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Registration and Re-Characterisation of Retention of Title Clauses

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The law around retention of title clauses needs reform. A retention of title clause is in essence a clause in a contract of sale whereby the "seller" A (and I will explain why it is in inverted commas soon) retains the ownership of the asset pending payment of the price. It is a way of securing the obligation to pay. If the "buyer" B fails to pay for the goods and becomes insolvent, unable to pay its debts, the "seller" can require the goods to be handed back.

I put "seller" and "buyer" in inverted commas for a reason. It was previously assumed that where B sold the goods on, or used them up in a manufacturing process and A had attempted to retain title not merely to the goods supplied, but the proceeds of sale or the manufactured goods he could not effectively do so. The reason for this, as explained in the case of *Re Bond Worth* [1980] Ch 228 was that the retention of title clause took effect over the proceeds of sale (say) as a floating charge. However, a floating charge would need to be registrable and if not registered would be void, ineffective, in insolvency. This had one further advantage. A common means of raising money for small and medium sized businesses is to factor or discount their book debts. This means that a single debt owed by a customer, but due in 90 days, or more likely a bloc of present and future debts, could be monetised now. It would be assigned to an invoice financier who would pay slightly less than the debt was for and collect the full amount of the debt later. The ineffectiveness of the proceeds clause meant that the assignee of the debts never had to worry about the position of the inventory supplier. In *Caterpillar (NI) Ltd v John Holt & Co* [2013] EWCA Civ 1232 party B buying the goods subject to such a retention of title clause, was described as a "fiduciary agent". The effect is that where the asset is sold on property passes directly to the sub-buyer, C, and B holds the proceeds on trust for A. As an agent, he is selling the asset on behalf of A, not on his own account. It was the fact that the sale was on B's own account that was critical in the decision that only a floating charge was possible in *Bond Worth*. This construction – in *Caterpillar* – gives the seller probable priority over receivables financiers, which has unpalatable commercial consequences. Essentially factoring becomes commercially risky. Another complication raises its head. *Caterpillar* also held that section 49 Sale of Goods Act was a complete code of when a party could sue for the price. If party B is seen as A's agent, the seller will be unable to ever sue him for the price as

Key Points:

- There are real problems with the current law on retention of title clauses and a need for reform.
- One possibility mooted has been to register retention of title clauses and re-characterise them as security interests. This has been resisted by some in the legal profession, but provides a solution to the problems in the law.
- A compromise of registering the clauses without re-characterising forces us to adopt many of the same outcomes as re-characterisation.
- Other solutions involve rewinding the clock, or redrafting the Sale of Goods Act and do not provide the additional transparency and publicity afforded by a registration scheme.

property passes not to B, but to the sub-buyer, C. Admittedly *PST Energy 7 Shipping v OW Bunkers Malta Ltd* [2016] UKSC 23, [2016] AC 1034 suggested that this was wrong. Section 49 is not the only way to sue for the price in a contract of sale. However, the contract in *Bunkers* was held not to be a sale at all – hence the inverted commas. The sellers, party A, in *Bunkers* supplied bunker oil under reservation of title terms to B who were allowed to burn the fuel in their ships' engines. Lord Mance described this not as a sale contract but as a contract to permit consumption prior to payment and passage of property after payment if unconsumed. The logic is that no contract where the "buyer" is expected to do something – like consumption or on-sale of the goods – rendering it impossible to transfer title to the buyer on payment counts as sale, and this raises the question "What is it then?" After *Caterpillar* the retention of title contract between seller and a buyer, expected to sell on, is likely to be one of agency, and factoring transactions become more vulnerable. The risk is that this form of finance is discouraged by increased legal risk and that this in turns impacts on funding available to small and medium sized businesses.

What to do then?

One possibility that has been mooted as part of a larger and more comprehensive reform of English secured transactions law is to register retention of title clauses. The point of registration of such clauses is publicity. It enables information concerning third party interests in the debtor's assets to be more visible, reduces search costs by potential creditors and other third parties seeking to determine the creditworthiness of the business and by treating all devices which have a security function as security it is more transparent. Most registration systems (although not the system in force in England under the Companies Act 2006) date priority from the time of registration. This means that a security interest (mortgage or charge) or retention of title clause has priority over anything registered after or not registered at all. This type of rule is essential. We need an incentive to register and losing priority to security rights created after ours but registered before ours creates that incentive. The incentive is usually stronger in that in most systems, as in England, Australia and common law Canada, the unregistered interest is void, ineffective in insolvency. In New Zealand that is not the case. An unregistered interest is valid but takes priority after all the registered interests. Sometimes a security interest can take priority over prior-registered interests. This happens most frequently in these UCC-based systems where – just as in a retention of title clause – the credit provided is used to buy the asset over which the security for the credit is taken; these are called purchase money security interests or pmsis. In theory this could render prior factoring arrangements vulnerable, but all systems have rules that prioritise the invoice financier over the pmsi holder.

This has one major additional consequence. Priority does not really much matter in the context of retention of title clauses. Party A does not have an interest in party B's goods taking priority over other creditors. They just aren't party B's goods. To talk about priority implies that we should treat a retention of title clause like a security interest – ie party B owns them and grants an interest back to party A. This is called re-characterisation and occurs in Article 9 of the Uniform Commercial Code in the USA and the Personal Property Security Acts in the Commonwealth.

Problem solved. Not quite. The City of London Law Society has very clearly set themselves against re-characterisation. One compromise that has been mooted by both the City of London Law Society and the Secured Transactions Law Reform Project is registration without re-characterisation, a possibility the research discussed here evaluates. There is a model for it in Quebec. In Quebec law a retention of title clause must be registered or it loses priority against any interest which has been registered over the debtor's assets. That loss of priority provides the incentive to register, despite the fact that Quebec law is clear that title to the goods remains in the hands of the seller and can be enforced against the buyer should the latter become insolvent. It is equally clear though that this means ownership of the goods in the hands of the seller is compromised. It is not fully respected. Additionally, the Commonwealth Personal Property Security Acts all have provisions dealing with when a purchaser of an asset subject to a security can take free of that security – ie obtain title to the goods and not be subject to the security interest. Those purchasing from a seller doing so in the ordinary course of business take free for example (see in Australia section 46 Personal Property Securities Act 2009 (Cth)). It is unreasonable to expect a party in such circumstances to ask whether this really is an allowable transaction or to hunt through a register; all this would achieve is to reduce the ready marketability of assets. Currently the question of how we deal with retention of title debtors selling assets to which they do not have title is found in the Sale of Goods Act 1979, and the Factors Act 1889. Two such provisions are section 25(1) Sale of Goods Act 1979, and section 9 Factors Act 1889 which deal with buyers, or those who have agreed to buy goods, who are in possession, but do not yet own the asset, our party B. Whether the third party purchaser, our party C, obtains good title depends, partly, on whether he had notice of "any lien or other right of the original seller in respect of the goods." Registration counts as notice. This is, as we saw, the point of registration. If retention of title clauses were registered, we might think that prima facie party C would have notice and would not receive good title. Clearly that will not provide an adequate outcome where the transaction appears to be in the ordinary course of business or where party C is a consumer, so some qualification is needed. Quebecois law therefore provides, for example, that purchasers in the ordinary course of business (article 2961.1 Quebec Civil Code) take free of the retention of title clause where it is over a universality or class of assets (usually inventory). In short Quebecois law replicates in many respects the features of a Personal Property Security Act. Further we would still need to legislate to ensure that the retention of title clause creditor was unable to take priority over prior invoice factoring arrangements. Functionally the outcomes are similar, if not identical. So why not just be honest, register and re-characterise?

There are of course other possibilities. We may not want to register retention of title clauses at all, perhaps on the basis that the parties chose a particular form of transaction and it is not for the law to change or re-characterise that as a charge. That is the City of London Law Society's position, and suffers from the fact that English law did historically do precisely that; as we have seen, it re-characterised retention of title clauses as floating charges over proceeds. But if that is what we choose we must either reanalyse the passage of property in a retention of title clause context – back to where we were essentially prior to *Caterpillar* and *Bunkers* – or engage in a redrafting of the Sale of Goods Act and other legislation to accommodate the fact that such contracts are no longer sales and deal with the problems of the new "agency" theory. None of these, however, provide the transparency and publicity that registration does.

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For information and background on the wider debate on secured transactions law reform see Secured Transactions Law Reform Project Discussion Papers at https://securedtransactionslawreformproject.org/policy-documents and https://securedtransactionslawreformproject.org/the-case-for-reform

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