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Retention of Title Clauses in Australia

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Whither the Romalpa Clause? The Demise of the Retention of Title Clause in Australia?

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ABSTRACT

In jurisdictions such as Australia and the United Kingdom the Romalpa clause is regarded as a legal invention of great utility with respect of the commercial sale of goods. However, it is less popular in the United States. Moreover, the common law jurisprudence relating to the clause has raised a number of difficult legal issues that have arguably impeded its proper operation. Further, the consideration by the courts of Romalpa matters on a case-by-case basis may well have obscured significant and compelling public policy concerns relating to insolvency. As such, the courts of the common law will now be made to cede their control over the development of Romalpa jurisprudence to an all-encompassing Australia statutory scheme on personal property securities. Moreover, recent changes to the Corporations Act, also impose new conditions on Romalpa clauses. Yet the marketplace still needs these clauses in order to provide a general sense of security to sellers through the prospect of obtaining some payment in the event of the buyer’s insolvency. The law is presently in an interesting position in relation to Romalpa clauses as the common law has established one, somewhat ad hoc, set of rules, and the new Personal Property Securities Act scheme will likely consolidate many of these rules. Whether the Personal Property Securities Act, will resolve all the legal issues, or create new controversies, remains to be seen.

1. Introduction

One should be cautious in making such statements, but it would appear that the halcyon days of the Romalpa clause are long gone. When the English Court of Appeal decided Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd1 (Romalpa) the decision was hailed as a landmark one and for at least two decades thereafter Romalpa clauses were a significant aspect of commercial practice in Australia, the United Kingdom and other jurisdictions. In their various guises, and in the cases that followed in various jurisdictions, the deficiencies of the Romalpa clause became evident.2 These types of clauses have been unpopular in the United States in part due to the Uniform Commercial Code. The regulation of the clause by the courts of the common law is now under pressure in Australia. One of the most recent challenges to the operation of the Romalpa clause has emerged from the amendments to the Corporations Act to the Corporations Act 2001 (Cth) under the Corporations Amendment (Insolvency) Act 2007. However, the final blow to the common law’s dominion over the Romalpa clause may well be contained in the Personal Property Securities Act 2009 (PPS Act) that has recently been passed by the Australian Parliament.3 At this stage the reforms under PPS Act will commence in May 2011.4 The amendments to the Corporations Act and the PPS Act’s regulatory scheme, appear to impose significant new conditions on the holder of a Romalpa clause.5 Arguably, these amendments will greatly limit the role of the various State and Territory Goods Acts and
the common law with regard to Romalpa clauses. Whilst some limitations will be created, the real effect of the amendments is most likely to be to fetter and condition the application of Romalpa clauses.

Under the common law there has always been some confusion over the Romalpa clause’s inter-play with the law of charges, securities and the proper scope and reach of both the common law and equitable doctrines of tracing. Arguably, these issues, particularly those that relate to tracing, have impacted upon the utility of Romalpa clauses under the common law. But the common law will now be supplanted by a detailed Australian regulatory scheme. The regulation of Romalpa clauses under the Australia’s changes to the law on personal property securities is a smaller part of a much larger scheme. But it is significant and far-reaching nonetheless. It is still uncertain as to whether it will put to rest many of Romalpa’s common law controversies.

The advantages of the Romalpa clause have always been clear. Whilst, never a completely effective means of preserving priority against other creditors in the event of a buyer’s insolvency, Romalpa clauses still serve some useful purposes. If they are properly drafted they can preserve title. Romalpa clauses are also capable of creating a trust relationship between the buyer and the seller. If properly understood and applied a retention of title clause can preserve the seller’s interests whilst avoiding the various pitfalls that attach to this area of the law. In particular, under the current common law scheme, care needs to be taken to ensure that the clause does not stray into the territory of the law of charges and securities, and that if a trust is intended, that it is performed, and that rights under the clause are exercised when required.

In this article I will analyze the legal issues that have surrounded the Romalpa clause under the common law and will consider whether these issues will be resolved under the Australia’s new regulatory scheme. The Romalpa clause has served as a purported instrument of commercial certainty for sellers. But, as noted, there have also been a myriad of legal complications that have attended the clauses. The commercial need for the clauses will not disappear, but neither will the countervailing need of the business community for certainty in insolvency law. The law is presently in an interesting position in relation to Romalpa clauses as the common law has established one, somewhat ad hoc, set of rules and the PPS Act will likely consolidate many of these rules. Whether the proposed reforms, if implemented, will resolve all the legal issues, or create new controversies, remains to be seen.

2. The Romalpa Problem

Romalpa clauses exist because of the desire of the seller to retain property in goods to the exclusion of the buyer, in the event that the buyer does not pay for the goods or where the buyer goes bankrupt. The purpose of these clauses is to ensure that there is some form of commercial certainty for the seller so that they can minimize their risks in sale transactions. As Spink and Ong note:
A retention of title clause enables the unpaid sellers to escape from the economic malaise of unsecured creditors. Such a clause can protect the creditor against the prejudicial effect of “hiving down” in the event that the debtor-buyer is a corporation and a receiver is appointed against the corporation which can secure performance of other obligations and liabilities owing by the debtor-buyer…

The fear that most sellers would have is that in the event of the buyer’s bankruptcy they, as unsecured creditors, would be a low priority when compared to the buyer’s secured creditors. As such it is necessary to employ a legal instrument in contracts of sale to protect against that possibility. Under the law, parties are able to employ Romalpa clauses because the various Goods Acts allow for property to pass when the parties intend for it to pass. For example in New South Wales section 22 of the Sale of Goods Act 1923 (NSW) provides that property passes when it is intended to pass. Provided that the relevant Romalpa clause is a part of the contract between the buyer and seller then it will have a good prospect of being enforced as intended.

But there are several difficulties that attend the application of Romalpa clauses under the common law. Firstly, despite the intent of the parties, property in the goods in question may actually pass. Secondly, there has been some judicial opinion that suggests that the effect of a Romalpa Clause, depending upon its construction, may give rise to a security or to a charge. In Armour v Thyssen Edehlsstahlerwerke AG this arose as an issue. However, Lord Keith of Kinkel held that no security arose because the creditor never passed title in the goods. Thirdly, if a trust arrangement is intended there is also the danger that this may not have eventuated. This particular problem has two parts; the question of whether the trust has been validly formed under law and whether the trust is possible in fact. The latter part was at issue in Associated Alloys v ACN 001 452 106 Pty Ltd when the High Court gave consideration to the meaning of the word “proceeds” in the proceeds sub-clause of the relevant Romalpa clause.

Fourthly, if a trust has in fact been created, or if some other fiduciary relationship exists, then the issue of tracing, either under the common law or at equity, is enlivened. Fifthly, given that the seller under a Romalpa clause is a creditor, there are sound legal policy reasons for consideration to be given to the legitimate interests of all the buyer’s other creditors. This particular difficulty is the matter that the Chattel Securities Act 1987 (Vic), the Corporations Act and the new PPS Act would seek to address. Finally, in constant attendance to the subject of Romalpa clauses, is the task of contractual interpretation. Where the parties are in dispute and the courts are called upon to resolve the matter, the multi-faceted nature of the modern Romalpa clause, with its variety of contingencies a milieu of legal concepts, can pose significant interpretative problems.

The Australian High Court’s decision in Associated Alloys illustrates many of the issues that are at stake with respect of Romalpa clauses. In Associated Alloys the plaintiff, Associated Alloys, had been trading with Metropolitan Engineering and Fabrications Pty Ltd for a period of 15 years. During the course of dealings between the parties Associated Alloys attached reservation of title clauses to its invoices. These clauses were quite detailed and purported to have a legal effect beyond mere retention of title.
The clause in Associated Alloys serves as a useful example for the overall Romalpa problem. The Associated Alloys clause stated:

[1] It is expressly agreed and declared that the title of the subject goods/product shall not pass to the [buyer] until payment in full of the purchase price. The [buyer] shall in the meantime take custody of the goods/product and retain them as the fiduciary agent and bailee of the [seller].

[2] The [buyer] may resell but only as a fiduciary agent of the [seller]. Any right to bind the [seller] to any liability to any third party by contract or otherwise is, however, expressly negatived. Any such resale is to be at arms length and on market terms and pending resale or utilisation in any manufacturing or construction process, is to be kept separate from its own, properly stored, protected and insured.

[3] The [buyer] will receive all proceeds whether tangible or intangible, direct or indirect of any dealing with such goods/product in trust for the [seller] and will keep such proceeds in a separate account until the liability to the [seller] shall have been discharged.

[4] The [seller] is to have power to appropriate payments to such goods and accounts as it thinks fit notwithstanding any appropriation by the [buyer] to the contrary.

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

From mid-1995 Metropolitan entered into contracts with a Korean company, Lucky Goldstar, for the manufacture of steel products. The completion of the Lucky Goldstar contracts required Metropolitan to purchase steel from Associated Alloys. All of the steel provided by Associated Alloys was used by Metropolitan to manufacture products for the Lucky Goldstar contracts.

In 1996 Metropolitan went into receivership and then liquidation. At that point Metropolitan owed Associated Alloys US $197,911.29. Further, Lucky Goldstar owed Metropolitan $2,048,500. Associated Alloy’s claim at first instance was rejected by Bryson J in the New South Wales Supreme Court on the basis that the monies owing to Associated Alloys constituted an unregistered charge over Metropolitan’s book debts. Under the then s 266 of the Corporations Law the charge was void for want of registration. An appeal to the New South Wales Court of Appeal failed on the same basis. The High Court granted special leave to appeal.

In dispute before the High Court was the sub-clause that purported to create a trust relationship between the buyer and the seller. Both the Supreme Court at first instance and the Court of Appeal had found that the proceeds sub-clause had instead created a charge over the book debts. The view that the Court of Appeal took was that the proceeds clause was liable to frustration, were it to be interpreted upon its bare terms, as the buyer could simply elect to not receive the proceeds of the sale of the seller’s goods. That is,
once the sub-sale had occurred the buyer gained a book debt. If the buyer wished to
defeat the seller’s interest the buyer could assign the book debt to another party thereby
never receiving the actual proceeds and frustrating the seller’s interests. Accordingly, for
reasons of business efficacy the Court of Appeal decided that the proceeds clause created
a charge over the book debts.

The High Court was not convinced by this reasoning. The High Court noted that the
language of the parties was not inexplicit. The High Court disagreed with the Court of
Appeal’s view that the proceeds sub-clause had to be construed as a charge for reasons of
efficacy. The High Court observed that were the term “proceeds” to be construed to refer
to book debts or monies received as payment, the buyer could still frustrate the interests
of the seller. Moreover, the High Court placed particular emphasis on the clear
language of the parties. The majority stated:

The reasonable operation of the Proceeds Subclause is effected, as a matter of necessity,
by the implication of the above contractual term providing for the discharge of the debt
when a trust is constituted under the Proceeds Subclause "equal in dollar terms [to] the
amount owing by the [Buyer] to the [Seller] at the time of the receipt of such proceeds".
This clause is capable of clear expression and is so obvious, as a means of effectuating
the commercial interests of the parties, that if the subject had been raised with them they
would have replied "of course".

The Court found that an agreement to create trust had arisen from the sub-clause. However, the Court found that no proceeds, at least as they construed the term
“proceeds”, could be found to exist with respect of the clause. On this basis the High
Court found that the trust did not properly come into operation.

The High Court’s decision in Associated Alloys is both praise-worthy and puzzling. The
Court’s approach to the interpretation of the parties intent to create a trust displays a
common sense approach to the task of contractual interpretation. However, there has been
justifiable criticism of the rather artificial way in which the Court dealt with the term
“proceeds” in the sub-clause. It seems strange, given that a trust relationship creates
fiduciary duties, and that a fiduciary relationship should allow the seller to trace into the
buyer’s debts, that the High Court should rule that “proceeds” cannot relate to book
debts. Further, given that Gummow J during the special leave application noted that
“proceeds” is a commercial term it seems unusual that the Court would then ascribe to
the term a meaning that is somewhat limited in its commercial operation. Accordingly,
sellers can take both comfort and caution from the judgment of the High Court in
Associated Alloys.

In the section below I will explore some of the legal issues raised by Romalpa clauses
generally, and in Associated Alloys specifically, that are typical of Romalpa clause
controversies under the common law. These are the rules that the Australia has now
sought to ‘codify’ in a new regulatory scheme. As will be seen below these rules are
manifestly unclear in both their scope and operation.

3. Interpreting a Romalpa Clause under the Common Law
To illustrate the ways in which the legal complexities surrounding the use of a Romalpa clause can arise it useful to consider a basic fact situation in which a retention of title may be employed. Consider that we have a Company A. Let us imagine that Company A sells timber and engages to do so with Company B. Obviously, Company A would be concerned about the risk of not receiving full payment from Company B. Thus, as part of the sales contract Company A may include a Romalpa clause such as that used in Associated Alloys. The attraction of this clause is that it purports to cover a number of different situations, all of which might reasonably occur at some point in the future. So Company A is being prudent and is acting to safeguard its interests. If Company B agrees to the clause then it validly forms part of the contract.

Upon receipt of the goods Company B may contract to then on-sell them to Company C. Alternately, Company B may contract with Company C, such that the former is bound to use the timber to manufacture some other good, before selling that to the latter. For the purposes of the exercise, assume that neither Company B nor Company C has paid their respective immediate seller. If Company C acquires possession of the newly manufactured timber goods it would be impossible for Company A to retain those goods. However, Company A may, under the common law or equity, wish to trace into the debt that Company C owes to Company B. Further, if Company B were to go bankrupt a dispute would likely arise between the administrator and Company A. This would most likely be the case if Company B still had timber which it had received from Company A but which has not been transformed into another good, or where Company B is owed payment by Company C. The stage would be set for a typical Romalpa dispute.

The matter of interpretation

The particular terms of the retention of title clause are of paramount importance. In the various cases that have come before the courts different clauses have been involved. It follows that the legal issues in dispute have varied along with the respective clauses. It is important also to look at all the facts surrounding the case, in particular the way that the parties have, or have not, given effect to the retention of title clause. As Williams J noted in Puma Australia v Sportman’s Australia:

> In my view the terms of the agreement are of critical importance, and little assistance is gained by using technical terms such as trustee, bailment and conversion in defining the rights and obligations of the parties. The court can, and will, give effect to an agreement governing commercial relationships and providing that legal and equitable rights and remedies should co-exist.

Given that Romalpa clauses now try to cover a variety of contingencies, it is likely that the types of clauses employed by parties will be multi-faceted and that several sub-clauses will be involved. The various sub-clauses will no doubt raise a number of issues and basic concepts that surround this area of commercial law. Consider the retention of title in sub-clause 1 of the Associated Alloys case:
It is expressly agreed and declared that the title of the subject goods/product shall not pass to the [buyer] until payment in full of the purchase price. The [buyer] shall in the meantime take custody of the goods/product and retain them as the fiduciary agent and bailee of the [seller].

This sub-clause provides for the basic retention of title. It provides that when full payment has been made the title will pass to the buyer. But in the interim the buyer is to be a fiduciary agent and a bailee of the seller. An interpretative issue arises in relation to the duties now incumbent upon the buyer. There are obvious differences between an agent and a bailee. An agent acts on the behalf of a principal with respect of certain defined purposes. As the High Court noted in *Petersen v Moloney*:

> The legal conception of agency is expressed in the maxim “Qui facit per alium facit per se”, and an “agent” is a person who is able, by virtue of authority conferred upon him, to create or affect legal rights and duties as between another person, who is called his principal, and third parties.”

The powers of a fiduciary agent are rather more circumscribed. The fiduciary agent's powers are limited to those enunciated in sub-clause 2. In contrast to agency, a bailment requires the delivery of goods from the bailor to the bailee, with the requirement that they either be 'redelivered to the bailor or dealt with in a stipulated way.' There is an overlap between the two roles and, under certain circumstances, fiduciary obligations can be attributed to a bailee. However, given the agency role of the buyer, if sub-clause 1 is read in conjunction with the other sub-clauses, such as those that provide for subsequent sale, it is unclear whether retaining title to the seller is a paramount concern of the parties. This inevitably makes the question of contractual interpretation more difficult.

There are two particular concerns that arise in relation to interpretation, and that relate most to sub-clause 1, with regards to agency and bailment. Firstly, if the parties wish for the buyer to act as a fiduciary agent of the seller, then logically this would be in relation to the matter of sale to third party buyers. But if this role for the buyer is contemplated by the parties, then a right to sell, as evinced in sub-clause 2 and sub-clause 5, arises and necessarily burdens any contractual right on the part of the seller to retain title and to reclaim the property. Further, the clause explicitly gives the buyer the right to use the goods in some other manufacturing process. This raises a concern voiced by Slade J in *Re Bond Worth*:

> where an alleged trustee has the right to mix tangible assets or moneys with his own other assets or moneys and to deal with them as he pleases, this is incompatible with the existence of a presently subsisting fiduciary relationship in regard to such particular assets or money.

The simple answer to this view, at least where the ability to mix goods is concerned, may be that where the rights of the fiduciary are strictly conditioned, as were by the terms set out in *Associated Alloys* and other cases, then there is no real incompatibility with the right created and the fiduciary obligation. The fact that there is direction from the seller and the fiduciary duty would preserve the right of tracing.
The second concern that might arise is whether the seller can require redelivery of the goods, where the buyer fails to satisfy the purchase price, in the absence of an express condition of redelivery. That is, there is a question as to whether the seller can enforce the bailment. It would stand to reason that a right of redelivery can be implied into the contract. But it is a requirement of implied terms and contract law that the term to be implied does not contradict an express term of the contract. Further it must be capable of clear expression. The problem that might emerge, unless the parties are careful in the drafting of their agreement, is that the right of redelivery is obvious but the time and exact circumstances under which it can take place are less clear.

Has Property Passed?

Having defined the basic terms in the sub-clause it is pertinent to consider whether property has passed after the subsequent sale to Company C. This will determine whether the sub-clause has any continuing operation in the hypothetical problem at hand. When the goods are sold from Company B to Company C it is not possible for sub-clause 1 to have any continuing operation. This was the view taken by Bryson J when Associated Alloys was decided in the NSW Supreme Court. Bryson J stated:

In my opinion the first subclause does not have continuing effect on title to goods if the goods referred to ("the subject goods/product") go out of existence or pass into the ownership of a third party. The clause must be read as a whole, and the second and fifth subclauses show clearly that it was contemplated that the purchaser might use the goods in a manufacturing or construction process, and that when that happens a different regime is to apply. … The first subclause is not intended to operate in some artificial way so as to attempt to maintain title in goods which have become an accretion to other goods, or have been incorporated in a new product, or have gone out of existence in some other way.

Where the goods do remain in their original state, and are in the possession of the buyer, the retention of title clause is still capable of operation. But when Company C’s property interests intervene the sub-clause ceases to have operation. Further, even where the goods are still in Company B’s possession, if they have been transformed then Company A’s property interests should cease. This stands to reason as in transforming the timber from Company A into some other timber product, Company B may have used other goods, from other sources, to create the good which it will sell to Company C.

All Monies Clauses - Is the Clause a Charge?

As discussed, one of the issues that arose in the High Court’s decision in Associated Alloys was whether the Romalpa clause was in effect a charge. In Associated Alloys the High Court found that the Romalpa clause, in particular sub-clause 5 (the Proceeds Subclause) was ‘an agreement to constitute a trust of future-acquired property.’ As such, it was not a charge. If the clause had been construed as a charge it would have been liable to have been registered under the Corporations Act. Such a charge can in fact be disregarded by an administrator under section 420 of the Corporations Act. But at any
rate, the charge would be void for the failure to register the charge. The issue that arose in Associated Alloys will likely continue to arise in Romalpa cases.

In the United Kingdom this issue has been in dispute in previous cases such as Armour, Borden and Clough Mill. In New South Wales this issue arose in Chattis Nominees Pty Ltd v Norman Ross Homeworks Pty Ltd (Receiver Appointed) (In Liq). There is a view that where an all monies clause exists, as it did in Chattis Nominees, the clause might more properly be viewed as a charge. Whereas, a basic retention of title clause, which attaches to a single contract, such as that in Armour, is not a charge. In Chattis Nominees the relevant Romalpa clause prevented title in goods from passing as such until other goods were also paid for by the buyer. In Chattis Nominees Cohen J noted the divergence of views on the issue of Romalpa clauses and charges. There was much academic commentary to suggest that under certain circumstances, such as those in Chattis, such a clause would operate as a charge. Cohen J paid particular respect to the arguments of Goodhart and Jones who argued that a clause that reserves title until all other debts are satisfied must be regarded as a security. However, this view did depend upon the possibility of the goods being resumed by the seller until all debts had been satisfied. Cohen J ultimately concluded that the clause in Chattis was not a charge. But he did so as he felt that he should follow the authorities in Romalpa, Puma, Armour, Clough Mill and Borden.

Given the conclusion reached in Chattis Nominees, and also on that point in Clough Mill, it might well be that a company such as Company A, knowing that it will be entering into a series of like transactions with Company B, would seek to employ an all monies clause. The advantage for the seller of the all monies clause is self-evident. The seller gets the whole of the value of the entirety of the series of transactions or as close to that amount as is possible. Viewed from the seller’s perspective the series of contracts is in fact one single transaction and the all monies clause reflects that view. But even where one is sympathetic to the motives of Company A it is difficult to go past the simple fact that the granting of a charge requires ownership of property and that further that when a buyer has fully paid for goods he should be able to consider himself the owner. Moreover, in agreeing to the clause it would seem as if the buyer for his part is granting the charge conditional on his paying for the specific goods under a particular contract. Accordingly, even though the terms of the clause used may refer to a retention of title something else is substantively at play.

There is a view, that perhaps the courts should look at the overall effect of the clause, rather than its specific terms, and decide on that basis whether a security or a charge has been formed. This is the substance over form approach, and arguably, the result might be different under this approach. The law here is unclear. Spink and Ong have suggested that there appears to be a divergence between the Australian approach, as illustrated by the High Court in Associated Alloys, and the UK approached, as evinced by the decision of the House of Lords in In Demand Information plc (in administrative receivership) and another v Michael Gerson (Finance) plc and another. In effect this is a conflict between a school of thought that favours the freedom of contract and one that favours an emphasis on the substance of the clause.
It should be noted that the all monies clause that was at dispute in *Chattis Nominees* is very different to the clause in *Associated Alloys*. The all monies clause seeks to retain property whilst other goods are unpaid. It is arguable that an all monies clause does go beyond the legitimate parameters of a retention of title clause.\(^56\)

Whilst the all monies clause is a tempting device it plays right into the difficulties created by the issue of charges and securities. As Goodhart and Jones note:

> If a true beneficial interest is reserved in goods supplied, it must follow that if after payment of the full purchase price of those goods the supplier recovers possession of them because of non-discharge of some other liability the supplier must refund the purchase price to the customer on the ground of total failure of consideration. But this would defeat the object of the clause, as it will almost always be the intention of the supplier that he should be entitled to recover the goods and resell them elsewhere without having to refund the purchase price. This, surely, can only be done if the clause is construed as creating a security for payment of the customer's debts to the supplier and not as a condition postponing the transfer of the beneficial interest.\(^57\)

Similar concerns were raised in *Puma Australia* as to the effect of all monies clauses. In particular, Shepherdson J noted that where there are regular transactions between the buyer and the seller the administrator would never be able to collect any moneys to which they would be entitled.\(^58\) It would seem that at least where all monies clauses are concerned, the clause should rightfully be construed as a charge or security. The purpose of the clause is to elevate the interests of the seller over that of the buyers other creditors. But where this would be given so wide a scope of operation, as would be the case with all monies clauses, it goes beyond the original narrow confines of the basic retention of title clause and should properly be construed as a charge or security.\(^59\) Further, even though Cohen J reached a contrary conclusion in *Chattis Nominees*, he was clearly impressed by the concerns raised by Goodhart and Jones.\(^60\) However, as Cohen J noted in *Chattis* the weight of judicial opinion suggests that all monies clauses are not charges.

**Tracing**

The demise of Company B, with debts owing to it from Company C, is an eventuality that Company A will have contemplated. Accordingly, the purpose of creating a fiduciary relationship is to preserve the possibility of tracing into Company B’s assets. As such, sub-clause 2 gets to the heart of the matter concerning Romalpa clauses because it raises the questions of both the fiduciary relationship between the buyer and the seller and the equitable doctrine of tracing. Sub-clause 2 provides:

\[2\] The [buyer] may resell but only as a fiduciary agent of the [seller]. Any right to bind the [seller] to any liability to any third party by contract or otherwise is, however, expressly negatived. Any such resale is to be at arms length and on market terms and pending resale or utilisation in any manufacturing or construction process, is to be kept separate from its own, properly stored, protected and insured.

The ability to trace into the financial obligations owed to a party will rest on whether the party is a fiduciary to the would-be tracer. In our hypothetical problem, as noted above,
once the property is sold from Company B to Company C, it will be beyond the power of Company A to recover the goods. What follows is that Company A will have a right to the proceeds of B’s sale to C. As McPherson ACJ noted in *Puma Australia* it is the result at both equity and the common law that a person in such a position would have the right to the proceeds. McPherson ACJ noted, “If I sell or convert your property, you are ordinarily entitled to the proceeds.” As Grantham and Rickett note:

> Tracing is an evidential process by which one asset is permitted to stand in the place of another asset for the purpose of whatever rights or claims the plaintiff may have had in respect of the first asset.

The right to trace is recognised at the common law. Its particular limits are uncertain. However, once the monies have been received and have been mixed in with other money, or put into some other form, the common law right to trace will cease to exist. McPherson ACJ noted in *Puma* “the common law, acknowledging that “money has no earmark”, abandons the pursuit to equity.”

If tracing is acknowledged as an evidential process then the logical first step in any tracing enquiry would be to place the seller’s assets against some other asset of the buyer. But the asset identified is relevant because tracing under equity or the common law will likely lead to different consequences because the two are mostly distinct. Further, if the asset is the debt rather than any funds receiver by the buyer then it is likely also that the results will be different.

The Australian authorities on tracing establish that the courts will at least attempt to trace into the buyer’s assets. However, in *Chattis Nominees* and again in *Associated Alloys* the question of tracing was tied to the trust arrangement created under the relevant Romalpa clause. Conceptually, this might be a mistake, if in fact the tracing remedy bases itself on the creation of a fiduciary relationship rather than just the trust relationship. Admittedly, a trust imposes a fiduciary obligation on the trustee (the buyer). But sub-clause 1 of the *Associated Alloys* clause explicitly made the buyer a fiduciary agent of the seller. On that basis tying the tracing remedy to the trust arrangement alone seems wrong.

If tracing is tied to the trust arrangement then different results might emerge. In *Chattis Nominees* the type of trust at issue was a defeasible trust. Effectively under a defeasible trust the seller would get the proceeds of the sale of the goods, whereas under an indefeasible trust the seller would get a proportionate share of the proceeds of the product manufactured and sold by the sub-buyer. In *Chattis Nominees* Cohen J found that Chattis could retain property in the furniture that it had sold to Norman Ross and which had not been sold. However, with respect of the goods sold by Norman Ross, Cohen J opined that there would be little chance of easy tracing. In dealing with the issue of tracing Cohen J showed particular concern with how the trust operated. The key issue appears to have been the preservation of the fiduciary obligation under the putative trust. The particular point that Cohen J was making is that where a buyer has the right to re-sell, and is not strictly required to keep monies separate, he is a debtor and not a trustee.
Essentially the remedy to trace emerges from the property right that the seller had in the original chattel good.75 There has been an academic view that tracing emanates from the rule against unjust enrichment.76 On either view to both base the tracing remedy and to confine its operation to the trust arrangement would appear unduly restrictive.77 However, it may not be the basis of the tracing right that is problematic so much as the operation. In effect we are asking what asset is it that the right of payment stands against. This can be either a physical asset such as a good, monies received or a debt. As Birks states, “Tracing is not a hunt for the original asset but an attempt to discover in which different asset the value of the original asset has been invested and is now located. The new asset implies a new right.”78

Returning to our hypothetical situation, if Company B has manufactured goods out of Company A’s goods, and these manufactured goods have yet to be sold to Company C, then theoretically it should be simple for Company A to trace into these goods. That is, the goods manufactured by Company B would stand against the goods sold by Company A. Upon the sale to Company C, Company A would simply be required to account to Company B for any excess amount because equity and the common law do not support unjust enrichment.

The jurisprudence suggests that the tracing remedy will be more or less ineffective unless the asset that corresponds to the original asset can be found. Where the goods manufactured by Company B, from A’s asset, exist unsold this evidentiary process is not problematic. But where the goods have been sold to multiple customers and monies have been mixed the evidentiary process is easily frustrated. This would support the approach of the courts in Clough Mill, Puma and Chattis Nominees in emphasising the paramount importance of the obligation of the buyer to account for the proceeds of the subsequent sale.79 As such, tracing may provide no benefit to the seller under circumstances where the goods are sold to multiple customers.

But this does not resolve the matter of whether tracing would be effective where an easily identifiable debt remains. If Company C owed a debt to Company B, which clearly arose due to the transaction between Company A and Company B then tracing would not be impossible.80 But at this point the difference between equity and law becomes important. Further, any amendment to the statutory law relevant to this area should also pay heed to the differences between equity and law.

If Company C owes a debt to Company B, arising in the manner described above, there would be two parties seeking payment; Company A and the administrator of Company B. Both are seeking to claim the benefit of the buyer’s contractual right. The seller asserts that the buyer’s contractual right is held on trust for the seller whereas the administrator is claiming priority over the seller. The issue would then be one of priority as between Company B’s appointed administrator and Company A. This is where the characterization of the tracing right becomes fundamentally important. If the dispute can now be characterized as one of priority then the interplay between law and equity, and the hierarchies contained therein, becomes fundamentally important. Should this be an acceptable proposition then one might even venture as far as to borrow a rule from land
law and employ the law of priorities to decide that a later legal trumps a prior equitable claim.\textsuperscript{81} If the tracing remedy is a right \textit{in personam} – that is, a right of an equitable nature, then it will be subservient to the legal right of the administrator. But if the right is one under law then the prior legal right is superior to the later legal right.\textsuperscript{82} If the common law right of tracing has given way to the equitable doctrine of tracing, because there are no clear monies identified to trace,\textsuperscript{83} then the right that Company A has is a right in equity to trace into the debt owing to Company B. The right that the administrator has is a right in law, emerging under contract, to receive payment on the debt.

Even where the two rights are legal rights, the seller may still lose priority to the administrator if proper notice has not been given. As Mason an Deane JJ noted in the case of \textit{Heid v Reliance Finance}:

\begin{quote}
Where the merits are equal, the general principle applicable to competing equitable interests is summed up in the maxim qui prior est tempore potior est jure - priority in time of creation gives the better equity. But where the merits are unequal and favour the later interest, as for instance where the owner of the later equitable interest is led by conduct on the part of the owner of the earlier interest to acquire the later interest in the belief or on the supposition that the earlier interest did not then exist, priority will be accorded to the later interest.\textsuperscript{84}
\end{quote}

Fairness would dictate that the administrator has every right to know of the seller’s interest and should not be blamed for unwittingly disposing of that interest. As will be discussed below, this position is more or less reflected in the amendments to the Corporations Law.

\section*{The Meaning of Proceeds}

Given the discussion above, the question of the meaning of the term “proceeds” may well be a moot point. But the discussion above relied upon the issue of priorities being decided upon under the equitable doctrine of tracing or where the seller, with the rights being equal, has sat upon their rights or given a better value to the administrators rights in some other way. If that situation does not arise then the meaning of proceeds still needs to be addressed.\textsuperscript{85}

In \textit{Associated Alloys} sub-clause 3 suggested the creation of a trust arising out of the book debt owing to the seller. But the High Court in \textit{Associated Alloys} declined to hold that a book debt constituted “proceeds” for the purposes of sub-clause 5. Given that the term “proceeds” must have the same meaning in sub-clause 5 as it does in sub-clause 3 this creates an interpretive problem.\textsuperscript{86}

It is clear that what Company B owes to Company A is a book debt. The same is true of Company C’s debt to Company B. A book debt can be defined as follows:

\begin{quote}
… it is an entitlement to payment. Once payment is made by cheque or otherwise, the book debt is extinguished by the payment. Hence the entitlement to the book debt no longer exists….\textsuperscript{87}
\end{quote}
An entitlement to pay is a chose in action. Furthermore, a chose in action is classified as property under the law. Thus, at least where tracing is concerned, there should be some asset which can easily stand in place of the original asset. The question before the High Court in Associated Alloys was whether proceeds referred to monies received or to book debts. The majority of the High Court held:

The proper construction of the phrase "the proceeds" is revealed by a consideration of the Proceeds Subclause as a whole. The phrase has the meaning employed by Sir George Jessel MR in his ex tempore judgment in In re Hallett's Estate. Knatchbull v Hallett, where the Master of the Rolls eloquently states the principles of tracing in equity. The phrase "the proceeds" is to be construed as referring to moneys received by the Buyer and not debts which may be set out in the Buyer's books (or computer records) from time to time. The concluding sentence of the Proceeds Subclause would be strained if the phrase "the proceeds" were to include book debts. In the event that a debt were subject to conditions, it may prove to be difficult to determine when the Buyer is in "receipt" of that intangible obligation. Moreover, to attempt to equate a chose in action, "in dollar terms", to a sum of money, namely "the amount owing by the [Buyer] to the [Seller] at the time of the receipt of such proceeds", is, at the very least, conceptually problematic. In contrast, limiting the phrase "the proceeds" to refer to payments made to the Buyer results in this equation operating with certainty.

On a practical level immediate payment is unlikely to occur. So when the transaction takes place a book debt is created. This must then be what the buyer has ‘received’ when the sale is made to his customer. It is difficult to agree with the High Court’s view that the characterization of “proceeds” as a chose in action is conceptually problematic. As noted, a chose in action is property. However, it is easier to agree that the proceeds might not have been set aside if the debts are mixed in with several other book debts.

**Giving Effect to a Trust**

There are two issues that need to be dealt with in relation the issue of whether a trust has arisen. Firstly, the question arises as to whether the agreement for a trust is capable of operation. Associated Alloys makes it clear that the provision for a trust within the terms of a contract will be effective with respect of the formation of a trust. Secondly, it must be determined whether the trust has in fact operated according to the terms specified by the parties. This part appears more difficult for practical reasons. In the ordinary course of a business monies received from sales to customers will not normally be specifically set aside in separate accounts to satisfy the debts owing to sellers. Instead, these monies will usually be placed in one account or another with the general understanding that the seller will be paid at a later date. But the High Court in Associated Alloys and the Queensland District Court in Rondo Building Services v Casaron, held that where monies were not put aside into separate account the trusts never operated.

This is a restrictive, though arguably correct, view. However, it could be argued that if the trust has properly formed the beneficiary should have recourse to compel the performance of the trust. That might suggest that funds, equivalent to those that were to
be set aside, should be found in the event of the buyer’s insolvency. But, this might prove unworkable given the rules of insolvency and the need to rank creditors.

4. The Corporations Act and the Proposed Reforms to Personal Securities Law

Having explored the uncertainties of the common law’s ‘regulation’ of Romalpa clauses it is now apt to consider the current and impending statutory regulation of this field. In this section I will first canvass the underlying policy reasons for regulation and then specifically consider the two relevant statutes. There are two statutes that need to be addressed. The first is the Australia’s forthcoming reforms to the law of personal property securities. At the time of writing the PPS Act’s reforms are yet to commence. However, it is useful to consider the proposed changes with regard to the fundamental policy issues that this area of the law raises. The second is the question of the application of the Corporations Act to the problem of Romalpa clauses.

Traditionally, the legal question of a charge or a security existed was a straight-forward matter. Unless a debt was created and attached to some property which was owned by the debtor there could be neither a security nor a charge. The very nature of a retention of title clause excludes this possibility. However, in its substantive nature the retention of title clause operates like a fixed or floating charge. That is it either attaches to specified property or to a category of property and discharges only upon the payment of debt.

But the policy question is somewhat more difficult. The policy question as it relates to the PPS Act will be discussed below. However, it is useful at this point to canvass the underlying policy issues. The point has been more or less made by Kirby J in Associated Alloys that equity has a poor public conscience. This is an important point and one that highlights the broader stage upon which the Romalpa clause exists. When an insolvency occurs the entire market is affected. Public order in the market requires an organised insolvency process rather than a ‘helter skelter’ grab for assets. For a seller to emerge with an unregistered interest and to claim and enforce priority over other creditors frustrates the process. In Associated Alloys Kirby J was greatly concerned with the impact that the Romalpa clause would have on other players in the market, particularly if they were originally unaware of its existence. During oral argument Kirby J stated:

The other question which is, it seems to me - I mean, you deal with it how and when you want - but a large issue of whether or not by their private dealings parties can make these arrangements which have the effect against the world, against third parties who deal with the corporation and subsequently it becomes insolvent, I mean this is the Corporations Law issue, and so far as I am concerned it is a very real question as to whether you can go making your own little clauses which are happily made as between you but which have, as you assert, consequences for completely innocent and ignorant, in the sense of unknowing, third parties who are dealing with the corporation in the meantime and who, it is the duty of the voluntary administrator to protect.

To turn the Romalpa clause into a security or a charge would have three appealing effects. Firstly, it would enable the market to see the true financial position of the buyer.
This position might be disclosed on an examination of the buyer’s books. But this would make the process easier. Secondly, it would facilitate an orderly insolvency process and reduce unnecessary litigation. Thirdly, it might side-step some of the more complex legal issues that seem to bedevil this area of the law.97

The argument against this is that the transactions to which Romalpa clauses relate are usually short to medium term. To require registration of these transactions would effectively impose more regulation upon the markets and burden their operation. Some rules are necessary for business, but other rules, though helpful in some respects, simply hinder commerce. Further, there is nothing to suggest that Romalpa controversies emerge with such a frequency as to make registration an absolute imperative.

5. The Personal Property Securities Act 2009

The PPS Act represents a massive undertaking by the Australian Government to radically change the area of personal property securities law. The impact on Romalpa clauses is incidental, but no less deliberate, and the PPS Act, will dramatically change the playing field. The PPS Act will commence operation in May 2011. The commencement date of 2011 was decided by the Council of Australian Governments in light of the breadth of the reforms and the need of the marketplace to be allowed significant time to adjust to the reforms. It is certainly worth considering the PPS Act considering the gravity of the proposed changes.98

In this section of the article I will canvass the proposed changes and consider the impact that they would have upon Romalpa clauses. My analysis will not focus on the detailed provisions of the PPS Act rather I will comment on the general nature of the proposed rules.

The PPS Bill was introduced into the House of Representatives on 24 June 2009 by the Australian Attorney-General, the Hon. Robert McClelland MP. In his Second Reading Speech the Attorney-General stated:

… The bill will replace the existing complex, inconsistent and ad hoc web of common law and legislation, involving over 70 Australia, state and territory acts. It will implement a single national law, creating a uniform and functional approach to personal property securities. Personal property is any form of property other than land. It includes goods such as cars, machinery, even crops and livestock, financial property such as currency and letters of credit and intangibles such as intellectual property rights. The bill will apply to all transactions which create an interest in personal property that secures a loan or other obligation.99

The PPS Act does offer the attraction of a single unitary regulatory scheme. At the time of writing the PPS Bill has twice been before a Parliamentary Committee and there have been numerous opportunities for stakeholders to comment on the basic rules now contained in the Act. That said, the last iteration of the PPS Bill, the 2009 version, which is now the PPS Act, was criticised for having been produced a bare three months after the
Standing Committee on Legal and Constitutional Affairs commented on the 2008 Exposure Draft legislation.  

These matters aside, the PPS Act will impact upon the law relating to Romalpa clauses through the definition of securities and the new rules relating to enforcement of these securities against third parties. It is likely that the substantive effect is that the PPS Act will involve outcomes that are much the same as those reached under the law as it presently stands.  

Under the PPS Act a national register would be created. The Attorney-General’s Department’s description of the register appears very similar to that of the trademarks register. That is, the register would be web-based and accessible at all times. The holder of any security, as defined under the PPS Act, would need to register their security. The registration would enable the holder of the security to access the legislative scheme that would be set up under the PPS Act.  

The PPS Act has effectively been on Australia’s legislative agenda since 2006. However, concerted efforts at reform began in haste under the Rudd Government in 2008. There has in truth been substantial consultation between the Australian Government and a variety of stakeholders. But the proposed scheme will have a dramatic market-wide impact. For our purposes we need only be concerned with those changes that will impact upon Romalpa clauses. It does seem safe to say that the rules that will affect Romalpa clauses have remained constant in the various iterations of the PPS Bill.  

It is clear that the definition of a security interest under the PPS Act will cover Romalpa clauses. The PPS Act defines a security interest as follows:

12 Meaning of security interest

(1) A security interest means an interest in relation to personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property).

Note: For the application of this Act to interests, see section 8.

(2) For example, a security interest includes an interest in relation to personal property provided by any of the following transactions, if the transaction, in substance, secures payment or performance of an obligation:

(a) a fixed charge;
(b) a floating charge;
(c) a chattel mortgage;
(d) a conditional sale agreement (including an agreement to sell subject to retention of title);
(e) a hire purchase agreement;

The security interest would attach to the property in question under the agreement. That is, there would need to be an identifiable subject matter, referred to as collateral, to which the security interest relates. Under the PPS Act attachment would occur when such goods are identified. The attachment would be “perfected” when the security interest is...
registered in the proposed PPS register. The approach of the Australian Government represents a significant shift away from the position established by the High Court in *Associated Alloys*. That approach vindicated the freedom of contract. The new PPS Act adopts a substance over form approach. The Explanatory Memorandum to the PPS Act states:

A security interest is an interest in personal property provided for by a transaction that secures the payment or performance of an obligation. In determining whether or not an interest is a security interest, the Bill takes a functional approach and focuses on the form of the transaction.\textsuperscript{107}

The rationale for including Romalpa clauses within this system has been addressed above. However, it is worth noting that the support for the reforms has not been unequivocal. The Victorian Bar and some law firms have expressed reservations in the course of consultations on the matter.\textsuperscript{108} The Federal Attorney-General’s Department in its submission to the Senate Legal and Constitutional Affairs Committee’s Inquiry into the 2008 Exposure Draft stated:

Current finance law is characterised by a complex network of regulation developed over time by Australia, State and Territory parliaments and courts. It is built on artificial distinctions around the legal form of the security taken, the legal personality of the grantor and the nature and location of the collateral. There is now widespread recognition that such considerations are immaterial to the substance of secured transactions.

To meet the demands of a competitive economy, Australian finance law must be reorientated around the rights of parties to enforce their interests in personal property in the event of a debtor default. The essential concern should be about who gains priority where competing interests exist. The law should not be seized by concerns about whether a grantor is an individual or a company, whether the property is wool, contract rights or a motor vehicle, or the location of that property.\textsuperscript{109}

The view put forward by the Attorney-General’s Department represents the broader Government view supporting simplifying the system and emphasising substance over form. This approaches preferences functionality over legalism. Whilst, in my view, it does seem debatable as to whether this change is in fact required, the public debate appears to be at the point of considering how to reform, rather than whether changes should be implemented.

**Concerns about the PPS Scheme**

One of the major issues that may emerge with the PPS Act is whether in fact the PPS scheme applies to all Romalpa clauses. It does seem clear that the PPS Bill is meant to apply, but there are example of loose language in the Bill. On the one hand the definition of security interests makes it abundantly clear that retention of title agreements are considered to be security interests. On the other hand section 8(c) of the PPS Act could easily exclude some Romalpa clauses. Section 8 delineates the type of agreements not covered by the Act. Further, a Romalpa clause could also be construed as “Chattel Paper.”\textsuperscript{110} If Romalpa clauses are chattel papers the PPS Act proposes to create a brand
new secondary market for these type of securities – albeit one that would be independent of the rules of the PPS scheme.\textsuperscript{117}

The Act also attempts to preserve the freedom of contract.\textsuperscript{112} But this is undermined by the creation of a complex priority system.\textsuperscript{113} The Act also creates rules as to “attachment” and perfection of security interests, including chattel paper, which will likely create further compliance burdens for Australian businesses. Whilst, the Act is clear that a registered security interest has priority over third parties, any creditor faced with this scheme will immediately register their security interest. The basic priority rules are provided in section 55:

\textbf{55 Default priority rules}

\begin{enumerate}
\item This section sets out the priority between security interests in the same collateral if this Act provides no other way of determining that priority.
\item Priority between unperfected security interests in the same collateral is to be determined by the order of attachment of the security interests.
\item A perfected security interest in collateral has priority over an unperfected security interest in the same collateral.
\item Priority between 2 or more security interests in collateral that are currently perfected is to be determined by the order in which the priority time (see subsection (5)) for each security interest occurs.
\end{enumerate}

These rules do not differ greatly from the common law’s rules on priorities, or the rules on priority developed under other statutory schemes. But what is different is the need for constant “perfection”\textsuperscript{114} and the possibility that a purchase money security interest gain super priority.\textsuperscript{115}

Where enforcement is concerned the PPS scheme imposes new requirements, akin almost to good faith requirements, that will most likely need to be litigated before they are properly understood. The enforcement provisions relate to the rights and remedies of security holders under the PPS scheme. The PPS Act provides:
Rights and duties to be exercised honestly and in a commercially reasonable manner

(1) All rights, duties and obligations that arise under this Chapter must be exercised or discharged:
   (a) honestly; and
   (b) in a commercially reasonable manner.

(2) A person does not act dishonestly merely because the person acts with actual knowledge of the interest of some other person.

Somewhat predictably the stakeholders to the Act have already expressed significant disquiet at the imposition of these new terms. What exactly constitutes behaving in a “commercially reasonable manner” in a priorities dispute between a retention of title holder and an administrator remains to be seen.

It simply is not clear as to how the Australian Government expects retention of title agreements to be regulated. Notably, section 115 allows the parties to contract out of the enforcement provisions of the PPS Act under certain circumstances – thereby rendering the scheme something of a nullity. If the enforcement of the scheme can be contracted away then the common law’s jurisprudence remains very much in operation. If a hybrid system emerges, as seems likely, both common law rules and the proper meaning of the statute will likely be in limbo for some time to come. Though this is a rather pessimistic view, the act, is likely to be subject to much uncertainty, and it may wind up undermining the very purpose that Romalpa clauses were intended to serve: encouraging the sale of goods.

The PPS and Romalpa’s Common Law

That the PPS scheme will impact on the common law is clear. The exact nature of the impact and the changes wrought will be unclear for some time. There will certainly be an impact on priorities and the doctrine of tracing.

The rules that relate to third parties broadly suggest that the security interest can be enforced provided that the goods to which they attach remain under the seller’s control. This essentially means that the goods must remain with the buyer in order to be subject to the retention of title clause. Given the discussion above relating to tracing, and the difficulties identified in relation to priorities, this seems consistent with the law as it currently stands. It can be seen that in Chatti Nominees and Associated Alloys, the courts were reluctant to engage in the task of tracing where the goods in question had left the buyer and had passed on to the buyer’s customer. If tracing under Australian law is something of a dead-end then it cannot be said that the holders of a Romalpa clause have lost anything. That said, the new changes would close off an avenue of appeal, albeit a largely unsuccessful one, for sellers. However, it can be argued that the changes recognise the reality of third party property interests and makes sensible arrangements for resolving priority issues.
But one of the strong basis for prioritizing these third party interests is that they have taken for value without notice of the seller’s interest. The existence of a register would effectively give notice. But the scheme does not currently require that they check the register. It is pertinent to consider then why the result should not be the same as under most Torrens systems of real property, a system of registration, where the third party interest with notice, becomes an equitable interest. The proposed rules prevent this occurrence by limiting the enforcement of the seller’s security interest. But given the overall goal of the register this seems a curious oversight.

Where the matter of trusts are concerned, given the view that the High Court has taken of the operation of trusts in Associated Alloys, the statutory changes, as an alternative, may have the advantage of being practical and predictable. The trust instrument was, and is, a viable instrument for the protection of the seller’s interests. Its application in Associated Alloys was frustrated by the approach of the High Court to the interpretation of “proceeds.” The utility of the trusts instrument in this area will now likely be supplanted by the proposed PPS register and the PPS regulatory scheme.\(^{117}\) Given the difficulties encountered in Associated Alloys and in cases such as Casaron the PPS scheme has the advantage of simplicity. However, the value of the PPS scheme depends greatly on the goods remaining with the buyer. Where the goods have left the buyer, the rules relating to trusts may still have scope to operate.

Fundamentally for Romalpa, the PPS Act tends to be equivocal about the freedom of contract. At times the PPS Act allows parties to contract out of enforcement but at other times it sets up a very clear scheme that should guide the parties. The whole point of Romalpa clauses is that they protect the prudent and cautious, and, that they allow parties to structure their affairs as they please. Under the PPS Act, it can be suggested that too much is conceded to the incautious. Further, the encroachment, in real terms, onto freedom of contract is a major philosophical change. However, parties are likely to amalgamate the PPS scheme into their contracts creating hybrid clauses, and, regrettably, much less certainty in their dealings.

Overall, there are some areas of uncertainty that are currently being debated with regard to the PPS Act. I will not discuss these issues in further detail but I will summarise their nature as they may emerge as issues that require resolution once the legislation commences operation. Firstly, the PPS Act has complex rules on priorities that do not necessarily resolve any of the problems that existed under the common law jurisprudence of Romalpa clauses. In part the PPS Act attempts to create a hierarchy between interests but does not also impose an obligation to search the register. Secondly, the register is intended not as a system of title, but rather as a ‘noticeboard.’\(^{118}\) By this it is meant to put lenders on notice.\(^{119}\) It remains to be seen as to what legal effect the courts will deem the register to have in priorities disputes. Thirdly, the PPS Act does greatly impact upon freedom of contract. But the way in which parties use it in their contracts will have implications for legal certainty. Fourthly, the PPS Act does not appear to oust the operation of trust arrangements. There will likely be a complex interaction between the PPS system and the law of trusts. Fifthly, the PPS Act will over-ride but not invalidate
the various State and Territory laws. Accordingly the interaction with the PPS scheme and a number of other laws is uncertain.

The forthcoming PPS scheme is highly ambitious and though other jurisdictions have adopted similar schemes there is no guarantee of its success. There are a number of uncertainties that relate in different ways to the application of Romalpa clauses. It is clear at least that the PPS will be a different scheme, even though there are clear similarities to the outcomes currently achieved under the common law, but whether it will be a better scheme is less certain.

6. The Corporations Law

The 2007 amendments to the Corporations Act more or less create the type of priority system that the PPS Act has now created, albeit on a lesser scale to the greatly ambitious PPS scheme. Section 442C may at first glance appear to radically effect the operation of Romalpa clauses. However, this is not the case. Section 442C seeks to strike a balance between the needs of administrators and sellers where Romalpa clauses are concerned. Further, the actual operation of s 442C still provides significant scope for the common law to operate.

Section 442C of the Corporations Act provides:

**When administrator may dispose of encumbered property**

(1) The administrator of a company under administration or of a deed of company arrangement must not dispose of:
   (a) property of the company that is subject to a charge, lien or pledge; or
   (b) property that is used or occupied by, or is in the possession of, the company but of which someone else is the owner or lessor.

(2) Subsection (1) does not prevent a disposal:
   (a) in the ordinary course of the company’s business; or
   (b) with the written consent of the chargee, lienee, pledgee, owner or lessor, as the case may be; or
   (c) with the leave of the Court.

(3) The Court may only give leave under paragraph (2)(c) if satisfied that arrangements have been made to protect adequately the interests of the chargee, lienee, pledgee, owner or lessor, as the case may be.

(4) If the administrator proposes to dispose of property of the company under paragraph (2)(a), the Court may, by order, direct the administrator not to carry out that proposal.

…..

(8) For the purposes of paragraph (2)(a), if:

(a) property is used or occupied by, or is in the possession of, a company; and
   (b) another person is the owner of the property; and
   (c) the property is subject to a retention of title clause under a contract; and
   (d) the owner demands the return of the property;
a disposal of the property that occurs after the demand is made does not mean that the disposal is not in the ordinary course of the company's business.

The key restriction is that the sale must be in the ordinary course of the business of the insolvent company. Further, the owner of the goods can petition the court to prevent the administrator from exercising her rights under sub-section 442C(2)(a). This leaves open to the courts the task of determining whether the underlying purpose of the Romalpa clause has been adequately served. Subsection 442C(8) might simply be viewed as a limitation of liability rather than as an affirmative right.

In effect s 442C still privileges the rights of the seller under a Romalpa clause. The subsection 442C(1) limitation on sale by the administrator serves, in light of the section as a whole, to condition the exercise of sale by the administrator. The s 442C also preserves the right of the seller to petition the court to prevent any proposed sale. The balancing of rights perspective is reflected in the Explanatory Memorandum to the Corporations Amendment (Insolvency) Act 2007. The Explanatory Memorandum states:

Section 442C of the Corporations Act prohibits an administrator disposing of property that is subject to a charge, that is used or occupied by the company, or is in the possession of the company but of which someone else is the owner or lessor. ……

It has been suggested that there is a need to clarify the law in relation to the operation of this provision in respect of property subject to a lien, pledge or retention of title clause. The reforms need to strike an appropriate balance between protecting the interest of the owner and security holder, and facilitating the rescue of viable companies in the interest of other creditors and stakeholders.¹²³

Ultimately, s 442C will in fact serve the underlying purpose of the Romalpa clause by ensuring that the seller at least receives some payment. The general nature of the amendments is such that s 442C would only very rarely be applied in a way that would result in the seller receiving no payment. It seems quite clear from the terms of s 442C and the Explanatory Memorandum that the balancing act requires that the interests of the seller are also adequately considered and satisfied as far as is possible.

The key concepts that will likely be in dispute, should a matter arise under s 442C, would relate to the manner of achieving balance and to the term “ordinary course of the company's business.” In my view, given the analysis above, a court would definitely not disregard the interests of the seller, but would attempt to provide some redress.

The question of an adequate balance between the seller and the buyer’s other creditors would need to be addressed on a case by case basis. The term “ordinary course of the company's business” could be read narrowly, so as to refer to contracts to which the buyer is already committed, or more broadly, to refer to contracts of the nature in which the buyer would normally engage. The broad interpretation potentially limits the rights of the seller because it effectively precludes retention of the goods. But, under the PPS Act the broad view is something of a nullity, as under the PPS Act the regulatory scheme would allow a registered security owner to reclaim his or her property.
There will need to be amendment to the Corporations Act now that the PPS Act has passed into law. At present Australia’s Federal Attorney-General’s Department is consulting on the Corporations Act Amendment Bill. The Bill is designed to bring the Corporations Act into compliance with the PPS Act.

7. Conclusion

The market will not soon lose its need for Romalpa clauses. The form that they take and the requirements that surround them may change but they will remain valuable in the market for the sale of goods. In many respects the PPS Act will codify existing law and provide some certainty in areas where in the past controversy had flourished. Whether these reforms were greatly needed with regard to Romalpa clauses is open to debate. Though the cases concerning Romalpa clauses brought forward complex legal matters they certainly were not a constant occurrence. Nor were the issues posed incapable of legal analysis. Nonetheless there is great value in a simplified national system that deals with these matters. However, the implementation of registration systems in real property, and in intellectual property areas such as trademarks, has not prevented new controversies from emerging.

It remains to be seen as to whether the common law’s rule over Romalpa clauses will completely fall. There are great advantages to regulation by statute, not least of which is certainty. However, in some form or another those issues flagged in the common law will likely reappear in the interpretation of the statute. What will most likely be in dispute before the courts will be the question of balance between the secured Romalpa clause seller and the buyer’s other creditors. There is no Australian jurisprudence upon this point. Nor is there any Australian case law that would provide the market with any indication of how the PPS scheme will be interpreted by the courts. It seems trite to make this observation, but, as the realm of common law jurisprudence gives way to an all-encompassing regulatory scheme, there are interesting times ahead in Australian law.

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1 Lecturer with the School of Law at Deakin University.
2 [1976] 1 WLR 676.
3 For example, in cases such as Re Bond Worth Ltd [1979] 3 WLR 629 the purported Romalpa clause was construed as a charge. See also Re Peachdart Ltd [1984] Ch 131. In Chattis Nominees Pty Ltd v Norman Ross Homeworks Pty Ltd (Receiver Appointed) (In Liq) (1992) 28 NSWLR 338 the NSW Supreme Court declined to extend the plaintiffs right to trace into the defendants assets. A similar conclusion was reached by the Australian High Court in Associated Alloys v ACN 001 452 106 Pty Ltd 202 CLR 588 (2000). Further in Associated Alloys the High Court adopted an unduly restrictive approach to interpreting key terms such as “proceeds.”

5 Attorney-General, The Hon Robert McClelland MP, Open Letter to Stakeholders, 8 July 2009. Available at:
This has yet to be tested in court however there is a view that section 442C of the Corporations Act 2001 (Cth) now allows an administrator to dispose of property that is the subject of a Romalpa Clause. As will be discussed below s 442C does not completely frustrate the interests of sellers who have the benefit of a retention of title clause.

For the most part the role of most of the various Goods Act legislations has been to allow the common law to operate by providing that parties are free to decide when title changes.

The transitional provisions of the PPS Act allow for existing Romalpa Clauses, and other interests, to be effectively outside of the scheme until 26 months after the date of Royal Assent. See section 309 Personal Property Securities Act.

The Personal Property Securities Act attempts to consolidate and slightly modify the common law.


Ibid at 351.


Ibid.

Sections 7(1) and 3(1) of the Chattel Securities Act 1987 (Vic) were at issue in General Motors v Southbank Traders (2007) 227 CLR 305. In General Motors the High Court held that s 3(1), which defined the term ‘security interest’, was capable of application to the seller of goods under a conditional sale. Section 7(1) allowed for an unregistered security interest to be extinguished in the events that goods were sold to a third party buyer for value in good faith without notice.

The parties traded from 1981 to 1996 until Metropolitan went into receivership and then liquidation. At that point Metropolitan became ACN001 452 106 (in liq).


Above n14 at 605.

Ibid at 602.

Ibid at 610.

The High Court was of the view that the term “proceeds” should not apply to debts. See further Denis Ong, ‘Romalpa Clauses and the Issues Concerning (i) The Meaning of ‘the Proceeds’ Received by the Buyer; (ii) The Buyer’s Credit Period; and (iii) The Charge/Trust Dichotomy in Relation to ‘the Proceeds’,’ (2000) 12(2) Bond Law Review 148.

Ibid.


Senate Legal and Constitutional Affairs Committee, Exposure draft of the Personal Property Securities Bill 2008, Final Report, Chapter 2 at p3. The use of the word ‘codify’ is perhaps a careless use of language by the Senate Committee.

Further, it is useful to use the clause in Associated Alloys as an example.

Which obviously corresponds with the basic principle of economics that people act rationally in their own perceived self-interest.

Even if Company B had not read the clause, but had just signed the contract containing the clause, the law dictates that they would still be bound by the terms of the clause – Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165.


Petersen v Moloney (1951) 84 CLR 91.

Ibid at 94.

Hobbs v Petersham Transport Co Pty Ltd (1971) 124 CLR 220 at 238 per Windeyer J.
There is an issue of substance over form that needs to be addressed with regard to interpreting the contract. This matter shall be addressed below.

Clough Mill Ltd v Martin [1985] 1 WLR 111. In Armour Lord Keith of Kinkel, at 353, was of the view that where the seller has retained title and then subsequently taken back the goods after the buyer has failed to pay, the seller is not required to account to the buyer for any additional amount the seller makes. Also Lloyd & Scottish Finance Ltd v Cyril Lord Carpet Sales Ltd and others [1992] BCLC 609.

In Associated Alloys and similar cases the right to inter-mix monies was strictly proscribed. The existence of the fiduciary relationship is crucial to the equitable remedy of tracing.

The existence of the fiduciary relationship is crucial to the equitable remedy of tracing.

Codelfa Construction Pty Ltd v State Rail Authority (NSW) (1982) 149 CLR 337. Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd (1979) 144 CLR 596.

Hospital Products Ltd v United States Surgical Corp (1984) 156 CLR 41.

Ansett Transport Industries (Operations) Pty Limited v Australia (1977) 139 CLR 54.


However, the clause in Associated Alloys was not an all monies clause.

Borden (UK) Ltd v Scottish Timber Products Ltd [1981] 1 Ch 25


(1992) 28 NSWLR 338 at 344.

But this does not bind other state Supreme Courts and there is no High Court precedent on this point.

Goodhart above n49. See also Stephen Gaegler, ‘Retention of Title Clauses,’ (1989) 2 Journal of Contract Law 34.

See Spink and Ong above n9.

[2003] 1 AC 368. See Spink and Ong above n9 at 220.

Id.

A view that has been expressed by other commentators. See further, Iwan Davies, ‘Reservation of Title Clauses: A Legal Quagmire,’ (1985) LMCLQ 49 cited in Robert Bradgate, ‘Retention of Title in the House of Lords: Unanswered Questions,’ (1991) 54 Modern Law Review 726 at 728. Davies writes, “To recognise a clause reserving ownership to secure payment of sums due on other transactions which might be totally unrelated to the sale of specific goods seems to go far beyond the confines of the law of sale of goods.”

Goodhart and Jones above n49 at 508.

Re Bond Worth Ltd [1979] 3 WLR 629.

This matter would be more or less settled under the proposed changes to personal property securities law.

Above n31 at 162.


Agip (Africa) Ltd v Jackson [1990] Ch 265.

Banque Belge v Hambrouch [1921] 1 KB 321. See also Puma per McPherson ACJ at 162.

Taylor v Plumer (1815) 105 ER 721.

Above n31 at 162.

Grantham and Rickett above n62 cite Foskett v McKeown [2000] 2 WLR 1299 as affirming the view of tracing as an evidential process.

In both Chattis Nominees and Puma the courts at least gave consideration to this matter.

Grantham and Rickett above n62 at 906 characterise the House of Lords’ decision in Foskett v McKeown as establishing that “the plaintiffs’ proprietary right in the traceable product as arising in response to, and as a means to vindicate, the plaintiffs’ proprietary right in the original asset.”

26
It should be noted that in interpreting the contract the clause has to be read as a whole. See further Barwick CJ in Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd (1968) 118 CLR 429 at 436-437. So reliance on one sub- clause in analyzing the issue of tracing to the exclusion of the other sub-clauses is unsatisfactory from the standpoint of contractual interpretation.

Though, notably it is not identified as such in the judgment. For a discussion of defeasible and indefeasible trusts see further Dennis Ong, Trusts Law in Australia, 3rd Edition, Federation Press, 2007.

In Associated Alloys the majority does not identify the purported trust as an indefeasible trust.

Above n48 at 346.

Ibid. See also Henry v Hammond [1913] 2 KB 515. Also Walker v Corboy (1990) 19 NSWLR 382.

Ibid.


Though, the weight of authority would support such an approach.


See also JN Taylor and Co Ltd v Freeman’s Bay Boats WA Pty Ltd (unreported 1908 of 1995, Supreme Court of Western Australia, BC9502961).

Though it might be a different case if the goods of a number of other companies are mixed in with Company A’s goods by Company B for sale to Company C.


See above n66.

Ibid at 339.

Completeness would also suggest that some consideration be given to this point.

See Ong above n23.

Re Rex Developments Pty Ltd (in liq) (1994) 13 ACSR 485 at 490 per Gallop J.


Above n14 at 602-603.

Ong above n23 makes the point that money held in a bank account is technically a chose in action because the bank owes that money to the account holder.

Above n13 at 610.

This makes sense from the perspective that putting all the money together into one account increases the amount of interest they might earn. This would not affect the identification of the debt owing to the seller as this would be clearly laid out as a book debt.

Rondo Building Services Pty Ltd v Casarom Pty Ltd [2002] QDC 128. In Casarom both the buyer and the seller failed to observe the trust.

See Radio Frequency Systems Pty Ltd v Noel Guthrie as the Liquidator of ULT Ltd (Receiver Appointed) (in liq) [2001] WASCA 195 where the West Australian Supreme Court found that a retention of title clause did not create a security.

Solomon above n25 at 80.


This is perhaps optimistic but a registration requirement would change the character of the right and would have clear effect in the priorities process.

Prior to being passed by Parliament the PPS Bill went through two major iterations, there have been two reports by the Senate Committee of Legal and Constitutional Affairs, the matter has concurrently moved from the Standing Committee of Attorneys-General to the Council of Australian Governments. Within COAG, New South Wales has agreed to implement the laws within its jurisdiction. The COAG process shows a desire by the Australia, States and Territories to avoid any constitutional law problems. Further, there have been very extensive and prolonged consultations with stakeholders.

But this is unlikely to prevent a high degree of confusion and debate.

See Parts 5.2 and 5.3 PPS Act.

The Attorney-General’s Department states, “The PPS Register is a single, national online register. Secured parties and potential secured parties will be able to use it to search for and register security interests in personal property. The Register will be web based, available in real time and accessible 24 hours a day, 7 days per week.” Available at:

See section 21 PPS Act.

See section 10 PPS Act.

Section 19 PPS Act.


Submission to the Senate Legal and Constitutional Affairs Committee, Exposure draft of the Personal Property Securities Bill 2008, Attorney-General’s Department, Submission 8, p. 18.

See Personal Property Security Discussion Paper, Review on the Law of Personal Property Securities, Attorney-General’s Department, April 2007. The Discussion Paper states, “Chattel paper is a composite of two existing items of property. The first is writings that evidence a monetary obligation. The second is a security interest in, or a lease of, specific goods or specific goods and accessions. Examples of chattel paper include a lease agreement, hire purchase agreement, a contract that includes a retention of title clause and an equitable mortgage of specific goods.” Whilst, the Discussion Paper is clear that a retention of title contract is a chattel paper the actual PPS Act is less clear.

See section 109 of the PPS Act which put chattel papers outside of the general enforcement scheme.

See section 18 of the PPS Act.

See Part 2.6 and Chapter 4 PPS Act.

This is the attachment of the security interest to the collateral.

Arguably, this undermines the whole point of Romalpa clauses and begs the question of why anybody would bother being a seller if the rules are so uncertain and there is the distinct possibility that your risk is magnified under the PPS scheme.

This confusion is also evident in a number of the submissions to both Senate Committees. Notably both reports of the Senate Committee on Legal and Constitutional Affairs are at pains to avoid describing the PPS scheme in any great detail. This is slightly unusual as in other law reform inquiries the Senators, many of whom have legal backgrounds, are normally able to engage with the legal concepts that are at issue.

See also section 69 PPS Act.


Ibid.

Above n103.

For example the United States has Article 9 of the Uniform Commercial Code. Article 9 of the UCC is law in every state of the United States. Canada and New Zealand have similar laws.

In fact s 442C would appear to give the administrators less power than they might otherwise have as it avoids the all or nothing outcome of Associated Alloys, Romalpa, Re Bond Worth and other cases.

Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007.