate to sell on behalf of the financier was limited to goods that complied with the sale contract, including the statutory implied terms of merchantable quality and fitness for purpose. This ensured that there would be no recourse against the financier for breach of contract. Nevertheless, the Court of Appeal held that an agent's authority to bind an undisclosed principal must have existed when the agent made the contract ostensibly as principal (compare Keighley Maxted and Co v Durant [1901] AC 240).

It is the policy of the courts, in England, where there is security with recourse to property which can be effected by means other than a transaction of loan or charge, not to treat it as registrable under s 396 of the Companies Act 1985 (as amended). This is so even though the exact economic effect might be carried out through a transaction which in form was registrable as a security interest in the goods. In this respect, a document purporting to be a sale of hire purchase agreements was construed by Eve J at first instance in Re George Inglefield [1933] Ch 1 as a charge on book debts whereas, in the Court of Appeal, it was held to be a sale (see also Lloyds and Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd and Others (1979) 120 NLJ 366). The approach adopted by Romer LJ in the Court of Appeal is instructive where he said:

> "The only question that we have to determine is whether looking at the matter as one of substance, and not of form, the discount company has financed the dealers in this case by means of a transaction of mortgage and charge, or by means of a transaction of sale: because, of course, financing can be done in either the one way or the other, and to point

> out that it is a transaction of financing throws no light upon the question that we have to determine." (p 27)

He then went on, in a very well-known passage, to analyse the differences between a transaction of sale and a transaction of mortgage or charge:

> "It appears to me that the matter admits of a very short answer, if one bears in mind the essential differences that exist between a transaction of sale and a transaction of mortgage or charge. In a transaction of sale the vendor is not entitled to get back the subject-matter of the sale by returning to the purchaser the money that has passed between them. In the case of a mortgage or charge, the mortgagor is entitled, until he has been foreclosed, to get back the subject-matter of the mortgage or charge by returning to the mortgagee the money that has passed between them. The second essential difference is that if the mortgagee realises the subject-matter of the mortgage for a sum more than sufficient to repay him, with interest and the costs, the money that has passed between him and the mortgagor he has to account to the mortgagor for the surplus. If the purchaser sells the subject-matter of the purchase, and realises a profit, of course he has not got to account to the vendor for the profit. Thirdly, if the mortgagee realises the mortgage property for a sum that is insufficient to repay him the money that he has paid to the mortgagor, together with interest and costs, then the mortgagee is entitled to recover from the mortgagor the balance of the money, either because there is a covenant by the mortgagor to repay the money advanced by the mortgagee, or because of the existence of a simple contract debt which is created by the mere fact of the advance having been made. If the purchaser were to resell the purchased property at a price which was insufficient to recoup him the money that he had paid to the vendor, of course he would not be entitled to recover the balance from the vendor." (p 27)

In that particular case, it was found that there was a transaction of sale and not one of mortgage or charge. This contrasts with the recent decision in Curtain Dream plc v Churchill Merchanting Ltd [1990] BCLC 925 where an agreement for the sale of stock by a company to a finance company, and for resale of the stock to the company on terms reserving title in the stock to the finance company, created a charge on the stock which was void as against creditors in the receivership of the company for want of registration. The critical indication of charge which impressed Knox J was the company's entitlement to redeem by repurchasing the stock, and this was confirmed by the facility letter containing references to "interest" and a "creditline".

As a matter of legal form, the main distinction between a chattel mortgage and an executory agreement to sell is that the first assumes an immutable debt or obligation for the performance of which the debtor's goods serve as security. In this sense, ownership is divided with legal title vested in the mortgagee and the beneficial ownership in the mortgagor who carries the burden of loss or damage, taxation and other costs. In the case of an executory contract of sale, there is no absolute debt - only a promise to pay. Nonetheless, it is simplistic to argue that the buyer obtains no interest in the goods because, how is it possible to maintain that the seller has full title in the goods where another has the right to acquire it by acts within his own control? In this vein, as Chancellor Kent wrote:

> "Absolute property denotes a full and complete title or dominion over it; but qualified property in chattels is an exception to the general right, and means a temporary or special interest, liable to be totally divested on the happening of some particular event." (Commentaries, Vol 2, Lecture xxxv.)

The key concept for understanding the property passing provisions of the SGA is relativity of title. With this in mind, ownership may be described as being analogous with a bundle of sticks so that algebraically, a chattel mortgage can be expressed as follows:

$$O - SC = SD$$

This is where O = full ownership and SC = the secured creditor's interest whereas SD = the security interest of the debtor. What we are doing here is dealing with a division into two of the bundle of rights making up ownership. It must be remembered that O and SC and SD are variables so that the debtor will start out with a bundle of varying size depending on the extent of his interest in the property to be used as security. In contrast to the chattel mortgage, the object of the debtor in a conditional sale is to acquire the *res*/property in question, i.e. "sale" credit as distinct from "loan" credit. The transaction may be translated as follows:

$$O - SD = SC$$

When one compares the chattel mortgage we have the same result:

$$O - SC = SD \text{ (chattel mortgage)}$$

$$O - SD = SC \text{ (conditional sale)}$$

Each transaction involves a process of subtraction. In the chattel mortgage, the debtor initially had the whole bundle of sticks and passed over some sticks to the creditor and kept some for himself, whereas, in the conditional sale, the creditor had the bundle of sticks and passed over some sticks to the debtor and kept some for himself.

It may be that, as a matter of consistency, the unifying elements in the transactions identified above should be recognised and a similar legal response to each should ensue. We shall now consider this matter further in relation to the following contractual mechanisms which provide for retention of title.

1. The Finance Lease

In a dynamic commercial setting it may not be sensible to try and distinguish sale from lease because what is involved in both is an allocation of risks and benefits vis à vis economic assets. Nevertheless, the traditional way in which the SGA deals with the question of risk is to associate it with property (*res perit domino*), a position which was replicated under the U.S. Uniform Sales Act. Interestingly the UCC, at least in theory, has expunged the "property" solution concentrating in Article Nine upon whether a security interest has been created. The main distinguishing factor is that if the creditor has a right to a surplus and is liable to a deficiency then this is a sale agreement, i.e. the "benefits" and "burdens" of ownership. The major difficulty with this analysis is that under the finance lease both the lessor and the lessee enjoy the "benefits" and "burdens" of ownership. Here the lessee will enjoy 95-99% of the residual value of the *res* at the end of the lease term, but will not enjoy an option to purchase (at least in the U.K.) since the lessee is still essentially selling its own tax depreciation to the lessor. At the same time, the lessor is exposed to both benefits and burdens because the term itself involves a risk, for example, if rental terms diminish or increase. This is particularly pertinent in the case of long term leases (over five years) where the residual value at the end is small. If a finance lessor wants to be sure that an asset will have an accountable, specified minimum value at a predetermined date in the future, an important method of minimising risk exposure is through a Residual Value Insurance Policy. Even if the lessor can retain the surplus realised by resale of the asset at the end of the lease term, it is obvious that because the opportunity and risk associated with the *res* can be separated from those associated with the "use of thing", this would suggest that there is no tenable distinction between a lease and a security interest. As H.Kripke has colourfully put it:

> "The man from Mars with a clear eye undistorted by training in law, accounting or taxation, would find in the instalment purchase a device by which the user of property acquired the right to use it in return for instalment payments which cover the costs advanced by someone else (the secured party or lender) plus a charge for the use of money. If a man from Mars looked at the long term lease with the same clear eye he

> would find precisely the same thing except that instalment payments by the user are limited, and at the end of a limited contracted period of use, the remaining use life of the property belongs either to the supplier of the funds or to the passive third-party lessor who occupies that position to receive the benefit of the tax manna. The similarities are so great that the differences should fade into insignificance." (H. Kripke (1982) 37 Bus Law 723 at p 727)

It is important to adopt a balanced approach. A distinction can be drawn between leases and conditional sales which represent a security interest, in particular, where the leases are of short duration which do not look to the ultimate acquisition of the goods by the lessee. In this context, application to the true lease of the remedies traditionally associated with the chattel mortgage would do violence to the contract rights of the parties. However, the question of public notice still remains.

In many periodic payment transactions, it is difficult to determine which part, if any, of the total payments is "principal" and which is interest. This demonstrates the difficulty of distinguishing between a lease/conditional sale/hire purchase transaction and sale. It has been argued that market conditions and other factors may prompt the transferee to agree to pay an amount equivalent to the value of the goods without the expectation of becoming owner (see Cuming (1983) 7 Can Bus LJ 251 at p 269). This approach is exceptional and it must be that the rental price will constitute a strong indication of the nature of the financing arrangement. In this respect, it will be instructive to look at the English position as it developed with regard to hire purchase transactions.

2. Hire Purchase

It is elementary learning that in Helby v Matthews [1895] AC 471 (compare Lee v Butler [1893] 2 QB 269), the House of Lords decided that a hirer under a hire purchase agreement who was entitled to terminate the hiring agreement at any time was not a person who had agreed to buy the goods within the meaning of s 9 of the Factors Act 1889. An important question arising out of the case was whether a hire purchase agreement where the rentals payable by the hirer were equivalent or substantially equivalent to the purchase price, but where an option had to be exercised by the hirer before title to the goods vested in him, could be treated as an agreement for sale. Since Lord Herschell affirmed in Helby v Matthews that the substance and not the mere form of the agreement had to be looked at, one would have thought that the answer admitted of little doubt, were it not for the decision of the Scottish Court of Sessions in Darngavil Coal Company v Francis (Surveyor of Taxes) (1913) 7 TC 1. In that case the appellant company had agreed to "rent" from a finance company a certain number of railway wagons for a number of years at a rental equivalent to their purchase price. The agreement gave the company the option, at the end of the rental period, of purchasing the wagons at a shilling each. The option was exercised. The question on appeal was how the rental payments were to be treated for tax purposes. If, as the surveyor had successfully argued before the Special Commissioners, this was really an agreement for sale with a suspensive condition - a conditional sale in other words - then the payments were clearly of a capital nature and therefore not deductible from the taxpayer's gain or profits; if, as the appellant company argued, the agreement was to be read literally, then they ought to have been entitled to deduct the whole of the payments as having been made on account of the use and possession of the wagons. The Court of Sessions dismissed the argument which had prevailed before the Special Commissioners with the single sentence that "the case [was] too plain for argument" (p 11). In other words, the court treated the agreement as a true hire-purchase agreement. However, since the agreement did not distinguish between that portion of each instalment which was payable on account of the option to purchase and that attributable to the hiring element, the appellant company was held to be entitled to deduct only this latter portion. Lord Dunedin (as he then was), who delivered the unanimous judgment of the court, made no attempt to justify the decision on the first point, either on principle or in the light of earlier cases.

The English courts showed little hesitation in applying the terms of a hire purchase type of agreement literally. Thus a deposit paid ostensibly on account of the option to purchase was treated as just that, and not for what it is in economic reality, a part of the purchase price (Kelly v Lombard Banking Ltd [1959] 1 WLR 41). The option to purchase was treated as a separate and severable part of the agreement (Whitelet Ltd v Hill [1918] 2 KB 808; Belsize Motor Supply Co v Cox [1914] 1 KB ~~244); and therefore, unless the agreement otherwise~~ provided (United Dominions Trust (Commercial) Ltd v Parkway Motors Ltd [1955] 2 All ER 557), survived any termination of the contract of bailment. A view more consonant with the parties' intention, one would have thought, and with the security nature of the agreement, would be to treat the option as contingent on existence of the bailment itself. In addition, instalments were held to be rentals payable in consideration of the use and possession of the goods (Brooks v Bernstein [1909] 1 KB 98; South Bedfordshire Electrical Finance Ltd v Bryant [1938] 3 All ER 580; Chatterton v MacLean [1951] 1 All ER 761), and not as they would have been in the case of a conditional sale agreement as payments on account of the purchase price (Hewison v Ricketts (1894) 63 LJQB 711; AG v Pritchard (1928) 97 LJQB 561). In some cases, the English courts did recognise the element of sale in hire purchase agreements. An example of this can be seen in Karflex Ltd v Poole [1933] 2 KB 251, where Goddard J held that in every hire-purchase agreement there was an implied condition that the person granting the option to purchase was the owner of the goods and entitled to give the option. He conceded that there was no such implied condition in an ordinary bailment for hire but justified the distinction on the ground that:

> "... this modern class of bailment ... has in it not only the element of bailment but also the element of sale. "(pp 263-264)

Two points deserve to be noted about Goddard J's judgment. In the first place, he expressly disclaimed any desire to assimilate the hire-purchase agreement to a conditional sale:

> "I say the element of sale, because of course, it is well known, since the leading case of Helby v Matthews, that the hire-purchase agreement, as drawn at present, is not a true contract of sale but an option of sale. " (p 265)

In the second place, the judgment fails to grasp the economic unity of all the payments made under a hire-purchase agreement, whatever label the agreement may attach to particular parts of them. In Poole's case the question was, *inter alia,* whether the hirer was entitled to recover his deposit on its being shown that the plaintiff company was not the owner of the car at the time it was delivered to the hirer pursuant to the agreement. It was held that he could, because the deposit was paid in exchange for an option to purchase, which in fact the company was not in a position to give. But Goddard J also considered briefly whether, if the plaintiff's defective title had not been discovered until a number of instalments of rent had been paid, the defendant-hirer would have been entitled to recover them. In the result he expressly left the point open for future decision. But if the learned judge had appreciated that, in an economic sense, the option and the bailment were indissolubly linked together he might, it is felt, have been less hesitant in supplying the answer. It took legislation, the Hire Purchase Act 1964, the Supply of Goods

(Implied Terms) Act 1973, and the Consumer Credit Act 1974 to generally formally assimilate hire purchase to sale on credit.

3. Recourse Credit Factoring

Significant problems arise in distinguishing between the purchase of receivables and the lending of money on the security of book debts. This distinction is particularly fine where the assignor gives recourse as the effect is the same as borrowing on the security of receivables. The Crowther Committee noted:

> "... those buying receivables, whether with or without recourse; are careful to exact a set of warranties from the assignor designed to ensure as far as possible that the receivables assigned are not only legally enforceable but likely to be paid. Since a breach of any of these warranties may entitle the assignee to recover his loss from the assignor the difference between sales with recourse and sales without recourse is not as clear as it might appear." (Crowther Committee on Consumer Credit, Cmnd4596 (1971) App III, para 5)

The mere fact that there is a right of recourse should not necessarily affect the categorisation of the transaction as a sale. The assignor's liability is not to repay an advance, i.e. an exchange of money for money as in the case of a mortgage, but rather to pay a sum in discharge of a recourse obligation (Lloyds and Scottish Finance Ltd v Cyril Lord (1979) 129 NLJ 366).

The above approach is confirmed by the accounting treatment where the relevant criterion is not that of recourse but whether the transferor has surrendered the control of future economic benefits embodied in the receivables (Finance Account Statement 77, Receivables Sold with Recourse). By virtue of s22 of this Statement, a transfer of receivables with recourse is recognised as a sale if all of the following conditions are met:

(a) The transferor surrenders control of the future economic benefits embodied in the receivables. Control has not been surrendered if the transferor has an option to repurchase the receivables at a later date;

(b) The transferor's obligation under the recourse provisions can be reasonably estimated;

(c) The transferee cannot require the transferor to repurchase the receivables except pursuant to the recourse provisions.

Where there is recourse to the client for credit risk, this contingent liability should be disclosed in the notes to the accounts. Factoring charges are treated as being in the nature of a finance cost and are dealt with as such among overheads in the detailed profit and loss account.

4. <u>Consignment Sales</u>

Under the UCC, a "sale on approval" is a special form of contract for sale in that the buyer may return the goods after trial even if they fully conform to the contract description. The most significant aspect of sale on approval, for our purposes, is that the buyer's creditors have no claims to the goods until acceptance and the seller bears the risk and expense of the return of the goods. In the case of a sale or return, the UCC treats this as functionally similar to consignment. The buyer takes the goods primarily for resale and in most cases is a merchant. Unless otherwise agreed, the buyer will bear the risk of loss and expense when exercising his option to return the goods, and while the goods are in his possession they are subject to the claims of his creditors in accordance with Article 2:326(2). The scenario anticipated here is summarised in the comment to Article 2:326 as follows:

> "The type of 'sale or return' involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold."

If despite the delivery to the buyer the supplier retains title, this is treated as a reservation of a security interest which attaches and is perfected pursuant to Article Nine. No such distinction is drawn under the SGA, although s18 rule 4 does not refer to goods as being "sold" but rather refers to delivery. It is clear that through this method Chalmers accommodated both a "contract of sale" and an "agreement to sell". The latter analysis does not entirely fit conceptually the "sale or return" transaction, i.e. here there is an agreement to sell subject to the buyer adopting the transactions. Moreover in the case of "sale on approval", many of these are "sales" (in the sense of property passing) subject to a right of rescission.

The UCC fails to distinguish between a "true" consignment and one intended as a security. The definition of "security interest" in Article 1:210(37) refers to consignments:

> "Unless a lease or consignment is intended as security, reservation of title thereunder is not a 'security interest' but a consignment is in any event subject to the provisions on consignment sales (Section 2-326)."

Article 2:326(3) provides:

> "Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as 'on consignment' or 'on memorandum'. However, this subsection is not applicable if the person making delivery
>
> (a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or
>
> (b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others, or
>
> (c) complies with the filing provisions of the Article on Secured Transactions (Article 9)."

It would seem from this that even a "true" consignment requires notice to be given to creditors. This approach reflects the criticism of the pre-UCC position, namely, consignment arrangements were functionally similar to conditional sales but whereas conditional sales had to be recorded publicly, the consignor's claims to the goods had to be recorded in only a few states.

The UCC aimed to cure the ostensible ownership problem through the insertion in Article 2:326(3) of the three conditions. If condition (c) is relied upon, Article 9:114 of the 1972 UCC revision provides that a "true" consignor's interest will be subordinated to a secured party who would have a perfected security interest in the goods if they were the property of the consignee, unless the consignor files in the register before the consignee receives possession of the goods and gives written notification to the prior secured party. However, the "true" consignor is not obliged to file under Article Nine and he can rely instead on the "sign law" anticipated in condition (a). This is the US equivalent of the reputed ownership provision, well-known to English bankruptcy law (now repealed), the scope of which was notoriously uncertain. In addition, the notoriety exception in condition (b) can also be criticised not least because the creditors of the debtor will fluctuate and may not know of the bankrupt's business methods.

The question of what constitutes a "true" consignment sale is highly pertinent in the Romalpa context. The reason for this is that there is a natural judicial hostility to security consignments which are considered to be secret liens. This factor may explain the restrictive interpretation of proceeds clauses in the post Romalpa case law. In the USA, the "true" consignment sale is linked with a price fixing mechanism which brings into focus important antitrust questions especially following the celebrated decision in Simpson v Union Oil Co 377 US 13 (1964). It may be that the purpose of a "true" consignment sale is to ensure quality of marketing and after-sales service. On the other hand, it could be argued that the most significant factor is the determination of the relationship as being one of principal and agent. Certainly in Canada, one of the common law tests for a "true" consignment was that the commission to be earned by the retailer was to be equal to the difference between the retail price of the goods charged, and a net fixed price established by the supplier. This would suggest that if a consignee is not obligated to pay the price of the goods until sale and can return unsold goods before sub-sale, this is a true agency relationship . Thus, the determining feature of a "false" consignment is whether the consignee is absolutely liable for the price of the "consigned" goods with no right to return the goods unsold. Nevertheless, it has to be admitted that the tests identified are not easy to understand because the consignment legal form seems so responsive to changing market factors that any test articulated is only going to be marginally useful.

The importance of consignment as a financing mechanism has waned in the USA. One major reason for this is that the "true" consignment gives the consignee a right to return goods not sold. Naturally, this is not attractive to sellers as they are required to assume the risk of market failure. Furthermore, the use of consignments for security purposes is minimal due to the ease by which security interests in inventory can be created under the UCC. It may be that the absence of a similar UCC-type of regime in England accounts for the importance of the consignment/agency question in the wake of the Romalpa line of case law.

5. 'Romalpa' Clauses

The process of reasoning described above is of importance in so far as it offers a guide as to how far English courts may be prepared to go in ignoring form for substance in other situations. The court views the use by the parties of non-registrable forms of secured borrowing transactions as the exercise of a legitimate option conferred by the legislation notwithstanding that the transaction may be within the mischief of s395 of the Companies Act 1985 (as amended). The Master of the Rolls, Sir John Donaldson, described the situation perfectly in Clough Mill v Martin [1985] 1 WLR 111:

> "The argument that the object of the exercise was to give the appellants security for the price of the yarn does not of itself advance the matter. Just as it is possible to increase the amount of cash available to a business by borrowing, buying on hire purchase or credit sale terms, factoring book debts or raising additional share capital, all with different legal incidents, so it is possible to achieve security for an unpaid purchase price in different ways, with different legal consequences. The parties have chosen not to use the charging method in relation to unused yarn." (p 125)

At times, the Scottish judiciary have given the impression that s17 of the SGA 1979 does not exist and that reservation of title is impossible under Scots law (cases include Clark Taylor and Co v Quality Site Development (Edinburgh) Ltd (1981) SC 111; Deutz Engines Ltd v Terex Ltd [1984] SLT 273). This approach was evident in the Second Division Appeal in Armour v Thyssen Edelstahlwerke AG [1989] SLT 182, reversed in the House of Lords [1990] 3 All ER 481. The appeal concerned an "all sums" clause which Lord Ross considered "plainly designed to provide security without possession" (p 186). This approach failed to recognise that as a matter of legal form, a distinction is drawn between the granting of a security interest (i.e. of a *jus in re aliena)* and the reservation of property which is not considered an orthodox security device requiring registration. The conventional position was restated by Lord Keith in the House of Lords as follows:

> "Can it be said that [the buyer] obtained anything which gave it the capacity to retain an ultimate right to the goods? That could be so only if the contract of sale gave them the property in the goods, but the contract of sale said that the property in the goods was not to pass until all debts due to the appellants had been paid. We are here very far removed from the situation where a party in possession of corporeal moveables is seeking to create a subordinate right in favour of a creditor while retaining the ultimate right to himself. It is true that by entering into the contract of sale [the buyer] agreed that they should receive possession of the goods on delivery but should not acquire the property until all debts due to the appellants had been paid, and thus agreed that the appellants would in effect have security over the goods after they had come into [the buyer's] possession. But at that stage [the buyer] had no interest of any kind whatever in any particular goods. [The buyer] was never in a position to confer upon the appellants any subordinate right over the steel strip, nor did it ever seek to do so." (pp 484-485)

It would be erroneous to maintain that English judges have not also been attracted to the position adopted in some of the Scottish cases. In this context, the most notable judgment is that of Judge O'Donoghue at first instance in Clough Mill Ltd v Martin [1984] 1 All ER 721, reversed in the Court of Appeal [1985] 1 WLR 111, where the learned judge formulated a "purpose and function" test:

> "[I]f the court is satisfied that this purpose was by way of security for the payment of unpaid purchase moneys then the transaction as a whole should be construed as a charge." (p 732)

Such an approach is startling in the light of Judge O'Donoghue's conclusion that because the right to repossess the goods arose only on default, the supplier had something less than ownership. The consequence of this approach would be to suggest that a bailor has less than an ownership right.

Essentially the conclusion arrived at above fails to recognise the distinction between form and function and that what was involved here was a policy decision. In construing the clause the way he did, Judge O'Donoghue was being no less formalistic than the parties themselves. Similarly, Lord Ross in Clark Taylor and Co Ltd v Quality Site Development (Edinburgh) Ltd (1981) SC 111 clearly considered a retention of title clause to be a security contrary to public policy as it:

> "... is designed only to freeze assets of a debtor and to keep them out of other creditors' hands, until a particular creditor's debt is paid in full, and were it to be regarded as constituting a proper trust in accordance with the law of Scotland, and were to be adopted widely by sellers of goods, the damage which would be done to the objectives of the law of bankruptcy and of liquidation would be incalculable." (p 112)

This argument is too embracing since it is a criticism which can apply to all security interests. Of course, it may be that the ostensible ownership problem (i.e. the separation of property from possession) is at the root of the objection, but if this is the case, it is contrary to principle that a creditor should be penalised merely because of the absence of an efficient system of registering personal property security interests.

One of the major criticisms of the retention of title mechanism is that debenture holders face the reduction of their traditional priority position. Nevertheless, an extravagantly drawn floating charge accompanied by a long catalogue of crystallising events is as much open to criticism as the retention of title clause mainly because of the lending monopoly danger associated with an after-acquired property clause. What is assumed here is that a creditor with an after-acquired property provision enjoys a special competitive advantage over other lenders in all his subsequent dealings with the debtor in that the clause could, if unchecked, effectively tie the debtor's hands to an existing and often exhausted line of credit thereby making it impossible to obtain fresh capital. It is possible to argue, therefore, that it could lead to a refined sort of peonage by locking a borrower into a closed system of credit.

Undoubtedly, the after-acquired property clause does create a "situational monopoly" in the sense that assets which come under the purview of the clause cannot, without the first creditor's consent, give another creditor a prior claim to those assets. It should not, therefore, be surprising to discover a link between the law's recognition of an after-acquired property clause and the priority rule for purchase money security. Insofar as the latter is based on the idea of "new money", it can be argued that if there was perfect competition in the lending market the purchase money priority interest would figure in a contract containing an after-acquired property clause in any case. The reasoning here is that it is impossible to determine how much the interest rate of the holder of an after-acquired property clause should compensate the debtor for the adverse effects of the creditor's situational monopoly. This would require an assessment of future contingencies as well as taking into account the relative bargaining strengths of the parties. In this sense, a retention of title clause, as an example of a purchase money provision, is a consistent accompaniment to an after-acquired property clause precisely in order to reduce these transaction costs. We shall now proceed to consider this concept in greater detail.

THE PURCHASE MONEY SECURITY INTEREST

The codification of personal property security law in the US evident in Article 9 of the UCC is predicated upon two major theses: First, the idea of security as a bargained for right which justifiably, in the absence of fraud, supersedes the *pari passu* principle of distribution; Second, security is conceived as being desirable *per se* as it stimulates economic growth and the modernisation of business. In this respect, the architects of the UCC were concerned with expanding the pool of assets available through the recognition of the floating lien accompanied by a simple first-to-file priority rule. It is doubtful whether any previous security statute has so warmly embraced the after-acquired property interest.

In the course of the drafting of Article 9, the validation of the floating lien met significant opposition. To combat the perceived dangers of the after-acquired property clause, the draughtsman of Article 9 included the purchase money security interest (the PMSI). This is defined in Article 9:107 as follows:

"A security interest is a 'purchase money security interest' to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used."

From this it would appear that Article 9:107(a) requires a specific correlation between the collateral in which priority is claimed and the specific price (obligation) relating to that particular item of collateral. Third party financiers under Article 9:107(b) need not show an express tie so long as the purchase money financier can prove that the outstanding indebtedness to be secured was in fact used by the debtor to acquire new assets. The point here is that purchase money loans contemplate a strict foreclosure, i.e.the debtor's payments are designed to correspond to the new asset's economic depreciation so that repossession of the asset will normally satisfy the purchase money creditor. There is, therefore, no question of the PMSI undermining the interest of other creditors, for example by shrinking the cushion of free assets that protects the earlier lender against default.

It is odd that although the UCC recognises a PMSI, the creditor with the after-acquired property clause still enjoys some situational monopoly. Thus there are significant procedural requirements necessary for obtaining a perfected PMSI in inventory and these are set out in Article 9:312(3). The most important requirements involve notification in writing to the holder of a conflicting security interest as well as the tracing requirement combined with the necessity that the "seller of the collateral" be able to identify the collateral sold. Seemingly, the obtaining of a PMSI will involve transaction costs that a creditor with an after-acquired property clause need not incur in order to get priority. These costs can be substantial, for example the tracing requirement vis à vis shifting stocks which can be so onerous as to prove virtually unacceptable. In particular with regard to raw materials, if the after-acquired property clause extends to a certain category and the debtor borrows funds from another creditor to buy raw materials of the same sort, the debtor will have to segregate physically the new materials from the old in order to give the second creditor a PMSI. It would appear that even though the UCC is a sophisticated security statute, it does not avoid many of the policy dilemmas presented by a Romalpa clause in England.

When the draughtsman of the UCC encapsulated the after-acquired property provision, it was natural that they should read the PMSI as widely as possible. Indeed, in the 1949 and 1952 drafts of the UCC, provision was made for the financing buyer which recognised the latter as being engaged in another form of financing acquisition of goods by equating the financing buyer with the purchase money lender. This approach would have necessitated a liberal tracing requirement and Article 9:107(c) of the 1952 draft envisaged a security interest where "the debtor receives possession of the collateral even though value given is not in fact used to pay the price". Subsequently, this provision was dropped from the final draft because it was considered to extend the PMSI to an unacceptable degree in that it took the concept beyond its common law heritage, i.e.identification of the asset. By abolishing Article 9:107(c), the draughtsmen were merely confirming a tracing rule. Indeed, it is the strict tracing requirement under Article 9 which has proven a significant handicap to the holder of a PMSI, especially if the materials supplied are mingled with other materials. In a similar way, the Romalpa line of case law reflects this dilemma.

1. The *Scintilla Temporis* Doctrine.

Where an asset is purchased with the assistance of moneys provided on loan, as in the case with the retention of title clause, a crucial question is whether the security interest was created before the beneficial interest of those entitled in equity to the purchased property. As a matter of principle, priority should be enjoyed by the purchase money supplier (see above). Thus, in Capital Finance Co Ltd v Stokes [1969] 1 Ch 261, an equitable security took the form that a purchaser of land (a company) agreed to execute a legal mortgage in favour of the vendor upon completion. An equitable mortgage was therefore created immediately, and this equitable security later merged into the legal interest. Where there is no such provision it might be argued, as did counsel for the supplier (Monsanto) in Re Bond Worth [1980] 1 Ch 228, that no security was ever "created" by the company as a purchaser under s 395 of the Companies Act 1985 (as amended) because Monsanto had reserved "equitable and beneficial ownership" in the goods delivered. This indeed was the position in Re Connolly Bros Ltd (No 2) [1912] 2 Ch 25 where a company sought to buy land and, for this purpose, entered into an agreement with a lender who paid money and received a charge as security for the advance. Previously, the company had entered into agreements with the debenture holders not to "create" a "prior" mortgage. It was held that at no stage was the company, as against the lender that is, unencumbered or an absolute owner of the legal fee simple so as to be free separately to charge the fee simple, that is, the purchaser never acquired more than an equity of redemption. More recently, the House of Lords in Abbey National Building Society v Cann [1990] 2 WLR 832 upheld the principle expounded in Re Connolly. The significance of this is that since the buyer company in a Romalpa scenario acquires no more than an equity of redemption in future goods, it does not "create" a charge registrable under s 396 Companies Act 1985 (as amended).

The *scintilla temporis* doctrine had provided a technical rationalisation for postponing the interest of the purchase money security holder. Under this principle, a moment of time *(scintilla temporis),* however short, which allowed for the after-acquired property interest to attach, was identified. This indeed was the position adopted in Church of England Building Society v Piskor [1954] 1 Ch 533. Here a purchaser, who had been let into possession by the vendor before completion, granted a number of equitable tenancies. The building society advanced money on completion without any prior agreement to do so. It was held that the true sequence of events was that the purchaser had first taken the legal fee simple and then granted a legal mortgage to the lender; that the two transactions were separate and divisible so that there was a *scintilla temporis* when the purchaser was the full legal owner free from any title of the lender which thereby fed the titles of the sub-tenants. Therefore the sub-tenancies were binding on the mortgagee.

Both the Re Connolly and Piskor decisions were considered by the Judicial Committee of the Privy Council in Security Trust Co v Royal Bank of Canada [1976] AC 503. The facts followed a familiar pattern. A company was acting under the direction of a receiver who had been appointed by a debenture holder under a previous debenture secured by a floating charge which contained a restrictive clause. The company granted a mortgage back to the vendor of land which the company was purchasing in order to secure the balance of the purchase price left outstanding. Following Connolly it was held that the floating charge affected the acquired land subject to the mortgage so that there was no breach of the restriction. Lord Cross sought to reconcile the differing authorities as follows at p 522:

> "[T]he basic difference between the two lines of cases is that in cases such as Re Connolly Bros Ltd (No 2) and this case the charge under the debenture only bites on property which is already fettered by the agreement to give the other charge, whereas on the facts of Church of England Building Society v Piskor the tenancy was created out of an interest which was then unfettered by any such agreement." (See also Lloyds Bank plc v Rosset [1989] Ch 350).

In Abbey National [1990] 2 WLR 832 the House of Lords were scathing of the legal fiction implied by the *scintilla temporis* and decided that the Piskor case should be overruled. This point is made forcibly by Lord Oliver as follows, at pages 853-854:

> "One is therefore presented with a stark choice between them. Of course, as a matter of legal theory, a person cannot charge a legal estate that he does not have, so that there is an attractive legal logic in Piskor's case. Nevertheless, I cannot help feeling that it flies in the face of reality. The reality is that, in the vast majority of cases, the acquisition of the legal estate and the charge are not only precisely simultaneous but indissolubly bound together. The acquisition of the legal estate is entirely dependent on the provision of funds which will have been provided before the conveyance can take effect and which are provided only against an agreement that the estate will be charged to secure them. Indeed, in many, if not most, cases of building society mortgages there will have been, as there was in this case, a formal offer and acceptance of an advance which will ripen into a specifically enforceable agreement immediately the funds are advanced, which will normally be a day or more before completion. In many, if not most, cases the charge itself will have been executed before the execution, let alone the exchange, of the conveyance or transfer of the property .... the reality is that the purchaser of land who relies on a building society or bank loan for completion of his purchase never in fact acquires anything but an equity of redemption, for the land is, from the very inception, charged with the amount of the loan without which it could never have been transferred at all and it was never intended that it should be otherwise. The *"scintilla temporis" is* no more than a legal artifice and, for my part, I would adopt the reasoning of the Court of Appeal in Re Connolly Bros Ltd (No 2) and of Harman J. in Coventry Permanent Economic Building Society v Jones and hold that Piskor's case was wrongly decided." (See also Lord Jauncey at pages 857-863).

Such an approach has great significance for retention of title clauses. In Re Bond Worth [1980] 1 Ch 228 the judgment of Slade J proceeded on this basis that there existed a *scintilla temporis* in which the buyer became the owner of both the legal and equitable interests in the goods. However, this is difficult to reconcile with the practical realities of the case since the seller (Monsanto) would not have agreed to supply the goods but for the retention of title clause. It appears, following Abbey National, that the issue of priority depends upon whether or not the purchase money security interest precedes the exchange of contracts so that there is nothing upon which the prior debenture, with its after-acquired property clause, may bite.

Title retention devices are no more registrable charges under the new legislation than they were under the old. Under s 395(2) of the Companies Act 1985 (as amended) a "charge" is defined as :

> "... any form of security interest (fixed or floating) over property, other than an interest arising by operation of law; and "property", in the context of what is the subject of a charge, includes future property."

It is unlikely that this amendment alters the conventional legal position. Insofar as Professor Diamond suggested a wide definition of security to encompass rights of retention, this was envisaged within a much wider context of the reform of English personal property security law. (See Diamond, A Review of Security Interests in Property (1989) at 9.3.2.) A wide definition of security would catch *inter alia* consignment sales and finance leasing mechanisms. This is at variance with the common law position where a bailee has no general proprietary interest in the goods bailed to him. Without a clear direction that this was indeed the intention of the legislature, the conclusion must be that only conventional security devices need to be registered.

2. Super purchase money security interests.

In England, there has been a natural judicial reluctance to recognise retention of title clauses which have the effect of being super purchase money security interests. The real dilemma here, as we have seen, is that English law focuses upon form as distinct from economic function. The emphasis on property reservation is that it allows the owner to seize the property should the debtor fail in one of his primary obligations, most notably, the payment of the price. Essentially, the commercial purpose of property retention is only to ensure priority; the supplier is not retaining the asset itself but rather the right to use the asset to gain repayment of the debtor's debt. On the basis of this approach, if the supplier recovers the goods for failure of the contract, the supplier should not be able to claim any surplus profit made on resale. However, the SGA 1979 does not allow for this conclusion as a natural consequence of a sale transaction. Even so, the Court of Appeal in Clough Mill Ltd v Martin [1985] 1 WLR 111 suggested that it was possible for such a resale to take place without rescission, a point clearly made by Robert Goff LJ as follows:

> "Now, if the contract was still subsisting, instead of having been determined by the seller's acceptance of the buyer's repudiation, it would be perfectly possible to conclude, on the basis of an implied term in the contract, that the seller could only resell so much of the material as was necessary to pay the outstanding part of the purchase price, the rest to remain available to the buyer for the purposes of the contract, and that if, contrary to that term, the seller were to sell more than was necessary to pay off the balance of the price, he must account for the surplus to the buyer. On that basis, any part payment would be retaining any profits obtained on a resale. But, if the contract has been determined, such a term could not be given effect to, unless it were to be held, on a true construction of the contract that the term survived the determination of the contract upon the seller's accepting the buyer's repudiation, for which I can see no basis as a matter of construction. So the situation would simply be that the property in [the material] belonged to the seller who could exercise his rights as owner uninhibited by any contractual restrictions. He could therefore sell the material for his own account; though he would, I consider, be bound to repay any part of the purchase price already paid by the buyer which must be appropriated to the goods so sold, because such sum would be recoverable by the buyer on the ground of failure of consideration."

It is probable that a sale contract would be rescinded in this circumstance which was the conclusion of the House of Lords in Armour and Another v Thyssen EdelstahlWerke AG [1990] 3 All ER 481.

A closely related problem to the above issue arises out of "all liabilities" retention of title clauses. It is significant that the seller in Armour would not have a special PMSI under the UCC. As a matter of principle, the buyer must be treated as the "owner" of the goods when he has fully paid for them~~, otherwise, the clause will be void for~~ total failure of consideration. This assumes that the buyer has not received that benefit which he was entitled to expect under the contract, i.e. the passage of general property in the goods. Where the supplier recovers only part of the goods delivered to the buyer because the latter may have disposed of the goods through "consumption" in a manufacturing process or sub-sale, this does not, in itself, preclude the buyer from claiming a proportion of any money paid over to the seller if it can be demonstrated that there had been a valid delivery of goods under severable contracts. Of course, in the Romalpa context, the issue is whether the price is apportionable and a distinction should be drawn between a partial failure of consideration which would not support a claim for money paid and a total failure of part of the consideration. This is the point which Robert Goff LJ made in Clough Mill when he said that the seller would "be bound to repay any part of the purchase price already paid by the buyer which must be appropriated to the goods so sold [by the seller after repossession] because such sum would be recoverable by the buyer on the ground of failure of consideration."

It would appear that the treatment of an "all liabilities clause" as a charge is likely to be more beneficial to the seller than a retention of title clause. For example, if the supplier delivers goods under separate contracts and is paid in full under one contract but not for the other, it follows that if the supplier repossesses the goods and sells them, he will have to account to the buyer for the sums the seller received under the first contract. This is pertinent when the price achieved in re-selling the goods is less than the combined value of the two contracts. The reason for this is that whereas a seller can treat non-payment of part of the purchase price under a single contract as a breach of the entire contract, a seller who has entered into several contracts cannot treat a failure to make payments under one contract as a breach of the other contracts.

UNCONVENTIONAL SECURITY DEVICES AND INSOLVENCY

One major tension which exists in the formal law surrounding contractual retention of title mechanisms is that suppliers feel compelled to use such clauses as a result of the law's failure to recognise the priority of their claims on corporate insolvency, whilst many insolvency practitioners regard these clauses as anathema to the speedy disposal of insolvencies as well as eroding the debenture holder's priority position. Although insolvency proceedings promote the collective will, it is doubtful whether the repossession of collateral by the secured creditor should interfere with this bankruptcy goal since if the secured party's collateral is worth more to the firm than to the third party, that collateral should end up back in the hands of the firm notwithstanding its repossession by the secured creditor in the interim. In practice though, there is no doubt that such repossession would hinder efforts to preserve the firm as a "going concern", and there may be substantial costs involved in repossession and the subsequent repurchase. One way of balancing the tensions here is to substitute for a secured party's actual substantive rights a requirement that the secured creditor accept the equivalent value of those rights. There is nothing anomalous in this approach because if the firm is worth more as a going concern than if it is broken up, giving the secured creditor the benefit of his bargain should not prevent a firm from staying together. Indeed, a failure to recognise the secured creditor's rights in full would prejudice the insolvency goal of ensuring that assets are used to advance the interests of everyone.

The Cork Committee (Insolvency Law and Practice (1982) Cmnd 8558) recommended treating the retention of title clause as a security interest and proposed a moratorium of 12 months from the commencement of a receivership with regard to the benefit of enforcing a reservation of title clause. The principal recommendations of the Cork Committee are to be found in paragraph 1650 of the Report and are set out as follows:

"(a) During a period of 12 months from the commencement of a receivership or an administration a seller should be prevented from exercising rights and remedies flowing from a reservation of title clause in a contract for the sale of goods and a receiver or administrator should be allowed to deal with the goods in a manner inconsistent with the title of the supplier.

(b) If the receiver or administrator sells the goods he should be obliged to account to the supplier for the proceeds of sale up to the amount secured by the reservation clause.

(c) If the receiver or administrator uses the goods in the manufacture of some product the proceeds of sale of the product should be applied in or towards the repayment of sums secured on reservation of title clauses affecting any of the constituent parts of that product.

(d) In the event of the proceeds being insufficient to pay all suppliers of goods under reservation of title clauses, the claim of each supplier should abate proportionately to the respective costs to the company of acquiring the goods incorporated in the product."

Neither the White Paper (A Revised Framework for Insolvency Law (1984) Cmnd 9175) nor the 1985 and 1986 Insolvency Acts gave a discussion on reservation of title clauses, presumably because the approach of the Cork Committee was deemed to resolve the matter. Nevertheless, these recommendations were not wholly accepted by the Government so that the provisions affecting reservation of title clauses are scattered throughout the Insolvency Act 1986. The moratorium idea was partially accepted in relation to the new office of administrator created under the Act who has an official function as a corporate rescuer. Consistent with this goal, no steps can be taken to enforce a retention of title clause without either the consent of the court or the administrator. (s10(1) Insolvency Act 1986) The administrator will have to notify all known creditors of the company under s21(b) of the Act, presumably advising them of his appointment and any claim they may have, for example by way of set-off or retention of title clause. Once an order is in force, s12(1) of the Insolvency Act 1986 provides that "every invoice, order for goods, or business letter which ... is issued by or on behalf of the company or the administrator" on which the company's name appears has to state that the company is now subject to such an order.

It is interesting that the approach taken under the 1986 Act concentrates upon economic substance rather than legal form. Consequently, the moratorium provisions extend to hire purchase agreements, chattel leasing arrangements (i.e. a bailment of goods capable of subsisting for more than 3 months) and a retention of title clause. Section 10 refers to the period between the presentation of a petition for an administration order and the making of an order or the dismissal of the petition. During this period, no security can be enforced and goods cannot be repossessed without the leave of the court. Section 11 refers to the period of the administration order and the moratorium on enforcement is couched in similar terms, but with the additional option of this taking place with the consent of the administrator. Strangely, the definition proffered for a retention of title clause under s251 of the Act to which the moratorium provisions attach would have, in any case, extended to all three credit instruments. This provides:

> "'retention of title agreement' means an agreement for the sale of goods to a company, being an agreement -
> (a) which does not constitute a charge on the goods, but
> (b) ~~under which, if the seller is not paid and the company is~~ wound up, the seller will have priority over all other creditors of the company as respects the goods or any property representing the goods."

Although paragraph (a) is accurate in the sense that reference can be made to a "charge" as being registrable under the Companies Act 1985 (as amended), more difficulty is presented with paragraph (b). This is because the seller is not seeking "priority over all other creditors" *strico sensu,* rather, he is seeking recovery of the goods as a proprietor and not as someone with a security interest in the goods.

The moratorium provisions will be excluded by an automatic termination clause upon the presentation of a petition for an administration order. Essentially, the effect of such a clause would be to end the debtor's interest in the goods thereby preventing him from being in possession subject to a (valid) retention of title agreement. An *ipso facto* termination provision is a standard term in hire purchase agreements where it is linked to the insolvency of the hire. In that context (where an option to purchase is provided) it would seem contrary to the principle of the equality of creditors, especially if the trustee in bankruptcy offers to tender the balance of hire purchase charges. Nonetheless, the efficacy of the clause is well established and, by analogy, may be extended to the reservation of title context.

One of the most important features of the Insolvency Act 1986 is s15. What is anticipated here is that the administrator can dispose of the goods in the company's possession which are held on retention of title as if they were unencumbered by the company. This is achieved by applying for a court order to authorise disposal and the court, in making the order, has to be satisfied that one or more of the purposes specified in the administration order will be satisfied. In this event, suppliers of goods under effective retention of title clauses will receive the net proceeds of sale, or if they are determined by the court to be less than the market value of the goods, sums will be provided to make up the market value (s15(5)(b) Insolvency Act 1986). Nevertheless there are important limitations here: First, the court is under no obligation to view invoice value at the time of supply as "market value" at the time of disposal; Secondly, there is no mechanism by which a supplier of goods on retention of title can object to disposal. At the same time, s27 of the Insolvency Act 1986 provides that any creditor or member can apply to the court for relief on the grounds that the company's affairs, business or property are being, or will be, managed by the administrator in a manner unfairly prejudicial to the interests of some part of the members or creditors. In this event, the court may under s27(4) discharge the administration order. Thus it would appear prudent for the administrator when using the goods to pay at least the use value of the goods. This action will prevent an application to the court by the seller on the ground of prejudice under s27 of the Insolvency Act 1986.

There are no provisions equivalent to ss10 and 11 of the Insolvency Act 1986 to confer a moratorium on security enforcement during the existence of an administrative receivership. Although s 43 of the Act gives similar powers to those enjoyed by the administrator under s15, it seems retention of title clauses are excluded. This is because s43 refers to the disposal of property subject to a "security" which is defined in s 246 (b) as meaning "any mortgage, charge, lien or other security". Such a conclusion is strengthened by the absence in s 43 of a separate reference included in s15 to hire purchase agreements encompassing retention of title clauses. The different treatment in terms of powers available to an administrator reflects the fact that he is now the official corporate rescuer. In contrast, the administrative receiver who is appointed by the holder of a floating charge is not seen in this light.

Undoubtedly, the failure of one company may lead to the failure of those who supplied it with raw materials and/or finished goods, that is, the "ripple effect" phenomenon. It could be argued that preventing such consequences is worth the cost of trying to keep the firm going and justifies placing burdens on a firm's secured creditors. As a matter of principle, this argument is difficult to follow. The wider effects of failure are hard to assess, and besides a characteristic of a market economy is that some firms will fail. Forcing creditors to keep assets in a relatively unproductive enterprise may limit the ability of the latter to invest in a more productive enterprise. Moreover, the approach is anomalous because it applies mainly in administration proceedings. Many firms fail with attendant deleterious social and economic consequences but are not subject to administration proceedings.

CONCLUSION

The Insolvency Act 1986 is a piecemeal reform, at least insofar as retention of title clauses are concerned. It seems that the validity of a retention of title clause has still to be determined. So, if the administrative receiver disputes the validity of the claim, the price of the goods will be paid into a joint deposit account, a practice which exactly mirrors the position of receiverships before the advent of the 1986 Act. There has been a general failure to recognise the economic reality of title retention contractual mechanisms as constituting security interests. Since the purpose of the property retention is only to ensure priority, the supplier is not essentially retaining the asset himself but rather the right to use the asset to gain repayment of the debtor's debt to him. Certainly this coheres with the accounting approach. Soon after the Romalpa decision, the Institute of Chartered Accountants in England and Wales recommended that a retention of title clause should be treated in the supplier's accounts as a sale since this is the intention of both buyer and seller (see Accounting for Goods Sold Subject to Reservation of Title, Institute of Chartered Accountants in England and Wales, Statement V24, now Statement 2:207) In the same vein, the accounting treatment of finance leasing and finance hire purchase contracts treats the property as an economic resource (see Accounting for Leases and Hire Purchase Contracts SSAP 21 (1987)) and seeks to prevent off balance sheet financing by requiring capitalisation of the resource in the accounts of the lessee/hirer.

The characterisation of systematisation of legal relations at different points in the sales process is particularly pertinent in the context of contractual retention of title mechanisms. This is especially so if the seller's right is categorised as "reserved" ownership since this would indicate that both parties have some kind of ownership. The emphasis on property reservation is that it allows the owner to seize the property should the debtor fail on one of his primary obligations. As such, it constitutes a security device. This inevitably invites scrutiny of a wider question, namely, the need or otherwise for registration of such interests (see Davies I.R., "The Reform of English Personal Property Security Law" (1990) 32 Malaya LR 88-113).

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Davies, Iwan R.

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