

# Examining the Application and Efficacy of Retention of Title Clause in the Protection of Small Businesses

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## Abstract

Retention of title clause is a potential legal device to ensure that small businesses that supply goods on credit sales to companies are not deprived of payment of purchase price of the goods if such companies become insolvent or liquidated. It is able to provide suppliers with super-priority in the payment of the purchase price from the companies' assets over secured creditors. The validity and enforceability of retention of title clause was first endorsed and upheld in the case of *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd*. However, subsequent case law has given rise to interpretational complexities and uncertainties which appear to eclipse its original objective and commercial benefits: contentious issues such as whether it constitutes the creation of a charge by the debtor company in favour of the creditor supplier, or whether it implicates agency, bailment or a fiduciary relationship that justifies the equitable doctrine of tracing. This article meanders through the "maze if not minefield" of the case law on retention of title clause, and determines how it can be made efficacious in application towards the protection of small businesses.

**Keywords:** Retention of title clause, Romalpa clause, Sale of Goods Act, Contract of sale, Property in goods, Passing of title, Fiduciary relationship

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## Introduction

Empirical and cross-national studies have long confirmed that small businesses constitute the engine of economic growth of any nation, due to their capacity to generate employment, stimulate productivity, reduce poverty and improved the standard of living of the people<sup>1</sup>. In addition, income and profit taxes from small businesses provide a significant revenue base for government towards social and infrastructural developments of the nation. However, small businesses are confronted with a serious challenge of inadequate capital to remain a going concern or expand their operations, particularly in developing economies where the markets favour incorporated companies far more than the small businesses<sup>2</sup>. Inevitably, most small businesses depend on the companies for survival, growth or expansion.

For instance, most small businesses thrive or sustain on the supply of raw materials or unfinished products to manufacturing and production companies. Such supplies may be on credit basis because credit purchases from suppliers is one inevitable source of capital for companies. Other sources of business capital for companies include loans from financial institutions and the creation of debenture stocks, both of which are usually secured by a charge on the companies' assets. A charge is a proprietary right created by a company in favour of a lender as security for repayment. It may be a fixed charge which is attached to a specified asset or property of the company, or a floating charge that attaches to a category of assets of the company both present and future<sup>3</sup>.

There is a requirement for a charge to be perfected by way of registration with a statutory body such as the Company House in the United Kingdom and the Corporate Affairs Commission in Nigeria<sup>4</sup>. Upon registration, the legal effect of a charge is that when the company is in default of repayment, or if it is insolvent and goes into liquidation, its assets are appropriated in favour of the secured lenders according to the priority of their security interests. For small businesses that cannot avoid the supply of products on credit to companies, they stand at a great risk of not getting paid for their supplies when the company is in distress or in liquidation. This is because

<sup>1</sup> See International Finance Corporation (2017), MSME Finance Gap: Assessment of The Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets. IFC, Washington, DC; OECD, (2016). Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard. OECD: Paris, France; Beck, Thorsten, Asli Demirgüç-Kunt, and Maria Soledad Martínez Peria. (2011). "Bank Financing for SMEs: Evidence Across Countries and Bank Ownership Types." *Journal of Financial Services Research* 39(1): 35–54; Chinweuba, E.T. and Sunday, O.C. (2015), "Quantitative analysis of the impact of small and medium scale enterprises on the growth of Nigerian economy (1993-2011)", *International Journal of Development and Emerging Economics*, Vol. 3 No.1, pp. 26-38

<sup>2</sup> Beck, T. and Demirguc-Kunt, A. (2006), "Small and medium-size enterprises. Access to finance as Growth Constraint", *Journal of Banking and Finance*, Vol. 30 No. 11, pp. 2931-2943; Edet, B.N., Anoka, A.F. and Antakikam, A.E. (2014). Bank lending, macro -policy variables and the growth of small-scale industries in Nigeria. *International Journal of Business and Social Science*, 5:9, 284-290

<sup>3</sup> Kunle Aina, (2011). The Machinery for Raising Capital by Companies through Debt Finances in Nigeria *International Journal of Advanced Legal Studies and Governance*, Vol.2, No.1, 85 -101

<sup>4</sup> See section 859H of the UK Companies Act 2006; and see also section 197 of the Nigerian Companies and Allied Matters Act 2020

priority in the settlement of the debts and liabilities of a company in receivership or in liquidation is according to the preferential order of the secured lenders of the company, before those of unsecured lenders and creditors.

One potential legal device to ensure that the small business creditor to a company is not deprived of payment is to include a retention of title clause in the contract of sale entered with the company. A retention of title clause is a clause in a contract for the sale of goods providing that ownership of the goods is retained by the seller until full payment of the purchase price is made<sup>1</sup>. This retention of title clause provides the small business supplier an assurance that, if the company becomes insolvent, it will have priority in the payment of the company's debt over the secured and unsecured lenders or creditors. The validity and effect of a retention of title clause was first endorsed and upheld in the English case of *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd*<sup>2</sup>, hence it is commonly referred to as the *Romalpa Clause*<sup>3</sup>.

The *Romalpa clause* is effective in achieving significant benefits in the interest of a creditor supplier to the debtor company: it may reserve the title to the goods in the supplier until full payment is made; and it may create in the supplier a proprietary right over the finished products into which the goods may have been mixed in a manufacturing process by the company, or the proceeds from the sale of the goods or the finished products. Consequently, upon default in payment, insolvency or liquidation of the debtor company, the creditor supplier is able to recover the goods supplied; the proceeds from the sub-sale of the goods to third parties; the finished products in which the goods have been mixed; or the proceeds from the sale of the finished products. In spite of these attractive potentials of the *Romalpa Clause*, there are doctrinal complexities inherent in its judicial application in certain contractual contexts.

In this article, we examine the nature of retention of title clause in its essential respects: its validity and enforceability as originally endorsed in the case of *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd*; the contentious issues surrounding its application as evident from subsequent case law, such as whether it constitutes the creation of a charge by the debtor company in favour of the creditor supplier<sup>4</sup>, or whether it implicates agency, bailment or a fiduciary relationship that justifies the equitable doctrine of tracing<sup>5</sup>. The objective of this article is to meander through the "maze if not minefield"<sup>6</sup> of the case law on retention of title clause, in order to determine how it can be made efficacious in application towards the protection of small business suppliers of goods to companies on credit.

## I. RETENTION OF TITLE CLAUSE

Commercial exigencies often impel the sale and purchase of goods on credit; when goods are sold and purchased with a contractual agreement between parties that payment of the purchase price is to be made on a future date. In order to protect the interest of the seller, retention of title clause may be included in the contractual terms, stipulating that the seller retains the property in the goods until payment of the purchase price is made by the buyer. The implication of retention of title clause is that until full payment of the purchase price, the seller remains the owner of the goods and this prevents the goods from forming part of the assets of the buyer to be appropriated to other creditors in the event that the buyer becomes insolvent or liquidated.

The foundation for retention of title clause is the freedom to enter into contract as provided under the Sale of Goods Act 1893 which allows parties to a contract for the sale of specific and ascertainable goods to decide when the property in the goods is to pass to the buyer<sup>7</sup>. The provision of section 19 of the Act recognizes the right of parties to a contract of sale to reserve the time when title to the goods may pass to the buyer, subject to stipulated conditions. In such a case, title does not pass until fulfilment of the stipulated conditions<sup>8</sup>. In effect, section 19 of the Sales of Goods Act is "an embodiment of the very basic contractual principle that parties are free to contract as they will, subject only to vitiating factors such as fraud or deceit"<sup>9</sup>.

<sup>1</sup> The foundational support for a retention of title clause is section 17 of the Sales of Goods Act 1893 which allows the freedom of contract by providing that property in goods passes when it is intended by the parties to pass, irrespective of delivery.

<sup>2</sup> (1976) 1 WLR 6

<sup>3</sup> Consequently, in this article the use of "Romalpa Clause" means the same thing as a title retention clause

<sup>4</sup> See the cases of *Re Bond Worth Ltd* [1980] Ch 228; *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrication Pty Ltd* (1998) 16 ACLC 1633; and *Rondo Building Services P/L v Casaron P/L & Anor* [2003] QCA 78

<sup>5</sup> See the cases of *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick* [1984] 1 W.L.R. 485; *Re Andrabell Ltd* [1984] 3 All E.R. 407; *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbutnot Factors Ltd* [1988] 1 W.L.R. 150

<sup>6</sup> According to Staughton J in *Hendy Lennox (Industrial Engines) Ltd v Graham Puttick Ltd* (1984) 1 WLR 485

<sup>7</sup> See section 17(1) which provides that: "Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred"; This Act is still applicable in most common law jurisdictions. It has been re-enacted in some jurisdictions like the United Kingdom, its place of origin, as the Sale of Goods Act 1979. In Nigeria, where it was received as a colonial statute in force as at 1<sup>st</sup> January 1900, some States of the Federation have also re-enacted it. But the re-enactments are only in dates because its provisions and sections remain unchanged in the re-enactments.

<sup>8</sup> According to section 19(1), "Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled; and in such a case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee or custodian for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled".

<sup>9</sup> J. Snead, 'Rationalising Retention of Title Clauses with Insolvency Law' [2004] UCL Jurisprudence Rev 288, 290

Retention of title clause is therefore a powerful device developed by sellers for the protection of their proprietary interests against counterparty credit risk. Sellers are able to manipulate the passing of title after delivery of goods, and provide that property in the goods shall not pass until either the price of the goods is paid or all moneys owed by the buyer to the seller are paid<sup>1</sup>. As a result of the retention of title, the proprietary interest of the seller enjoys a form of super-priority over other interests in the goods, whether created earlier or later in time in favour of other creditors, whether secured or unsecured. This ultimate objective of retention of title clause to secure the seller should the buyer become insolvent before payment of purchase price was aptly captured by Mummery J, in the case of *Compaq Computer v Abercorn Group*<sup>2</sup> thus;

“The broad purpose of an agreement that a seller retains title to goods pending payment of the purchase price and other moneys owing to him is to protect the seller from the insolvency of the buyer in circumstances where the price and other moneys remain unpaid. The seller's aim in insisting on a retention of title clause is to prevent the goods and the proceeds of sale of the goods from becoming part of the assets of an insolvent buyer, available to satisfy the claims of the general body of creditors”.

Retention of title clause in a conditional sale was judicially recognized as early as 1895 in the case of *McEntire v Crossley Brothers Ltd*<sup>3</sup>. Although the case was not based on retention of title clause, the condition for the passing of property in the goods had similar effect as the seller was held to retain title. The House of Lords decided in the case that since the seller had not passed title to the purchaser the latter could not create a valid charge over the machine that was supplied under a conditional sale. But for the first time, it was in the case of *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd*<sup>4</sup> that the court determined the nature, validity and enforceability of modern retention of title clause. In the case the plaintiff (seller) had supplied aluminium foil (goods) to the defendant (buyer) under a contract of sale which contained a far-reaching retention of title clause.

In substance, the clause in issue provided that the buyer was to keep the goods for the seller in the capacity as fiduciary owner and was to store them in such a way that they could be identified as such. But if the buyer manufactured the goods, or mixed the goods with other materials, then the seller would be the owner of the new manufactured products. Also, the buyer was entitled to sell the goods to a third party within the normal course of business, but if the purchase price of the goods was not paid the buyer was to assign to the seller any claims the buyer had against the sub-buyer. Eventually, the buyer became insolvent and went into receivership before paying for the goods. The retention of title clause clearly empowered the sellers to claim the quantity of the unsold goods which was taken over by the receiver.

However, the issue turned on the quantity of goods which the buyer had already sold to a third party. Under the provisions of the Sale of Goods Act the sub-buyer obtained good title to the goods, thus extinguishing the seller's rights over the goods<sup>5</sup>. Therefore, the seller could not claim the goods but instead claimed an interest in the proceeds of the re-sale, on the ground of a right to trace the proceeds of sale. At the court of first instance, the claim of the seller was upheld. Upon appeal by the defendant, the claim was affirmed. The Court of Appeal held that when the buyer sold the goods with the seller's authorization, there was a legal duty to account for the goods according to the inherent fiduciary relationship of principal and agent, or bailor and bailee. The holding of Roskill LJ is worth reproducing *in extenso*;

I see no difficulty in the contractual concept that, as between the defendants and their sub-purchasers, the defendants sold as principals, but that, as between themselves and the plaintiffs, those goods which they were selling as principals within their implied authority from the plaintiffs were the plaintiffs' goods which they were selling as agents for the plaintiffs to whom they remained fully accountable. If an agent lawfully sells his principal's goods, he stands in a fiduciary relationship to his principal and remains accountable to his principal for those goods and their proceeds. A bailee is in a like position in relation to his bailor's goods. What, then, is there here to relieve the defendants from their obligation to account to the plaintiffs for those goods of the plaintiffs which they lawfully sell to sub-purchasers?<sup>6</sup>

This case therefore established retention of title clause as an effective device for a seller to recover goods supplied but unpaid for, even when the goods have been sold by the buyer to a third party, including the tracing of the proceeds of the sub-sale. From the holding of Roskill LJ, the application of the legal principles of fiduciary relationship, bailment, agency, and tracing constitute features of retention of title clause which enable sellers to make their claims to goods supplied, products manufactured from such goods, any proceeds of sale of the goods

<sup>1</sup> L. Gullifer, 'Retention of title clauses: a question of balance' in A. Burrows and E. Peel (eds), *Contract Terms* (Oxford, Oxford University Press, 2007) 285

<sup>2</sup> [1993] BCLC 602 at p. 611

<sup>3</sup> [1895] AC 457

<sup>4</sup> (1976) 1 WLR 6

<sup>5</sup> See section 25(2) of the Sale of Goods Act 1893

<sup>6</sup> At page 690

or the manufactured products. In the application of these legal principles to a contract of sale with retention of title clause, the buyer is deemed to be in possession of the goods as a mere bailee and failure to pay the purchase price entitles the seller to recover the goods.

Where the buyer has sold the goods to a third party, such sale is considered to be made in the capacity of agent. Therefore, the buyer is under obligation to account to the seller, as the principal, for the proceeds of sale. The buyer may have mixed the goods with other materials in the manufacture of new products, and the products have been sold out. In such a case, the fiduciary relationship which is held to exist between the seller and buyer gives rise to the doctrine of tracing in favour of the seller. The seller's legal title to the goods is traced to an equitable interest in the new products or the proceeds of sale of the new products. But this straightforward application of these legal principles to retention of title clause in *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* is hardly the same and with similar result in all cases.

As we shall see in the next part of this article, subsequent cases involving contract of sale with a *Romalpa Clause* yielded different and more complex results, including unintended consequences for sellers. This is with particular reference to when a *Romalpa Clause* seeks to extend to goods that the buyer has sold to third parties; products manufactured from the supplied goods; and proceeds from the sale of the goods or the manufactured products. Enforcing a *Romalpa Clause* in such cases has been confronted with the difficult process of identifying or distinguishing the seller's goods in the mix. In some cases, it proved impossible and the *Romalpa Clause* failed<sup>1</sup>. But since the case of *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* different types of retention of title clause have been introduced in contracts of sale of goods to guide against the failure of retention of title clause and protect the seller.

### **Types of Retention of Title Clause**

The most basic and simple type of retention of title clause is one that provides that ownership of the goods does not pass until the buyer pays the full purchase price of the goods. This title clause gives the seller the right to enter the buyer's premises and recover the goods. The seller's title to the goods subsists and the failure or inability of the buyer to pay the purchase price entitles the seller to retrieve the goods<sup>2</sup>. But there are circumstances in which the seller's title to the goods may be defeated, notwithstanding the fact that the contract of sale includes a *Romalpa Clause*.

The seller may fail to retain title in the process or at a time when the buyer appropriates the goods in a way that significantly changed the nature or character of the goods. For examples, where the seller's goods are mixed or mingled with other goods belonging to the buyer or a third party, so that the singular identity of the goods is lost. Also, when the seller's goods are affixed to those of the buyer's or a third party and cannot be safely severed. And where the seller's goods have become permanent fixtures to the land or structure of the buyer or a third party<sup>3</sup>. The following different *Romalpa Clauses* may be drafted with these vitiating circumstances in mind.

#### **a. All Monies Clause**

This clause provides that the seller retains title to the goods until all debts accruing from the purchase price and owed by the buyer are paid. An All Monies clause is more desirable where there is a regular trading relationship between the parties and it is difficult to associate particular invoices with particular goods<sup>4</sup>. This clause may be made to apply to the debts owed by the buyer for the supply of all goods under a particular contract of sale, or it may apply to all the supplies made by the seller to the buyer. It may also apply to all other indebtedness of the buyer for the different supplies made by the Seller at different times.

The effectiveness of the all monies clause is that there is no limitation as to which monies the payment is made as a condition for the passing of title to the buyer. The seller is able to retain title until the recovery of all outstanding debts accruing from past, present and future. This implies that title in the goods may never pass to the buyer when there is a continuous supply by the seller and a continuous indebtedness by the buyer. For title to pass, the buyer must pay all monies which accrue from the purchase prices of all the goods supplied.

#### **b. Fiduciary Relationship Clauses**

These clauses cover cases where the seller retains title but permits the buyer to sell the goods to third parties, or to mix the goods in the manufacture of new products. The implication of these clauses is that until full payment of the purchase price is made by the buyer, a fiduciary relationship is created which makes the buyer a trustee or retains the seller's title through tracing. Thus, where the buyer sells the goods to a third party a clause may provide that the buyer keeps the proceeds in a separate account on trust for the seller, until the purchase price is paid. If the buyer mixed the goods with other goods to manufacture new products, a clause may provide for the equitable tracing of the seller's title to the new products or the proceeds of sale of the new products.

<sup>1</sup> See the case of *Borden (UK) Ltd v Scottish Timber Products Ltd* (1981) 1 Ch 25 where seller could not enforce the *Romalpa Clause*.

<sup>2</sup> A. Tettenborn, "Of Bunkers and Retention of Title: When is a Sale Not a Sale?" [2016] LMCLQ 24

<sup>3</sup> L. Guillifer, (2014). "The Interpretation of Retention of Title Clauses: Some Difficulties" *Maritime and Commercial Law Quarterly*, 4: 564

<sup>4</sup> Andrew Kelly and Richard Atkin, *Navigating through the Minefield of Retention of Title Clauses*, 40 *Australian Construction Law Newsletter* #126 May/June 2009

The ingenuity in the drafting of fiduciary relationship clauses is that the seller is able to retain title where the title would otherwise be defeated by a sub-sale to a third party, in which case the third party acquires a good title pursuant to the provision of section 25(2) of the Sale of Goods of Act<sup>1</sup>; or the loss of title after the goods is mixed with other goods in a manufacturing process of new products, such that the seller's goods become unidentifiable in the new products. It is instructive to note that in spite of the usefulness of fiduciary relationship clauses, some contentious issues may arise to jeopardize a successful retention of the seller's title.

For instance, while the fiduciary relationship clauses may retain the seller's interest in the proceeds of sale of the goods, or in the new products made from the goods, such interest may be considered as a charge, which needs to be registered otherwise would be void against other secured creditors of the buyer. Hence, according to Longmore LJ in the case of *Caterpillar (NI) Limited v John Holt & Company (Liverpool) Limited*<sup>2</sup>, "[T]hat is just an inherent result of a retention of title clause and shows that it has dangers as well as benefits ... Ironically, whilst seeking to protect the seller from non-payment these clauses can in fact produce the opposite effect". From case law, the next part examines the dangers that bedevil retention of title clauses, no matter how ingenuous they may be drafted. The dangers and the attendant contentious issues mark the limits of retention of title clause.

## II. THE LIMITS OF RETENTION OF TITLE CLAUSE

As already noted, the usefulness of retention of title clause to sellers is its ability to attach to the original goods and the proceeds of sub-sale of such goods, including the manufactured products from the goods and the proceeds of sale of the manufactured products. Thus, retention of title clause grants the seller absolute proprietary right to recover the goods if the buyer fails to pay the purchase price. And from the authority in the *Romalpa case*, the seller's title extends to the proceeds of sub-sale of the goods under a fiduciary relationship implied in retention of title clause. However, subsequent case law has shown the limits of the *Romalpa Clause* in the protection of sellers because it may not successfully allow the sellers to retain title in the proceeds of sub-sale of the goods to third parties, the manufactured products from the goods, or the proceeds of sale from the manufactured products.

In the case of *Re Bond Worth Ltd*<sup>3</sup> decided four years after the *Romalpa case*, the court interpreted the retention of title clause contained in the contract of sale as nothing but an attempt to secure payment for the goods with the effect that the clause only created a charge over the goods in favour of the seller. In that case, the buyer was a manufacturer of carpets and the seller supplied fibre to the buyer. The fibre was supplied to the buyer on the condition that until each order had been fully paid for, the fibre therein was to remain in the "equitable and beneficial ownership" of the seller, and the proceeds of any sub-sale of the fibre or of the sale of any products of which the fibre was a component were to belong to the seller until the buyer had made payments accordingly.

The court held that since the whole purpose of the retention of title clause was to afford the seller a security for the payment of the purchase price of the fibre under each supply, the seller's right was necessarily a right by way of mortgage or charge. According to Slade J;

"In my judgment, any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt or appropriates such property for the discharge of the debt, must necessarily be regarded as creating a mortgage or charge, as the case may be. The existence of the equity of redemption is quite inconsistent with the existence of a bare trustee-beneficiary relationship".

The conclusion of the court was that because the clause purporting to retain the seller's title in the fibre merely created in favour of the seller a floating charge over the goods, and since the charge had not been registered, it was void and unenforceable. Similarly, in the subsequent case of *Re Peachdart Ltd*<sup>4</sup> the seller could not enforce retention of title clause which extended to the proceeds from the sales of the products manufactured with the goods supplied to the buyer. In the case, the seller sold leather to the buyer, a manufacturer of handbags, on the condition that the seller was to retain title to the goods until the purchase price of all the goods delivered to the buyer had been fully paid. The buyer was allowed to resell the leather or to sell any handbags made from it provided that the proceeds of any such sub-sales or sales were to belong to the seller until full payment for all the leather delivered to the buyer. The court rejected the seller's reliance on the authority of the *Romalpa case* to support the claim to the proceeds of sub-sales from the leather and the sales from the handbags.

Vinelott J stated that it was "impossible to suppose" that the buyer was under an obligation to give the proceeds from the sub-sales and sales into a separate trust accounts for the seller, with the effect that the buyer would be disabled from using the money in the business of manufacturing of handbags. This implied that the buyer could produce and sell handbags but could not use the money from the sales of the products. The court ruled that for commercial exigency, retention of title clause had to be interpreted to mean that the parties had intended to

<sup>1</sup> Which provides to the effect that a purchaser in good faith without notice of any encumbrances such as a subsisting interest of another party acquires a good title.

<sup>2</sup> [2012] EWHC 2477

<sup>3</sup> [1980] 1 Ch 228

<sup>4</sup> [1983] 3 All ER 20

create a charge over the proceeds of sales in favour of the seller; the seller's ownership of the leather transformed into a charge after the leather was used to produce the handbags, and the charge floated to attach to the proceeds from sale of the handbags. Consequently, because the charge was not registered it was void and enforceable.

The reasoning of the court in *Re Bond Worth Ltd* which greatly influenced the decision in *Re Peachdart Ltd* is that the legal title to the goods is transferred to the buyer and that the seller only retains equitable and beneficial interest the moment the goods are sold to third parties or consumed in the manufacturing process of new products. This reasoning implies that title to the goods is transferred to the buyer in *scintilla temporis* and what the buyer granted back to the seller at that moment is a security in the form of a charge<sup>1</sup>. Contrary to the decision in the *Romalpa case*, it was held in *Re Bond Worth Ltd* and in *Re Peachdart Ltd* that it could not be intended that the buyer would sell the goods or the new products from the goods as agent or under a fiduciary relationship. Otherwise the proceeds, including profits, would belong to the seller such that the seller would receive a windfall higher than the purchase price of the goods which the buyer agreed to pay under the contract of sale. In *Clough Mill Ltd v Geoffrey Martin*<sup>2</sup>, a case also decided in the shadows of *Re Bond Worth Ltd* and *Re Peachdart Ltd*, Goff LJ held thus;

“I find it impossible to believe that it was the intention of the parties that the seller would thereby gain the windfall of the full value of the new product, deriving as it may well do not merely from the labour of the buyer but also from materials that were his, without any duty to account to him for any surplus of the proceeds of sale above the outstanding balance of the price due by him to the seller”.

The decisive factor in both cases is that the seller's title cannot subsist after the goods have been sold by the buyer or consumed in a manufacturing process because from that moment the title of the seller is converted to a security interest by way of charge over the proceeds of sales of the goods or the new products. Prior to *Re Peachdart Ltd* and following *Re Bond Worth Ltd*, it was decided in the case of *Borden (UK) Ltd v Scottish Timber Products Ltd*<sup>3</sup> that, though the sellers may have retained title to the goods, once the goods were mixed in the manufacture of new products the seller's title to the goods disappeared. In that case, the goods supplied by the seller to the buyer were resin used by the buyer in the manufacture of chipboard. The court held that the interest of the seller after the manufacturing process could only be regarded as a mere charge over the chipboard which, for lack of registration, was void and enforceable against the buyer.

Other remarkable cases that distinguished the *Romalpa case* and adopted the reasoning and decision in *Re Bond Worth Ltd* include *Re Andrabell Ltd*<sup>4</sup>; *Pfeiffer (E) Weinkellerei Weinenkauf GMBH and Co v Arbuthnot Factors Ltd*<sup>5</sup>; and *Modelboard Ltd. v Outer Box Ltd*<sup>6</sup>. In these cases, the goods supplied were mixed by the buyers in the processing of new products. The courts held that the purported title to the new products only created a security charge for the purchase prices the buyers owed rather than retaining the sellers' title to the new products or the proceeds from sales of the new products. The courts ruled that because the sellers' title would have been defeated by the buyers paying the purchase prices for the original goods, the sellers' interests became a charge which required registration in order to be valid and enforceable against the buyers.

The limits of retention of title clause in these cases have not only been firmly established, the *Romalpa case* “has been almost distinguished to death”<sup>7</sup>. As noted in the preceding part of this article, the foundation of retention of title clause as validated and enforced for the first time in the *Romalpa case* is the Sale of Goods Act. However, in the relatively recent case of *PST Energy Shipping LLC v OW Bunker Malta Ltd*<sup>8</sup> (the *Bunker case*), the Supreme Court of the United Kingdom held that a contract under which a buyer agreed to deliver bunker fuel to a shipowner subject to retention of title clause was not a contract “of sale of goods” within the meaning of section 2(1) of the Sale of Goods Act. The court reasoned that since the contract provided that the seller would retain title until payment and that the buyer was entitled to consume all or some of the goods before payment of purchase price, then it could not be interpreted as a contract of sale of goods.

While the case affirmed the precedent that the seller's title is defeated by a sub-sale or the mixing of the goods to form a new product<sup>9</sup>, the *Bunker case* went further to hold that with respect to goods such as materials that are expected to either be sold to third parties or consumed in a manufacturing process, title to the goods does not really pass to the buyer. The buyer is only expected to pay the purchase price within the term of credit granted by the seller. And because title does not pass to the buyer before the goods are sold or processed into new products, the

<sup>1</sup> L. Gullifer, “The Interpretation of Retention of Title Clauses: Some Difficulties” [2014] LMCLQ 564, 565

<sup>2</sup> [1985] BCLC 64, 73

<sup>3</sup> [1981] 1 Ch 25

<sup>4</sup> [1984] 3 All ER 407

<sup>5</sup> [1988] 1 WLR 150

<sup>6</sup> [1992] BCC 945

<sup>7</sup> According to G. McCormack, *Secured Credit under English and American Law* (Cambridge: Cambridge University Press, 2004), 182

<sup>8</sup> [2016] UKSC 23

<sup>9</sup> As held in *Re Bond Worth Ltd*; *Re Peachdart Ltd*; *Re Andrabell Ltd*; *Pfeiffer (E) Weinkellerei Weinenkauf GMBH and Co v Arbuthnot Factors Ltd*; and *Modelboard Ltd. v Outer Box Ltd* (supra)

transaction cannot constitute a sale contract such that failure of the buyer to pay the purchase price cannot be enforced under the provisions of section 49 of the Sale of Goods Act<sup>1</sup>.

In the earlier case of *Caterpillar (NI) Ltd v John Holt & Co (Liverpool) Ltd*<sup>2</sup> (the Caterpillar case) it had been held that recovery of payment of purchase price by the seller under section 49 of the Sale of Goods Act could not succeed unless the *Romalpa Clause* was ineffectual, or the sale contract stipulated that payment must be made on “a day certain”<sup>3</sup>. The *Caterpillar case* did not hold that such transaction was not a sale contract but its ruling on the unenforceability of the contract under the Sale of Goods Act was deeply troubling for the *Romalpa Clause*. However, the *Caterpillar case* is remarkable as it was the first case that appeared to follow the *Romalpa case* after the emasculating effect of *Re Bond Worth Ltd* and its line of cases because the judgment concluded that the retention of title clause in the case extended to the proceeds of a sub-sale<sup>4</sup>.

Rather than uphold this remedial effect on the *Romalpa case* and overrule the ruling on non-enforceability of retention of title clause under the Sale of Goods Act as held in the *Caterpillar case*, the *Bunker case* dealt a more devastating blow<sup>5</sup>. The implications of the *Bunker case* include that once the goods supplied by the seller have been disposed by the buyer either through sub-sale or manufacturing process before payment of the purchase price, the seller cannot bring a claim for the payment under the provisions of the Sale of Goods Act. Given the fact that the Sale of Goods Act is the substratum of retention of title clause, as validated and enforced in the *Romalpa case*, the exclusion of the Act in resolving the issue of non-payment of purchase price of goods supplied by the seller and appropriated by the buyer does not bode well for the commercial objective and benefits of retention of title clause.

### Protecting Small Businesses through Retention of Title Clause

In the context of small businesses that almost always likely to supply raw materials and agricultural products on credit sale to companies, the case law since the *Romalpa case* is not encouraging. The judicial authorities seem to suggest that no matter how cleverly and comprehensively a retention of title clause is drafted, there is a high possibility that it may not offer the seller the expected protection if and when the buyer fails to pay the purchase price before becoming insolvent, or taken over by receivers, administrators or liquidators. Under the authorities of *Re Bond Worth Ltd* and its line of cases, if retention of title clause seeks to extend to proceeds of sub-sale of goods supplied, the new products processed from the goods or the proceeds of sale from the new products, it may be held as constituting a floating charge which needs to be registered for validity and enforceability.

Also, under the authorities of the *Caterpillar* and *Bunker* cases a claim for the purchase price of goods supplied by the seller subject to retention of title clause in a sale contract may not be enforceable against the buyer under the Sale of Goods Act, with unpleasant consequences for the seller. This case law does give rise to complexities and uncertainties in the application and efficacy of retention of title clause in a contract of sale. As much as possible, small businesses need to be saved any complex formalities such as registration of retention of title clause and its attendant costs which may impose additional burden, and constrict their ability to survive in an environment that is already unfriendly. More so, if purchase price for goods supplied cannot be simply enforced in a straightforward manner, stripped of undue legal uncertainties, affected small businesses could be mortally affected.

Rather than allow the original objective and benefits of retention of title clause to be eclipsed by the case law subsequent to the *Romalpa case*, vital lessons can be gleaned from the decisions and *ratios decidendi* for the purpose of sustaining the objective and benefits. Consequently, in some jurisdictions such as Australia, statutory provisions have been enacted requiring the registration of retention of title clauses. By virtue of the provisions of the Australian Personal Property Securities Act 2009, retention of title clause is deemed to be a security interest that must be registered for it to be valid and subject to priority rules *vis-s-vis* other secured creditors. Nigeria has similar statute, the Secured Transactions in Movable Assets Act 2017, but unlike the Australian's, it does not make any provisions for registration of retention of title clause.

<sup>1</sup> PST Energy Shipping LLC v OW Bunker Malta Ltd [2016] UKSC 23, Per Lord Mance, at p. 39

<sup>2</sup> [2013] EWCA Civ 1232

<sup>3</sup> According to the section: (1) Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods. (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although the property in the goods has not passed and the goods have not been appropriated to the contract.

<sup>4</sup> The *Romalpa Clause* in the *Caterpillar case* involved a sale of generators and parts, and included a provision that “prior to title passing Buyer shall be entitled to resell or use the products in the ordinary course of business and shall account to the Seller for the proceeds of sale”. The court held the *Romalpa Clause* in favour of the seller.

<sup>5</sup> With respect to the enforceability of claim for purchase price of goods supplied on credit under a contract subject to retention of title clause, the *Bunker case* raised the question: “When is a sale not a sale? See A. Tettenborn, “Of Bunkers and Retention of Title: When is a Sale Not a Sale?” [2016] LMCLQ 24; As noted by Gullifer: “The result is properly described as curiuser and curiuser and demonstrates that the draftsman’s quest for the perfect ROT (retention of title) clause can sometimes be counterproductive”. See L. Gullifer, “The Interpretation of Retention of Title Clauses: Some Difficulties” [2014] LMCLQ 564, 565

This article does not recommend statutory requirement for the registration of retention of title clause in developing economies like Nigeria. With particular respect to small businesses, the burden and effect of such requirement would far outweigh any intended benefits. Leading studies and recommendations on Ease of Doing Business towards promoting the growth and viability of small business in developing economies have not recommended the registration of retention of title clauses<sup>1</sup>. Most of the recommendations are focused mainly on granting or improving access to finance for small businesses. But in addition to access to finance, there is a need for appropriate legal framework to protect small businesses from losing or dissipating whatever finance available for their operations. Especially, small businesses need to be protected against forfeiting the purchase prices for any goods they supplied on credit to companies that eventually become distressed, insolvent or liquidated.

Therefore, in the interest of small businesses, a legal framework that provides for the creation, validity and enforcement of retention of title clause is necessary in emerging economies in Asia, Latin America and Africa. Besides clarifying the uncertainties and resolving the complexities around the application of retention of title clause, as evident from the case law, a positive and purposive legislation can address its inherent limitations towards achieving its legal objective and commercial benefits. For such legislation to make the application of retention of title clause more efficacious in the protection of small businesses, it is important that it contains the following key recommendations which are borne out from the decisions and implications of the current case law on the *Romalpa Clause* in common law jurisdictions.

- i. The legal title to the goods and the beneficial interest in proceeds of sale or any new products from the goods supplied to the buyer should remain in the seller until full payment of the purchase price for the goods.
- ii. Imposing an obligation on the buyer to insure the goods received under the contract of sale with the interest of the seller expressly noted on the insurance policy.
- iii. Requirement for the buyer to clearly identify and mark out the goods received from the seller before and during any sub-sale or manufacturing process until full payment of the purchase price.
- iv. Provide for right of the seller to maintain a claim for the payment of the purchase price notwithstanding the provisions of section 49 of the Sale Goods Act.
- v. The right of the buyer to dispose the goods supplied by the seller either by way of sub-sale or manufacturing process should be subject to the consent of the seller first had and obtained.
- vi. Stipulation of mutual agreement between seller and buyer as to the capacity in which the buyer would dispose the goods through sub-sale or manufacturing process, whether as agent, bailee, trustee, or any other fiduciary position.
- vii. Provide for the seller's right to bring a claim for the attachment of the buyer's bank accounts for the purpose of recouping the full purchase price.

## Conclusion

In spite of its apparent restrictive interpretation in current case law, retention of title clause remains a powerful device for the protection of proprietary interests of sellers, particularly small businesses that supply goods on credit to companies. It avails such businesses a legal mechanism to avoid total loss of the purchase price of the goods supplied because they are able to recover the goods, the proceeds of sub-sale of the goods; the new products formed from the goods, or the proceeds from the sale of the new products. In case of insolvency or liquidation of a company before payment of the purchase price for goods supplied by a small business, retention of title clause ensures that the proprietary interest of such small business enjoys a form of super-priority over other interests in the goods, whether secured or unsecured.

These benefits of retention of title clause which underlined its validation and enforcement in the *Romalpa case* remain more relevant in contemporary developing economies. The emasculating effect of subsequent case law is part of legal developments, and common law jurisdictions need to respond by legislating retention of title clause in order to project and sustain its benefits. The above recommendations may well constitute an effective guide for a proper and better drafting of retention of title clause. However, given the uncertainties of its judicial interpretation since the *Romalpa case*, only a positive legislation which enacts the recommendations may succeed in ensuring an efficacious application of retention of title clauses, especially for the protection of small businesses.

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<sup>1</sup> See for examples, Beck, T. and Demircuc-Kunt, A. (2006), "Small and medium-size enterprises. Access to finance as Growth Constraint", Journal of Banking and Finance, Vol. 30 No. 11, pp. 2931-2943; OECD (2015), New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments, OECD Publishing, Paris; International Finance Corporation (2017), MSME Finance Gap: Assessment of The Shortfalls and Opportunities in Financing Micro, Small And Medium Enterprises in Emerging Markets. IFC, Washington, DC.