HIGH COURT OF AUSTRALIA

GAUDRON, McHUGH, GUMMOW, KIRBY AND HAYNE JJ

ASSOCIATED ALLOYS PTY LIMITED APPELLANT

AND

ACN 001 452 106 PTY LIMITED (IN LIQUIDATION)
(FORMERLY METROPOLITAN ENGINEERING
AND FABRICATIONS PTY LIMITED) & ANOR RESPONDENTS

Associated Alloys Pty Limited v ACN 001 452 106 Pty Limited
[The Associated Alloys Case]
[2000] HCA 25
11 May 2000
S65/1999

ORDER

Appeal dismissed with costs.

On appeal from the Supreme Court of New South Wales

Representation:

F M Douglas QC with W Haffenden and J A Springthorpe for the appellant (instructed by K J Minotti & Co)

B A J Coles QC with M J Cohen for the respondents (instructed by Brown & Partners)

CATCHWORDS

Associated Alloys Pty Limited v ACN 001 452 106 Pty Limited

Equity – Distinction between trust and charge – Seller supplied goods subject to retention of title clause – Total purchase price not paid – Buyer insolvent – Goods no longer ascertainable – Whether retention of title clause trust or charge – Whether trust constituted – Intentions of the parties – Relationship between trust and debt – Significance of beneficiary's qualified ability to draw upon trust property – Significance of lack of requirement in trustee to keep trust property separate – Equitable obligations of trustee – Evidentiary requirements to prove trust – Liability to account.

Corporations Law – Distinction between trust and charge – Lack of obligation in Corporations Law to register trust – Reservation of title or *Romalpa* clause – Effectiveness against liquidator of insolvent company.

Contracts – *Romalpa* clause – Construction of contractual terms – Implication of terms – Significance of considerations of inutility and commercial practicality – Relationship between contractual and equitable rights.

Words and phrases – "trust" – "charge" – "registrable charge".

Corporations Law, ss 262, 263, 266.

1 GAUDRON, McHUGH, GUMMOW AND HAYNE JJ. This appeal is brought from a decision of the Supreme Court of New South Wales sitting as the Court of Appeal (Sheller, Beazley and Stein JJA)[1] ("the Court of Appeal"). It dismissed the appellant's appeal from the decision of Bryson J in the Equity Division[2]. Bryson J had dismissed proceedings by the plaintiff (the appellant) which were instituted by summons.

The issues

2 The issues in this Court principally concern the construction and effect of a paragraph in a retention of title, or "Romalpa"[3], clause. The text and scope of clauses which have come to be so described are not uniform[4]. Reference to the vague and undifferentiated, such as the categorical phrase "Romalpa clause", is no substitute for a particularised application of the relevant principles of law and equity to the construction and operation of the text at hand. It is possible to decide which of the submissions made to this Court is correct only by paying close regard to those matters.

3 In dismissing the appeal to the Court of Appeal, Sheller JA (with whom Beazley and Stein JJA concurred) held that the material paragraph of the retention of title clause, which is set out later in these reasons, was a "charge" within the meaning of s 9 of the Corporations Law ("the Law"). Section 9 defines "charge" to mean "a charge created in any way and includes a mortgage and an agreement to give or execute a charge or mortgage, whether on demand or otherwise". Part 3.5 (ss 261-282) of Ch 3 of the Law as it then stood[5] was entitled "CHARGES" and contained a regime for the registration of those

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1 *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrication[s] Pty Ltd (Voluntary Administrators Appointed) (Receivers and Managers Appointed)* (1998) 16 ACLC 1633.

2 *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrications Pty Ltd* (1996) 14 ACLC 952; 20 ACSR 205.

3 From *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676; [1976] 2 All ER 552.

4 *Clough Mill Ltd v Martin* [1985] 1 WLR 111 at 114-115; [1984] 3 All ER 982 at 985-986. For examples of retention of title clauses, see McCormack, *Reservation of Title*, 2nd ed (1995), Ch 5; Lightman and Moss, *The Law of Receivers of Companies*, 2nd ed (1994), Ch 12.

5 This Part of the Law was amended by items 86-154 of Sched 3 of the *Company Law Review Act* 1998 (Cth) which placed these sections within the newly created Ch 2K, headed "Charges".

"charges" identified by s 262. Bryson J held that the material paragraph was "a charge on a book debt", the expression used in s 262(1)(f) and given an extended meaning by s 262(4)[6]. It followed that the registration provisions were applicable.

4 Section 266(1) of the Law provides that, where the registration requirements have not been satisfied, such a charge on property of a company (here the first respondent) will be void as against the liquidator or administrator of the company or, where a deed of company arrangement has been executed, the administrator of the deed. On the hypothesis that the material paragraph of the retention of title clause was a registrable charge created by the first respondent in favour of the appellant, the relevant registration obligation was the lodgment of a notice under s 263 of the Law within the prescribed period (s 266(1)(c)). This was not done. It is the respondents' submission that the conclusions of the Court of Appeal and Bryson J were correct. These were that the material paragraph of the retention of title clause was a registrable "charge" within s 262 of the Law and, as there was a failure to lodge the notice required by s 263, the charge created by that paragraph is void as against the administrators of the first respondent and its liquidator. The appellant asserts that there was no registrable "charge" created by the first respondent in its favour and that the material paragraph was effective as an agreement for value to constitute trusts binding the first respondent in favour of the appellant in respect of certain after-acquired property.

5 The Law does not render a trust or agreement to constitute a trust void against the administrators or liquidator of the first respondent for want of registration. Nor does the legislation require the registration of trusts or agreements to create trusts. The distinction between the institutions of the trust and the charge is thus essential for this appeal. It is made essential by reason of the text of the Law and the particular criterion selected for its operation. The distinctions involved here have been seen by some as representing a sterile,

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6 Section 262(4) states:

> "The reference in paragraph (1)(f) to a charge on a book debt is a reference to a charge on a debt due or to become due to the company at some future time on account of or in connection with a profession, trade or business carried on by the company, whether entered in a book or not, and includes a reference to a charge on a future debt of the same nature although not incurred or owing at the time of the creation of the charge, but does not include a reference to a charge on a marketable security, on a negotiable instrument or on a debt owing in respect of a mortgage, charge or lease of land."

overly conceptualist approach to the solution of legal controversies[7]. However, these distinctions serve to identify the various building blocks of the law of property. Moreover, distinctions between the two institutions have been adopted by legislatures, as here with the Law, to mark the ambit of various regulatory regimes.

6 In *In re Bank of Credit and Commerce International SA (No 8)*[8], Lord Hoffmann, with whose speech the other Law Lords agreed, gave a description of an equitable charge in which he emphasised that the proprietary interest created thereby is held by way of security, so that the chargee may resort to the charged asset only for the purpose of satisfying some liability due to the chargee. The charge is subject to the equity of redemption retained by the owner. However, the beneficial interest held under an express trust is not so limited in nature. The remedy of the beneficiary is to proceed in equity for the performance of the trust, not for the sale of trust property to satisfy a secured liability[9].

<u>The facts</u>

7 The appellant, Associated Alloys Pty Ltd ("the Seller"), sold steel to the first respondent, ACN 001 452 106 Pty Limited (In Liquidation) (formerly Metropolitan Engineering and Fabrications Pty Ltd) ("the Buyer"), between 1981 and 1996. In about 1987 or 1988, the Seller began to issue invoices to the Buyer with the reservation of title clause, the subject-matter of this appeal, printed on the reverse side.

8 Invoices were issued by the Seller to the Buyer on 31 August, 26 September and 26 October 1995. Each individually numbered invoice recorded the details of the supply and shipment of steel by the Seller, in accordance with an individually numbered order of the Buyer. Each invoice also recorded a particular United States dollar sum owed by the Buyer to the Seller in respect of the particular shipment of steel supplied thereunder: Invoice No 583 for $US61,361.29 and Invoice No 592 for $US80,630.00, together in fulfilment of

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7 A tendency observed, but not commended, by Professor Scott, *The Law of Trusts*, 4th ed (1987), vol 1 at §4A.

8 [1998] AC 214 at 226.

9 Other distinctions are drawn in Waters, *Law of Trusts in Canada*, 2nd ed (1984) at 82-85; Meagher and Gummow, *Jacobs' Law of Trusts in Australia*, 6th ed (1997) at [227]-[229].

Order No 37603; and Invoice No 598 for $US69,920.00, in partial fulfilment of Order No 37605 ("the Invoices"). On the front of the Invoices was recorded, under the heading "PAYMENT TERMS", "PAYMENT DUE APPROX MID/END NOVEMBER '95". The bottom of the front of the Invoices was marked "Romalpa Clause set forth on the reverse side hereof applies".

9 An identical clause was printed on the reverse side of the invoices numbered 592 and 598. Invoice No 583 omitted the clause. The significance of this omission will be considered later in these reasons. The clause provided:

> "RESERVATION OF TITLE
>
> '[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*'." (paragraph numbers and emphasis added)

It is the operation of the fifth paragraph of the clause ("the Proceeds Subclause") which is of prime importance for this appeal. It is unnecessary to determine the construction and effect of the other paragraphs of the clause, other than for the purposes of construing the Proceeds Subclause.

10 The facts which necessitate the construction of the Proceeds Subclause can be outlined in short compass. The Buyer has not paid the Seller the full amount owing under the Invoices. The Buyer has, however, used the steel supplied under the Invoices, as well as additional steel supplied by the Seller in fulfilment of other orders in the period after 31 May 1995, in the fabrication of pressure vessels, heat exchangers and columns ("the Steel Products"). The fabrication of these manufactured goods was for the purpose of supplying a company incorporated in the Republic of Korea, Lucky Goldstar ("the Third Party")[10]. Bryson J found that the steel supplied by the Seller to the Buyer under the Invoices had been used to manufacture the Steel Products for the Third Party and that some components, possibly no more than one pressure vessel had yet to be shipped to the Third Party[11].

11 The Buyer came under voluntary administration early in February 1996, conducted by the second respondent and his partner. A bank, which held a fixed and floating charge over the Buyer's assets, appointed a receiver and manager later in that month. Subsequently, the Buyer went into liquidation.

12 In order for the Seller to succeed in this appeal, several hurdles must be overcome. First, the meaning of the Proceeds Subclause must be ascertained. This involves determining what are "the proceeds" to which the Proceeds Subclause refers. Secondly, it must be determined whether the trusts that the Proceeds Subclause purported to create in respect of future receipts were indeed constituted. This involves ascertaining the obligations assumed by the parties, a

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10 This appeal may be contrasted with cases concerning no more than the resale of goods supplied. For recent examples of clauses operating upon proceeds of resale of such original goods, see *Puma Australia Pty Ltd v Sportsman's Australia Limited (No 2)* [1994] 2 Qd R 159 at 160; *Re Highway Foods International Ltd (in administrative receivership)* [1995] 1 BCLC 209 at 210; De Lacy, "Romalpa Revalued?", (1993) 57 *The Conveyancer and Property Lawyer* 375. Further, in the present case it may be noted that the agreement to supply the Third Party did not contain any additional retention of title clause: see Hanbury & Martin, *Modern Equity,* 15th ed (1997) at 682.

11 (1996) 14 ACLC 952 at 954; 20 ACSR 205 at 208.

matter in which their intentions are important. Thirdly, if, pursuant to the contracts between the Buyer and the Seller, the trusts were constituted, the interaction between the trusts and the other contractual relations between the parties must be identified. Fourthly, the findings of the primary judge upon the evidence must be examined to determine whether the Seller made out its claim for relief.

Construction of the Proceeds Subclause

13 The Proceeds Subclause operates, conditionally, "[i]n the event that the [Buyer] uses the goods/product in some manufacturing or construction process of its own or some third party". This event occurred on each occasion the Buyer used the steel supplied by the Seller to manufacture the Steel Products. No question arises as to the Seller retaining any proprietary interest in the steel it supplied under the Invoices to the Buyer. This is because the steel supplied by the Seller was no longer capable of being ascertained in the Steel Products manufactured by the Buyer. This loss of ascertainability may be contrasted with the circumstances in which the first paragraph of the reservation of title clause applies. This paragraph has an operation where the steel supplied by the Seller remains intact in the hands of the Buyer or is otherwise dealt with by the Buyer in such a way that the steel supplied does not lose its ascertainability. In such a case, the goods would remain the property of the Seller and an action in trover or detinue would lie against the Buyer[12] and, in support of such an action, injunctive relief might be available in an appropriate case[13].

14 The remainder of the Proceeds Subclause is divisible into two parts. The first part describes a subject-matter of commercial value. The second part operates to confer an interest in equity in that subject-matter.

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12 *Penfolds Wines Pty Ltd v Elliott* (1946) 74 CLR 204 at 229; *Gollan v Nugent* (1988) 166 CLR 18 at 25.

13 As was sought in *Penfolds Wines Pty Ltd v Elliott* (1946) 74 CLR 204, and see *Puma Australia Pty Ltd v Sportsman's Australia Limited (No 2)* [1994] 2 Qd R 159 at 166-169, 171-173.

<u>"The proceeds"</u>

15 The subject-matter of commercial value is described in the Proceeds Subclause as "such part of the proceeds of such manufacturing or construction process as relates to the goods/product [supplied by 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". Various questions of construction arise for consideration. No question of uncertainty arises. The Proceeds Subclause will, consistently with the reasoning of Barwick CJ in a well known passage in *Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd*[14], bear that meaning which the court decides is its proper construction.

16 The questions of construction may be encapsulated as follows. First, whether the phrase "the proceeds of such manufacturing or construction process" includes one or more of the following: (i) the undelivered physical goods produced by the Buyer's (or third party's) manufacturing or construction process; (ii) obligations owed to the Buyer arising from, for example, the sale of those manufactured goods (for example, the obligations in debt of the Third Party owed to the Buyer in respect of the sale of the Steel Products); (iii) monetary sums paid by others to the Buyer, for example, upon the realisation by the Buyer of its book debts. Secondly, the meaning of the phrase "as relates". Thirdly, whether the concluding sentence deeming "[s]uch part … to equal in dollar terms the amount owing by the [Buyer] to the [Seller] at the time of the receipt of such proceeds" operates to delineate the meaning of "proceeds".

17 It is convenient to turn to the second question. The phrase "as relates" confines the ambit of the word "proceeds". The "proceeds" are not undifferentiated. Rather, they must be in respect of the Buyer's (or a third party's) manufacturing or construction process which, in turn, used the "goods/product" (that is, the steel) supplied by the Seller under *each* invoice. Thus, three lots or sets of "proceeds" arise for consideration in this appeal, each lot corresponding to each of the Invoices. It will be necessary to return to this aspect of the Proceeds Subclause when determining whether any "proceeds" were received by the Buyer in relation to each of the Invoices.

18 The first and third questions are interrelated. The second sentence in the Proceeds Subclause operates to circumscribe the meaning of the phrase "part of the proceeds" used in the first sentence. The reference in the second sentence to

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14 (1968) 118 CLR 429 at 436-437.

"the time of the receipt of such proceeds" disposes of the proposition that the phrase "proceeds" includes the undelivered physical goods produced by the Buyer's manufacturing or construction process. These goods cannot be a "receipt", in any conventional sense of the word, of the Buyer. As such, to avoid a manifest incongruity, goods resulting from a manufacturing or construction process of a third party are not "proceeds".

19 The critical question remains whether the phrase "the proceeds" is limited merely to the funds comprised in payments made by the Third Party to the Buyer or whether it also includes the obligations in debt owed to the Buyer by the Third Party, that is, the choses in action, or book debts, of the Buyer.

20 In the Court of Appeal, Sheller JA stated[15]:

> "Bryson J was of opinion that the proceeds of the manufacturing process on which the [Proceeds Subclause] imposed a trust in favour of [the Seller] were 'book debts, both before and after they are received and held in trust'. Central to [the Seller's] submissions on this appeal was the proposition that the trust attached not to book debts but to the fund created from moneys paid by [the Third Party] in discharge of its indebtedness for the manufactured goods [the Buyer] sold to it. This contention gains some support from the last sentence in the [Proceeds Subclause] which equated the part of the proceeds held in trust with an amount owing 'at the time of the receipt of such proceeds'.
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> In my opinion, the proceeds of the manufacturing process to which [the Proceeds Subclause] referred was the price agreed to be paid for the goods derived from that process. …
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> [The Seller's] submission was that [the Proceeds Subclause] did not make [the Buyer] trustee of such book debts but of the fund created when payment was received. However, in my opinion, if [the Proceeds Subclause] is to have any operation it must have operated to charge the book debts as defined immediately they came into existence. If it were otherwise, [the Buyer] would be left to deal with the book debts as it pleased. …
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> The [Proceeds Subclause] was designed to protect [the Seller] from the consequences of [the Buyer's] insolvency by charging part of its book debts.

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15 (1998) 16 ACLC 1633 at 1640-1641.

> This was achieved by using the device of a trust. The trust embraced part of the proceeds of the manufacturing process when the price to be paid for those derived goods became payable either immediately or in the future and continued until [the Buyer] paid [the Seller] for the goods [the Seller] sold to [the Buyer] and [the Buyer] used in the manufacturing process. It was one trust and involved as an essential feature a charge on [the Buyer's] book debts.
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> For that reason, in my opinion, [the Proceeds Subclause] was void as against the liquidator and administrators because it created a registrable charge, no notice of which had been lodged by [the Buyer], on property of [the Buyer], namely its book debts. I do not think it is permissible to treat as separate the trust, subject to which moneys received were held, when the book debts were paid and argue that although those moneys were the subject of a trust, whether by charge or otherwise, they were not the subject of a registrable charge within the meaning of s 266(1) of [the Law]."

21 Sheller JA in these passages identifies a matter of some commercial significance. If the book debts of the Buyer do not fall within the meaning of "proceeds", the Buyer could have, for example, assigned or factored the book debts owed by the Third Party with impunity[16]. The Invoices contain no contractual prohibition against assignment[17]. Assuming, on this hypothesis ("the first hypothesis"), that the Third Party was notified of the assignment by the assignee, it is likely that no payments thereafter would be made by the Third Party to the Buyer. Thus no "proceeds" would be received by the Buyer. Accordingly, on this construction of the phrase "the proceeds", the Buyer would have been at liberty to arrange matters so that there would have been no subject-matter for the operation of the Proceeds Subclause. The ease with which this

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16 In a number of the English cases where the arrangements in question were held to involve assignments by way of security of book debts owed by the third party, the buyer assigned or factored the book debts and questions of disputed priorities then arose between the seller and that assignee under the factoring arrangement. See, for example, *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150; *Compaq Computer Ltd v Abercorn Group Ltd (t/a Osiris)* [1993] BCLC 602.

17 As to the consequences of breach of such a provision, see *Devefi Pty Ltd v Mateffy Pearl Nagy Pty Ltd* (1993) 113 ALR 225 at 234-237; *Don King Productions Inc v Warren* [1998] RPC 817 at 827-828; [1998] 2 All ER 608 at 632-633; affd [1999] 3 WLR 276 at 314-316; [1999] 2 All ER 218 at 233-234.

could have been done and the effects upon the commercial utility of the clause appeared to lead Sheller JA to consider that what was identified as "the proceeds" included a charge on the book debts.

22 However, the first hypothesis outlined above is not exhaustive. A further commercial difficulty may arise even if the phrase "the proceeds" be construed to encompass the book debts of the Buyer. The concluding sentence of the Proceeds Subclause confines "proceeds" to equate "in dollar terms the amount owing by the [Buyer] to the [Seller] *at the time of the receipt of such proceeds*" (emphasis added). The Buyer thus remained at liberty to deny a subject-matter upon which the Proceeds Subclause could operate by entering into a forward sale agreement for goods it had yet to manufacture.

23 On this hypothesis ("the second hypothesis"), the forward sale agreement would be entered into before the Buyer entered into any supply agreement with the Seller for the steel necessary to manufacture those goods sold under the forward sale agreement. Further, it is to be assumed that, at the time of entering into the forward sale agreement, the third party purchaser would be obliged in debt to the Buyer for the purchase price of the goods yet to be manufactured. The Buyer would thus, at the time of entering into the forward sale agreement, be in receipt of "proceeds" within the meaning of the Proceeds Subclause. But no obligation of indebtedness between the Buyer and Seller, in relation to the steel to be used to manufacture the goods sold under the forward sale agreement, would exist at the time of the receipt by the Buyer of the material "proceeds". Hence there would be no amount of "the proceeds" available to be held on trust. Thus it would appear that, by using a forward sale agreement, perhaps a relatively unsophisticated commercial arrangement compared to the retention of title clause under consideration, the Buyer could achieve a result which would deny an effective operation to the Proceeds Subclause.

24 It follows that, on either construction of the phrase "the proceeds", the Buyer would be at liberty, to some extent, so to arrange its affairs as to deny an effective operation to the Proceeds Subclause. This is important in considering the reasons of Sheller JA in the passages set out above. As noted above, his Honour construed the Proceeds Subclause as including book debts partly because he considered (on the first hypothesis) that it would otherwise often have no operation. Thus, he concluded, "to have any operation it must have operated to charge the book debts as defined immediately they came into existence"[18]. Although the first hypothesis shows how the clause could be deprived of

18 (1998) 16 ACLC 1633 at 1640.

effective operation were "the proceeds" considered not to include book debts, the second hypothesis shows that the clause may still have no effective operation even if it *were* to include book debts. The fact that the Proceeds Subclause is drafted in such a way as to allow the Buyer to evade its operation is the Seller's misfortune. But since the clause leaves open the taking of steps to render it commercially ineffective, whether it includes book debts or not, neither construction is to be preferred by considerations of possible inutility.

25 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*[19], 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[20]. 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.

Interplay between law and equity

26 It is necessary to determine the equitable rights, liabilities and remedies which arise from the purported operation of the Proceeds Subclause. A pendent question also arises as to the manner in which the Buyer's contractual rights and obligations are affected by equitable considerations. The disposal of this question necessitates, to use Lord Wilberforce's expression, the "flexible interplay of law and equity"[21]. This interplay is, however, confined by the terrain

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19 (1880) 13 Ch D 696 at 708-709.

20 Questions as to the application of moneys received, which it is unnecessary now to answer, may arise where a running account exists between a supplier (eg the Seller) and purchaser (eg the Buyer).

21 *Quistclose Investments Ltd v Rolls Razor Ltd* [1970] AC 567 at 582.

of case law, which, in this field of discourse, was described by Staughton J as "a maze if not a minefield"[22]. It is of some importance that parties to sophisticated commercial transactions have structured, and will continue to structure, their affairs on the basis that a certain and predictable course can be charted through this terrain[23].

27 In *Gosper v Sawyer*, Mason and Deane JJ observed[24]:

> "The origins and nature of contract and trust are, of course, quite different. There is however no dichotomy between the two. The contractual relationship provides one of the most common bases for the establishment or implication and for the definition of a trust."

28 This appeal illustrates their Honours' point. The contracts, in respect of each of the Invoices, spoke for the future and provided the attachment of a trust for "the proceeds" received from time to time. There being value, and equity regarding as done that which ought to be done, a completely constituted trust would arise in respect of those "proceeds" (giving that word the meaning considered above) as they were received by the Buyer[25].

29 In their joint judgment in *Kauter v Hilton*, Dixon CJ, Williams and Fullagar JJ identified[26]:

> "the established rule that in order to constitute a trust the intention to do so must be clear and that it must also be clear what property is subject to the trust and reasonably certain who are the beneficiaries".

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22 *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 1 WLR 485 at 493; [1984] 2 All ER 152 at 159.

23 Great Britain, *Report of the Review Committee on Insolvency Law and Practice*, (1982) Cmnd 8558 at 1627 ("the Insolvency Committee Report").

24 (1985) 160 CLR 548 at 568-569.

25 *Palette Shoes Pty Ltd v Krohn* (1937) 58 CLR 1 at 26-27; *Federal Commissioner of Taxation v Everett* (1980) 143 CLR 440 at 450. See also the United States authorities considered under the heading "Debtor Declaring Himself Trustee for Creditor" in Bogert, *The Law of Trusts and Trustees*, 2nd ed rev (1984), §19.

26 (1953) 90 CLR 86 at 97.

However, their Honours went on to emphasise that a plaintiff who seeks to prove too wide a trust need not fail altogether[27]. This, as will later appear when dealing with the "credit period", is a matter of some importance. In *Kauter v Hilton* it was found that the deceased had intended to create a present trust upon the deposit of moneys in various bank savings accounts. The trust was fully constituted although the deceased had reserved to himself the right to withdraw any interest which accrued on the accounts in his lifetime. It would have been a breach of trust for the deceased to have disposed of the moneys from time to time in the accounts, apart from the interest, without the consent of a beneficiary.

30 In the present case, it is no objection to the effective creation of a trust that the property to be subjected to it is identified to be a proportion of the proceeds received by the Buyer; a proportion referable to moneys from time to time due and owing but unpaid by the Buyer to the Seller.

31 In respect of those proceeds from time to time bound by the trust, there is nothing in the terms of the trust to negative the ordinary consequence that the trustee (the Buyer) is bound to apply that sum by accounting to or at the direction of a beneficiary (the Seller). It is convenient to identify the condition which limits the beneficiary's entitlement to call upon the trust property later in this judgment. As Professor Hayton points out[28], with reference to authority[29], because equity treats as done that which ought to be done, even if the proceeds were paid into a general bank account of the Buyer there could be a tracing remedy where the recipient was obliged to hold a particular portion of the proceeds on trust.

32 In the situation just considered, where the trust is performed and discharged by appropriation of the proceeds by the Seller, the relevant trust relationship between the Buyer and the Seller is brought to an end. A question may then arise

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27 See also *Re Armstrong, deceased* [1960] VR 202.

28 Underhill and Hayton, *Law Relating to Trusts and Trustees*, 15th ed (1995) at 12(n); cf Hayton, "The Uses of Trusts in the Commercial Context", in Hayton (ed), *Modern International Developments in Trust Law*, (1999) 145 at 168.

29 Including that of the Supreme Court of Canada in *Air Canada v M & L Travel Ltd* [1993] 3 SCR 787 at 804-805 in which reliance was placed upon the judgment of Hope JA in *Stephens Travel Service International Pty Ltd (Receivers and Managers Appointed) v Qantas Airways Ltd* (1988) 13 NSWLR 331 at 348-349, with which Kirby P and Priestley JA agreed.

whether, despite the Seller having been funded in this way, it might retain a good claim for that amount by an action in debt against the Buyer. The answer to that will be found not in trust law but in the terms, express or implied, of the contract between the Buyer and the Seller. In the formulation of those terms, particularly any implied terms, there is, to adapt the words of Lord Wilberforce, "surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies"[30] and the giving of effect to "practical arrangements" by "the flexible interplay of law and equity"[31].

Intentions of the parties

33 In *Commissioner of Stamp Duties (Qld) v Jolliffe*[32], Isaacs J considered that a party who had used the term "trustee" for the title of a savings bank account could not be heard to deny the trust and to assert an absolute entitlement to the moneys in the account and the interest derived therefrom. The majority (Knox CJ and Gavan Duffy J) held that the respondent was not excluded from averring that he had not intended to create a trust and that, rather, he had used the term "trustee" for the sole purpose of procuring interest he believed, by reason of certain legislation, would not have been payable by the bank if the account had been in his own name and not as a trustee. In *Kauter v Hilton*[33], the Court treated *Jolliffe* as deciding, for the purposes of the legislation there in question, that "[a]ll the relevant circumstances must be examined in order to determine whether the depositor really intended to create a trust".

34 This is not one of those cases where the language employed by the parties for the transaction is inexplicit so that the court is left to infer the relevant intention from other language used by them, from the nature of the transaction and from the circumstances attending the relationship between the parties[34]. An express obligation upon the Buyer to keep the "proceeds" separate would have pointed to the existence of a trust if none had been explicit[35]. This would have

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30 *Quistclose Investments Ltd v Rolls Razor Ltd* [1970] AC 567 at 581.

31 *Quistclose Investments Ltd v Rolls Razor Ltd* [1970] AC 567 at 582.

32 (1920) 28 CLR 178.

33 (1953) 90 CLR 86 at 100; cf the English decision of *Midland Bank plc v Wyatt* [1995] 1 Family LR 696 at 707.

34 *Walker v Corboy* (1990) 19 NSWLR 382.

35 *Cohen v Cohen* (1929) 42 CLR 91 at 100-101.

been because, as McPherson ACJ has put it, such an obligation "is a hallmark duty of a trustee"[36]. But where the existence of a trust is explicit, the absence of an express obligation to keep trust moneys separate does not deny the trust. Rather, there being a trust, it follows that equity imposes various obligations and duties on the trustee. One of these is the obligation to get in the trust property and keep it distinct from the property of the trustee and from property held on other trusts. No question presently arises of the variation or abrogation of such obligations by statute or by express provision in a settlement[37].

35 In the present case there is nothing to suggest, at this subjective level, that the parties in their written instrument did not mean what they said, or did not say what they meant. There is no suggestion of a sham[38]. It must follow that the terms of the Invoices embodied the intentions of the parties[39]. Moreover, there was no case made, nor is there any evidence apparent, on which it could be contended that the Proceeds Subclause was a scheme to evade the operation of what was then Pt 3.5 of the Law. The agreements which included the Proceeds Subclause were not made in breach of a statutory prohibition upon their formation or upon the doing of a particular act essential to their performance or otherwise making unlawful the manner of their performance[40].

36 The points made in the last paragraph may be illustrated by reference to the speeches of Lord Herschell LC in two cases decided by the House of Lords in May 1895 and long regarded as basic authorities in commercial law. They are *McEntire v Crossley Brothers*[41] and *Helby v Matthews*[42]. The House of Lords

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36 *Puma Australia Pty Ltd v Sportsman's Australia Limited (No 2)* [1994] 2 Qd R 159 at 162.

37 cf *Armitage v Nurse* [1998] Ch 241 at 253-254.

38 See *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 at 802; *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449 at 454-458, 467-469; *Sonenco (No 87) Pty Ltd v Commissioner of Taxation* (1992) 38 FCR 555 at 591-592.

39 *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* decided by the House of Lords in 1979 but reported [1992] BCLC 609 at 613.

40 *Fitzgerald v F J Leonhardt Pty Ltd* (1997) 189 CLR 215 at 229-230, 249-250.

41 [1895] AC 457.

42 [1895] AC 471.

held that certain hiring transactions with options to purchase did not fall within provisions of the bills of sale or factors legislation. To arguments that the transactions fell within "the mischief" of the legislation in question which therefore ought to be read as applicable, the Lord Chancellor responded that the statutory language should not be strained to achieve that result; rather, the legislation needed amendment[43]. The sequel after long debate in the United Kingdom was the introduction of specific legislation regulating hire-purchase agreements[44].

37 In *McEntire*, Lord Herschell LC said[45]:

> "Here the parties have in terms expressed their intention, and said that the property shall not pass till the full purchase-money is paid. I know of no reason to prevent that being a perfectly lawful agreement. If that was really the intention of the parties, I know of no rule or principle of law which prevents its being given effect to. I quite agree that if, although the parties have inserted a provision to that effect, they have shewn in other parts of the agreement, by the language they have used or the provisions they have made, that they intended the property to pass, you must look at the transaction as a whole; and it might be necessary to hold that the property has passed, although the parties have said that their intention was that it should not, because they have provided that it shall."

38 The present case is not an example of an arrangement whereby, upon its proper construction, proceeds subject to the trust in favour of the Seller were defined otherwise than by reference to the state of indebtedness between the Buyer and the Seller, and the beneficial interest of the Buyer in a greater sum might have been appropriated by the Seller to give it a windfall. Equity favours the identification and protection of an equity of redemption and, in that regard, prefers substance to form[46]. In a case such as that discussed above, this might have provided a footing for the treatment of the interest of the Seller as no more

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43 *McEntire v Crossley Brothers* [1895] AC 457 at 466; *Helby v Matthews* [1895] AC 471 at 477.

44 See Goode, *Hire Purchase Law and Practice*, 2nd ed (1970) at 2-10.

45 [1895] AC 457 at 463.

46 *Salt v Marquess of Northampton* [1892] AC 1.

than a charge upon the proceeds to secure the indebtedness of the Buyer[47]. It is unnecessary to express any concluded view upon the matter.

39 If the Proceeds Subclause had been drafted so as to constitute a trust over the entire proceeds, a question would have arisen as to whether the parties intended that the Seller obtain the beneficial interest in the profits of the Buyer. It may be, as Robert Goff LJ emphasised in *Clough Mill Ltd v Martin*[48], a manifestly peculiar outcome to find that the parties to such an agreement intended that the Seller obtain the windfall of the full value of the newly manufactured products. Whilst it may be difficult to conceive what other intention could sensibly be imputed to the parties[49], certain observations of Windeyer J and Lord Wilberforce would require careful attention.

40 In *Gurfinkel v Bentley Pty Ltd*[50] Windeyer J said, in a situation comparable to that in this case, that in modern times the law ordinarily will take the parties at their word and the court will be slow to find that a bargain is not as the parties expressed it. In *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd*[51], the House of Lords decided that a particular form of trading agreement did not create any charge over book debts. Lord Wilberforce gave the leading judgment. His Lordship referred to the evidence and continued[52]:

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47 See *In re Welsh Irish Ferries Ltd* [1986] Ch 471 at 478; *Compaq Computer Ltd v Abercorn Group Ltd (t/a Osiris)* [1993] BCLC 602 at 612; *Re Highway Foods International Ltd (in administrative receivership)* [1995] 1 BCLC 209 at 216.

48 [1985] 1 WLR 111 at 120; [1984] 3 All ER 982 at 990. Whilst expressed generally, the reasons of Templeman LJ in *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 at 44-45 do not appear to be directed to retention of title clauses such as the Proceeds Subclause; cf *Tatung (UK) Ltd v Galex Telesure Ltd* (1989) 5 BCC 325 at 332.

49 See also the observations of Oliver LJ and Sir John Donaldson MR in *Clough Mill Ltd v Martin* [1985] 1 WLR 111 at 124, 125; [1984] 3 All ER 982 at 993, 994.

50 (1966) 116 CLR 98 at 114; cf *Re Curtain Dream plc* [1990] BCLC 925 at 935, 937, 939.

51 [1992] BCLC 609.

52 [1992] BCLC 609 at 615.

> "To suppose, in the face of this, that the assignments were made not by way of sale but by way of security, would be to impose upon the parties a form of transaction totally different from that which they had selected, namely one of sale and which there is no evidence whatever that either of them desired."

His Lordship added[53]:

> "In block discounting 'transactions', the purchaser is acquiring an asset (viz a book debt) which he did not create, as to the validity of which he has no knowledge, which he is not going to collect, and of any default in whose realisation he may be ignorant. He naturally requires a certain margin, or reserve, or as is sometimes said, security to ensure, so far as possible, that he will get what he has bargained for. But it is a fallacy (into which the appellants' argument falls) to argue from this towards a conclusion that the transaction as a whole is one of security or charge. There are many contracts, of sale, or for building work, or otherwise, where some security is required by one party that the other will fulfil his promise. But this does not alter the nature of the contract itself or turn it into a contract by way of charge."

41 Further, it is unnecessary to consider the characterisation of a clause which results in residual trust property vesting in the Buyer[54] or which gives rise to a trust defeasible upon payment of the debt[55]. It is explained later in these reasons that upon receipt by the Buyer of the relevant "proceeds", the debt arising under the relevant agreement would have been discharged. That is, the constitution of a trust "equal in dollar terms [to] the amount owing by the [Buyer] to the [Seller] at the time of the receipt of such proceeds" would discharge the debt by performance.

42 The submissions for the Buyer proceed on the footing that the arrangement established by the instruments in question here could not be a trust because such

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53 [1992] BCLC 609 at 616.

54 See *Compaq Computer Ltd v Abercorn Group Ltd (t/a Osiris)* [1993] BCLC 602 at 613-614.

55 See *Re Weldtech Equipment Ltd* [1991] BCC 16 at 17; [1991] BCLC 393 at 394; *In re Bond Worth Ltd* [1980] Ch 228 at 248; *Tatung (UK) Ltd v Galex Telesure Ltd* (1989) 5 BCC 325 at 333; cf Ong, *Trusts Law in Australia*, (1999) at 547.

a trust would fail to satisfy the three certainties restated in the passage from *Kauter v Hilton* set out above[56]. The parties must, it was suggested, have intended (and created) no more than the security for the moneys owing by the Buyer to the Seller. As indicated above, that conclusion does not follow and there was an agreement effective in equity to bind, from time to time, the relevant "proceeds". It remains to consider the contractual terms to which reference was made above.

<u>The contractual terms</u>

43 The contractual agreements of the Buyer and Seller, in respect of each of the Invoices, included the amount to be paid by the Buyer for the steel supplied under each Invoice and stated "PAYMENT DUE APPROX MID/END NOVEMBER '95". This latter term operated as a period of credit, commercially benefiting the Buyer. The question that arises is whether this term is inconsistent with the intention to constitute a trust in the manner described above. That is, whether the purported liberty of the Buyer not to pay the Seller is consistent with the obligation to create a trust of "proceeds" which might be received by the Buyer during the period of credit. This question is resolved by reference to the contract as a whole, including the implied terms that arise.

44 The rules governing the implication of an implied term as a matter of fact were stated by the Privy Council in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings*[57] and have subsequently been approved and applied in numerous decisions of this Court[58]. In *Codelfa Construction Pty Ltd v State Rail Authority of NSW*, Mason J restated the five conditions laid down by the Privy Council[59]:

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56 (1953) 90 CLR 86 at 97.

57 (1977) 180 CLR 266 at 283.

58 These include *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 at 605-606; *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337 at 351-352, 404; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 65-66, 95, 117-118, 121; *Moorgate Tobacco Co Ltd v Philip Morris Ltd [No 2]* (1984) 156 CLR 414 at 435; *Adelaide Corporation v Jennings Industries Ltd* (1985) 156 CLR 274 at 281-282; *Hawkins v Clayton* (1988) 164 CLR 539 at 571-573; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410 at 422, 441.

59 (1982) 149 CLR 337 at 347.

> "(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract".

45 The implication of an implied term operates to align, or give congruence to, the rights and obligations of the Buyer and Seller in contract and the intention of these parties to create a trust in the manner described above. An implied contractual term arises, as a matter of business efficacy, that upon the receipt by the Buyer of the relevant "proceeds" (and thus the constitution of a trust of part of those proceeds), the obligation in debt is discharged. The express term in the agreement (referred to above) which provides for a period of credit within which the debt need not be paid by the Buyer is, in turn, incorporated as an express term of the trust. This term thereby prescribes the period within which the Seller, as beneficiary, cannot call upon the trust property (if the trust is constituted during the credit period). The implied term thus provides one means of discharging the debt by performance. No relevant inconsistency arises between this implied term and the express term in the agreement providing for a period of credit for the Buyer.

46 As indicated earlier in these reasons, each of the three agreements to supply steel was evidenced in part by one of the Invoices. In *Byrne v Australian Airlines Ltd*, McHugh and Gummow JJ said[60]:

> "If the contract has not been reduced to complete written form, the question is whether the implication of the particular term is necessary for the reasonable or effective operation of the contract in the circumstances of the case; only where this can be seen to be true will the term be implied[61]."

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

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60 (1995) 185 CLR 410 at 442.

61 *Hawkins v Clayton* (1988) 164 CLR 539 at 573.

parties, that if the subject had been raised with them they would have replied "of course".

47 Further, no inconsistency arises between the contractual agreement and the creation of a trust of property "equal in dollar terms [to] the amount owing by the [Buyer] to the [Seller] at the time of the receipt" of the proceeds[62]. Manifestly, this term did not operate to constitute a trust in respect of the whole of the proceeds received by the Buyer except, perhaps, coincidentally.

<u>Corporations Law</u>

48 The Proceeds Subclause is an agreement to constitute a trust of future-acquired property. It is therefore not a "charge" within the meaning of s 9 of the Law and the detailed provisions of the Law governing charges thus do not apply to it. The Proceeds Subclause is not a "registrable charge" within s 262 and the Seller had no obligation to lodge a notice under s 263 within the prescribed period (s 266(1)(c)). In turn, the Proceeds Subclause is not void as against the administrators or liquidator of the Buyer (see s 266(1)).

49 The circumstance that the then Pt 3.5 of the Law was not attracted to the Proceeds Subclause is of commercial significance. For third parties, such as financial institutions seeking to assess the credit-worthiness of the buyer, the non-registration of the Proceeds Subclause on a public register may create practical difficulties. These difficulties are capable of remedy by legislation[63].

50 However, as one may expect, there would be two sides to any argument to which such a proposal might give rise. The lack of any statutory obligation to register the Proceeds Subclause (for example, under s 263(1) of the Law) creates commercial incentives for entities, in the position of both the Buyer and the Seller, to incorporate clauses such as the Proceeds Subclause into their purchase agreements. These clauses reduce the risk of non-payment by the buyer. To the extent that this financial, or credit, risk is reduced, the commercial viability of the transaction for both parties may be increased. For example, the availability of this means of reducing credit risk for the seller may result in the seller accepting

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62 See Underhill and Hayton, *Law Relating to Trusts and Trustees*, 15th ed (1995) at 11-12.

63 Recommendations for reform in this area of law were proposed in Ch 37 of the Insolvency Committee Report, some of which were enacted by the *Insolvency Act* 1986 (UK): see Hanbury & Martin, *Modern Equity*, 15th ed (1997) at 685-686.

a lower cost price per unit of steel. Competitive pressures may thus operate upon the parties to incorporate clauses such as the Proceeds Subclause in their transactions.

51 In the Law, the legislature has chosen to select as the criterion of operation of the registration provisions that which it defines as a "charge". The contractual and trust arrangement with which this appeal is concerned did not involve the creation of such a charge or an agreement to create one. To treat the Proceeds Subclause as an agreement which falls foul of the Law is to rewrite the statute. It is not for the courts to destroy or impair property rights, such as those arising under trusts, by supplementing the list of those rights which the legislature has selected for such treatment.

<u>Relief</u>

52 It is convenient to set out the relief sought by the Seller in the summons:

"1. (a) A declaration that in the events which have happened the second [respondent] (or additionally or alternatively the [Buyer]) holds upon trust, for the benefit of the [Seller] the sum of $US197,911.29 (or such other sum as the Court deems fit) in respect of the goods referred to in Schedule A hereto (hereinafter referred to as 'the goods').

(b) An order that the second [respondent] (or additionally or alternatively the [Buyer]) account to the [Seller].

2. Additionally or alternatively a declaration that in the events which have happened the [Seller] is entitled to the sum of $US197,911.29 (or such other sum as this honourable court deems fit).

3. Additionally or alternatively –

(a) A Declaration that in the events which have happened title in the said goods did not, at any time, pass to the [Buyer].

(b) A Declaration that the second [respondent] (or additionally or alternatively the [Buyer]) is guilty of conversion of the goods.

(c) Damages.

> 4. Additionally or alternatively an Order that the second [respondent] (or additionally or alternatively the [Buyer]) pay to the [Seller] the sum of $US197,911.29."

In addition, the Seller sought such further declarations, orders or directions as the Court deemed fit, as well as interest and costs. The goods referred to in Sched A of the summons were identical to the description of the steel supplied to the Buyer under the Invoices. To determine the Seller's entitlement to the relief sought it is necessary to consider certain findings of fact of Bryson J.

<u>Evidence of receipt of "the proceeds"</u>

53 It was for the Seller to make out its case. In the end, this appeal turns on a critical gap in the evidence. Bryson J observed that if the Seller had any remedies they arose under the Proceeds Subclause. His Honour considered the evidence and said[64]:

> "[The Buyer] has done nothing to identify any part of the proceeds as relating to the steel in [the Invoices], and has done nothing to set aside and hold any part of the proceeds in trust for [the Seller] …
>
> [T]here is no basis on the evidence on which any particular one of the [Steel Products], whether they have been delivered to [the Third Party] or are still in [the Buyer's] hands, can be identified as having been produced from the goods in any one of the [Invoices]. Nor is there any basis for carrying out any process of apportionment; if such a process were appropriate, the evidence would not enable it to be done."

In the first of these passages, Bryson J refers to "proceeds" in the hands of the Buyer. This reference erroneously assumes that the payments received by the Buyer from the Third Party, as at the time of judgment, were "proceeds" within the meaning of the Proceeds Subclause. However, in the context of the further findings quoted above, it is not possible to identify, as conceded in this Court by counsel for the Seller, whether any payments made by the Third Party to the Buyer were related, within the meaning of the Proceeds Subclause, to the steel supplied by the Seller under any particular invoice. Thus whilst the Proceeds Subclause operates in each case as an agreement to constitute a trust of future-acquired property, the Seller has not demonstrated receipt of the future-acquired

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64 (1996) 14 ACLC 952 at 956-957; 20 ACSR 205 at 210-211.

property by the Buyer. In turn, therefore, it cannot be concluded that any trust in favour of the Seller was constituted under the Proceeds Subclause.

54 This lacuna in the evidence is fatal to the claim for the equitable relief made by the Seller. It is not disputed that the steel supplied by the Seller under the Invoices has been used in the Buyer's manufacturing process to produce the Steel Products. Further, as at the time of judgment of Bryson J, the Buyer had received part, but not complete, payment from the Third Party for the Steel Products[65]. However, the question remains whether the Buyer has received those payments: (a) as trustee for the Seller, in the event that the payments received were "proceeds"; or (b) for its own benefit, in the event that the payments received were not "proceeds". Neither the declarations sought, nor the remedy of equitable tracing against the Buyer, nor any liability of the Buyer to account as trustee will arise if the payments received were not "proceeds" within the meaning of the Proceeds Subclause. The burden of proving that a trust was constituted by the Proceeds Subclause, in respect of each of the Invoices, lay on the Seller. This appeal may be contrasted with the position that would have resulted if the Buyer had, hypothetically, received all payments from the Third Party with respect to the Steel Products. If this had occurred (which has not been contended by any of the parties) the inference may have to have been drawn that the Buyer had received the "proceeds" from the Third Party, in respect of each of the Invoices.

55 The proceedings were constituted by summons and heard promptly. However, the procedure adopted meant that the issues did not appear as would have been the case had there been pleadings. If such rigour had been applied it may have been readily identifiable to the parties, perhaps prior to trial, that the Seller had failed to prove an essential fact in issue, namely the receipt of "proceeds" by the Buyer. Without proof of this threshold fact, no trust relationship can arise under the Proceeds Subclause between the Seller and Buyer.

56 The Seller submitted that an order to account should nevertheless be made against the Buyer; in substance, as a way of identifying whether the Buyer had received "proceeds" within the meaning of the Proceeds Subclause in relation to the Invoices. Counsel for the Buyer correctly identified the weakness in this submission. Before a party can be ordered to account, liability to account must be established. The Seller's failure to prove that the Buyer is a fiduciary, owing trust obligations to the Seller, denies its claim to this remedy.

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65 (1996) 14 ACLC 952 at 954; 20 ACSR 205 at 207.

Conclusion

57 Whilst we differ from the Court of Appeal, which held that the Proceeds Subclause was a "charge" within s 9 of the Law which was registrable under Pt 3.5, the appeal nevertheless cannot succeed for the reasons just given. In particular, the case for the equitable remedies sought by the Seller was not made out. The ultimate conclusion that the relief sought by the Seller had to be refused should not be disturbed and the appeal to this Court should be dismissed with costs.

58 It is therefore unnecessary to determine the ancillary issue of whether the Proceeds Subclause was a term of the agreement to supply steel in relation to Invoice No 583, which omitted the retention of title clause.

59 KIRBY J. This appeal comes by special leave from the New South Wales Court of Appeal[66]. That Court unanimously rejected an appeal from the orders of the primary judge, Bryson J[67]. The appeal concerns the operation of a retention of title clause in the dealings between the principal parties. The question in issue arises in the context of rights asserted on behalf of one of the parties which seeks to rely on the clause, against the other party who is the liquidator of an insolvent company.

Retention or reservation of title clauses

60 In the eponymous way of our legal system[68], which is still so reliant on legal decisions, retention of title clauses have become known as "Romalpa clauses". This followed a decision of the English Court of Appeal dealing with the effectiveness of such a clause in *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd*[69] ("*Romalpa*"). That decision was by no means the first in which a clause in contractual dealings between parties had attempted to separate the title to, and possession of, goods sold by one party to another. More than a century ago, in *McEntire v Crossley Brothers Ltd*[70], Lord Herschell LC drew such a device to the attention of the United Kingdom Parliament in case it should wish to cure the "mischief" thereby disclosed.

61 The basic question is whether, by the language used in the Corporations Law ("the Law")[71], the legislature has adequately addressed the mischief. That is, can the seller who has parted with possession of goods to the buyer, by means of the retention of title clause utilised in the case, and without registration of its interest, defeat the priorities which the Law enacts in cases of corporate

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66 *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrication[s] Pty Ltd (Voluntary Administrators Appointed) (Receivers and Managers Appointed)* (1998) 16 ACLC 1633 per Sheller JA (with whom Beazley and Stein JJA agreed).

67 *Associated Alloys Pty Ltd v Metropolitan Engineering and Fabrications Pty Ltd* (1996) 14 ACLC 952; 20 ACSR 205.

68 Another example is the so-called *Mareva* injunction or order: *Cardile v LED Builders Pty Ltd* (1999) 73 ALJR 657 at 665, 674; 162 ALR 294 at 305, 317.

69 [1976] 1 WLR 676; [1976] 2 All ER 552.

70 [1895] AC 457 at 466.

71 Sections 262(1), 266(1).

insolvency and afford an effective preference to itself over unsecured creditors of the insolvent company?[72]

62 When the *Romalpa* case was decided, much of the legal commentary upon it was overcome by admiration for the perceived ingenuity of the device upheld in the decision and ecstatic about its potential to afford protection from the rigours of insolvency law to well-advised parties. It was predicted that the decision in *Romalpa* would "have a greater impact on commercial law than almost any other case decided this century"[73]. Those words appeared to reflect popular commercial sentiment at the time[74]. However, as more cases were decided about retention of title clauses, and more analysis came to be written about the decisions[75], the "fundamental flaw" of such clauses[76] in the context of statutory priorities governing insolvency came to be recognised.

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72 *In re Wallis & Simmonds (Builders) Ltd* [1974] 1 WLR 391 at 404; [1974] 1 All ER 561 at 573; *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 at 44.

73 Goode, *Proprietary Rights and Insolvency in Sales Transactions*, 2nd ed (1989) at 84.

74 cf de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327.

75 A number of texts have been written on the subject. See Parris, *Retention of Title on the Sale of Goods* (1982); Parris, *Effective Retention of Title Clauses* (1986); McCormack, *Reservation of Title*, 2nd ed (1995); Davies, *Effective Retention of Title* (1991); Wheeler, *Reservation of Title Clauses: Impact and Implications* (1991); Goode, *Proprietary Rights and Insolvency in Sales Transactions*, 2nd ed (1989), Ch 5; Collier, *Romalpa Clauses: Reservation of Title in Sale of Goods Transactions* (1989).

76 Everett, "Romalpa Clauses: The Fundamental Flaw", (1994) 68 *Australian Law Journal* 404.

63 The English "invention" outlined in *Romalpa* spread quite quickly, although with mixed success, to Scotland[77], Ireland[78] and New Zealand[79]. In Canada, the courts accepted that the transfer of title to goods was ordinarily determined according to the contractual intentions of the parties, which were to be discerned from the terms of their agreement, their conduct and the circumstances of the case[80]. But Canadian courts have been resistant to retention of title clauses which endeavour to defeat or postpone other creditors in cases of insolvency[81], unless the interest suggested by such clauses is registered as a charge[82].

64 In this respect, the Canadian courts may have been influenced by the consistent decisions of United States courts which have held that, under the *Uniform Commercial Code*[83], any attempt by a seller to reserve title or a proprietary interest in goods shipped or delivered to a buyer will only have the effect of creating a security interest in those goods, irrespective of any written agreement or other expressed intention of the parties[84]. The fundamental

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77 eg *Clark Taylor & Co Ltd v Quality Site Development (Edinburgh) Ltd* 1981 SLT 308; *Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339.

78 *Sugar Distributors Ltd v Monaghan Cash and Carry Ltd* [1982] ILRM 399; *Kruppstahl AG v Quitmann Products Ltd* [1982] ILRM 551. For criticism of Romalpa clauses in the Irish context, see de Lacy, "Anglo-Irish Retention of Title: The Current Position", (1987) 22 *Irish Jurist* 212 at 219-220.

79 *Len Vidgen Ski & Leisure Ltd v Timaru Marine Supplies (1982) Ltd* [1986] 1 NZLR 349; cf McCormack, "Reservation of title in England and New Zealand", (1992) 12 *Legal Studies* 195; Ahdar, "*Romalpa's* Empire: the reception of reservation of title clauses in New Zealand", (1993) *Lloyd's Maritime and Commercial Law Quarterly* 382.

80 *Prodaniuk Auction Service Ltd v Holowach* (1989) 99 AR 134.

81 *Re Basarab Construction Co Ltd* (1972) 17 CBR (NS) 175.

82 *Re Aquarius TV Ltd* (1975) 21 CBR (NS) 144; *Re Eye Patch Shop of Canada Ltd* (1975) 21 CBR (NS) 224; *Re Hillstead Ltd* (1979) 26 OR 289; *Williston Lake Logging Ltd (Receiver of) v Milos Equipment Ltd* (1989) 75 CBR (NS) 257; cf de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 366, fn 134.

83 §1-201(37), §2-401.

84 *Providence Electric Co Inc v Sutton Place Inc* 287 A 2d 379 (1971); *Morton Booth Co v Tiara Furniture Inc* 564 P 2d 210 (1977); *Williston on Sales,* 5th ed (1996), vol 3 at §23-8 citing *Evans Products Co v Jorgensen* 421 P 2d 978 (1966).

rationale behind these decisions has been the commitment of the United States courts to upholding the statutory priorities of securities in the event of insolvency. If the seller wishes to obtain what is in effect a security interest in the goods, and thereby to secure priority in relation to such goods or their equivalent value, the registration requirements of the Code must be complied with[85].

65 In Australia there has been a great deal of academic[86], law reform[87] and other[88] writing about retention of title clauses. Although the Australian Law Reform Commission remarked in 1988 that the use of "reservation of title clauses" in contracts to supply goods was "increasingly common"[89] and although the Commission favoured a new system of registration of such interests[90], very few cases on the issue are reported[91]. This might reflect the observation by

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85 *Uniform Commercial Code*, Art 9. See *De Vita Fruit Co v FCA Leasing Corporation* 473 F 2d 585 (1973).

86 Chalmers, "'Romalpa' Retention of Title Clauses", (1986) 60 *Australian Law Journal* 545; Muir, "Recent Developments in 'Reservation of Property' Clauses", (1985) 13 *Australian Business Law Review* 3; Collier, *Romalpa Clauses: Reservation of Title in Sale of Goods Transactions* (1989).

87 Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988), vol 1 at 306-308.

88 Priestley, "The Romalpa Clause and the Quistclose Trust" in Finn (ed), *Equity and Commercial Relationships* (1987) 217; Gageler, "Retention of Title Clauses", (1989) 2 *Journal of Contract Law* 34.

89 Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988), vol 1 at 306.

90 Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988), vol 1 at 306, based on the *Personal Property Security Act* 1967 (Ontario). The Commission did not prepare draft legislation on this issue, explaining, at 308, that "to be effective, it would require agreement between the Commonwealth and the States".

91 One such case noted by de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 339, fn 40 is *Puma Australia Pty Ltd v Sportman's Australia Ltd [No 2]* [1994] 2 Qd R 159. See also Everett, "Romalpa Clauses: The Fundamental Flaw", (1994) 68 *Australian Law Journal* 404 at 407-408.

Australian lawyers of the growing disillusionment with such clauses elsewhere as a "latent giant reawaiting a final *coup de grâce*"[92].

66 No Australian parliament has legislated on the issue, despite the suggestions of law reform bodies designed to cure the mischief said to lie at the heart of such clauses[93]. Judicial refusal to give effect to the clauses may be nothing more than a recognition by judges of the apparent inconsistency (at least in certain circumstances) of permitting such clauses to disturb the priorities amongst the creditors of the buyer when they become insolvent and where the clause appears to defy the carefully enacted legislation about such priorities.

67 Generally speaking, the judges in England who have considered such clauses have been willing to give them effect only in circumstances where: (1) they are clearly accepted as part of the agreement between the parties; and (2) they can be applied to the original goods that were sold where such goods may be readily identified, retrieved intact, reconstituted, separated and returned to the seller; or (3) a separate financial account or fund has been established, as proper to a fiduciary relationship between the parties, in order to receive the proceeds of the sale of the goods possessed by one but still purportedly owned by another[94].

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92 de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 368.

93 Such as the proposal for federal-State legislation contained in the report of the Australian Law Reform Commission, *General Insolvency Inquiry*, Report No 45 (1988), vol 1 at 306-308. In the United Kingdom, legislative reform has been proposed successively by Crowther, *Report of the Committee: Consumer Credit* (1971) Cmnd 4596 (Crowther Report); Cork, *Report of the Review Committee: Insolvency Law and Practice* (1982) Cmnd 8558 at 369-370 (Cork Report); and Diamond, *A Review of Security Interests in Property*, (1989) at 2 (Diamond Report), but these proposals have not been taken up by the Parliament. See de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 367, fn 137; cf Goode, "The Modernisation of Personal Property Security Law", (1984) 100 *Law Quarterly Review* 234 at 250; and Cowan, Clark and Goldberg, "Will English Romalpa Clauses Become Registrable Securities?", (1995) *Cambridge Law Journal* 43.

94 *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 at 44; cf Gregory, "Romalpa Clauses as Unregistered Charges – A Fundamental Shift?", (1990) 106 *Law Quarterly Review* 550.

68 Where there is doubt that the clause ever truly became part of the agreement between the parties; where the goods bought have been converted by manufacture into some other product so as to lose their original identity[95]; where the goods have been on-sold to others who have no notice of the clause; and where the receipts in payment for the derived goods have been mixed in the financial records of the buyer, it is hardly surprising that judges have been reluctant to give effect to legal form over commercial substance. Insolvency is a misfortune for all who are affected by it. It is natural that creditors should attempt to protect their own particular positions. But it is imperative that the rules laid down by the legislature should still be obeyed.

69 In the present case, the last three of the four features noted above, which serve to deny effectiveness to retention of title clauses in other jurisdictions, are present. The duty of this Court is to give effect to the Law[96]. It should not be diverted from that duty by the retention of title clause adopted in this case.

The facts

70 Associated Alloys Pty Ltd ("Alloys"), which is the appellant, sold steel to Metropolitan Engineering and Fabrications Pty Ltd ("Metropolitan"), which is the first respondent[97]. Metropolitan is in liquidation. The liquidator of Metropolitan is the second respondent.

71 Before 1991, and perhaps as early as 1987 or 1988, Alloys began including in its invoices (including those sent to Metropolitan) a statement placed at the foot of the front page in extremely small type face. There was no "red hand"

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95 *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 1 WLR 485; [1984] 2 All ER 152; cf *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25 at 35, 44; *Clough Mill Ltd v Martin* [1985] 1 WLR 111 at 124; [1984] 3 All ER 982 at 993.

96 cf de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 365-366 referring to (and criticising) *Clough Mill v Martin* [1984] 1 WLR 1067 at 1080-1081; [1984] 1 All ER 721 at 732.

97 Consequent upon the liquidation, Metropolitan changed its name to "ACN 001 452 106 Pty Limited (In Liquidation)" (see transcript of proceedings, 7 December 1999 at 94). It is convenient to continue to describe the company as Metropolitan throughout these reasons.

(as Lord Denning once suggested[98]) to call attention to the statement. All that appeared were the following words (shown in the typeface used):

"Romalpa Clause set forth on the reverse side hereof applies".

On the back of the invoice form, a retention of title clause appeared, which included the following sub-clause (with sub-clause number added):

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

72 It is common ground that, in the events that occurred, this sub-clause is the only part of the clause relevant to the present proceedings. Three invoices in question were sent by Alloys with, or immediately following, the supply of steel to Metropolitan in August, September and October 1995. These were invoices no 583 for $US 61,361.29, no 592 for $US 80,630 and no 598 for $US 69,920. For some unexplained reason, the "Romalpa clause" was not contained on the reverse of invoice no 583. In January 1996, in respect of the goods referred to in the foregoing invoices, Metropolitan paid Alloys $US 14,000. This left a balance of $US 197,911.29 outstanding.

73 The steel described in invoices nos 583, 592 and 598 was used by Metropolitan for the fabrication of pressure vessels, heat exchangers, columns and other industrial equipment for a company referred to as "Lucky Goldstar" operating in the Republic of Korea. Most of the steel products manufactured by Metropolitan had been shipped to Lucky Goldstar when the proceedings were commenced. However, one pressure vessel remained in Metropolitan's possession. For obvious reasons those in charge of Metropolitan's fortunes hoped to complete the contract with Lucky Goldstar.

74 Administrators were appointed to Metropolitan in February 1996. Subsequently, Metropolitan went into liquidation. The administrators then became the liquidator. The purported continuing interest of Alloys in the title to the steel supplied to Metropolitan was never registered under s 262 of the Law. Therefore, other creditors dealing with Metropolitan, their customers and the public were not notified of its existence. To all those who were unaware of the private contractual dealings between Alloys and Metropolitan, the property in the steel would have appeared to pass with the sale of the goods to Metropolitan and

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98 *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163 at 170.

Metropolitan's subsequent physical acquisition of, and assertion of control over, such goods.

75 In April 1996, Alloys commenced proceedings in the Supreme Court of New South Wales to assert its alleged rights under the retention of title clause. It did so notwithstanding the supervening administration and later liquidation of Metropolitan. Alloys sought a declaration that the liquidator or Metropolitan held $US 197,911.29 in trust for the benefit of Alloys. It also sought an order that the liquidator of Metropolitan account to Alloys in respect of that sum, or a declaration to the effect that Alloys was entitled to the sum claimed. Finally, it sought a declaration that title in the goods, the subject of the retention of title clause, had not passed to Metropolitan, so that Metropolitan or the liquidator were guilty of conversion to the extent that they had acted in derogation of Alloys' interests.

76 It was never claimed that the sum of $US 197,911.29, or any other sum, was, or had ever been, in a separate account or fund. That amount simply represented the balance due on a taking of accounts between Alloys and Metropolitan for the steel which the former had supplied to the latter. It appears that substantial sums were received by the liquidator from Lucky Goldstar[99]. Payments were consequently made to various creditors including Alloys. But, by reason of its retention of title clause, Alloys claimed an entitlement to all such payments received by the liquidator and Metropolitan from Lucky Goldstar up to their outstanding balance. It sought to isolate its transactions with Metropolitan from the general activities of the liquidator.

Findings of the primary judge

77 In May 1996, the primary judge dismissed Alloys' claim for relief[100]. In his reasons, Bryson J described the manufacturing process in which Metropolitan converted the steel products to its own products. From this description, he concluded that[101]:

> "The property in the derived products in [Metropolitan's] hands is in [Metropolitan]; the property in the derived products which have been delivered to Lucky Goldstar is in Lucky Goldstar."

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99 Transcript of proceedings, 7 December 1999 at 40-41.

100 *Associated Alloys Pty Ltd v Metropolitan Engineering and Fabrications Pty Ltd* (1996) 14 ACLC 952; 20 ACSR 205.

101 (1996) 14 ACLC 952 at 955; 20 ACSR 205 at 210.

Bryson J also found that[102]:

> "there is no basis on the evidence on which any particular one of the derived products, whether they have been delivered to Lucky Goldstar or are still in [Metropolitan's] hands, can be identified as having been produced from the goods in any one of the three invoices. Nor is there any basis for carrying out any process of apportionment; if such a process were appropriate, the evidence would not enable it to be done."

78 The evidence did not disclose that any steps whatever had been taken by Metropolitan, or insisted upon by Alloys, to ensure that the funds received for the derived goods, title in which Alloys claimed to have retained, were kept separately and apart from the ordinary finances of Metropolitan. On the contrary, like the products themselves, the funds were simply incorporated into the undifferentiated affairs of Metropolitan. Bryson J found that[103]:

> "[Metropolitan] has done nothing to identify any part of the proceeds as relating to the steel in these invoices, and has done nothing to set aside and hold any part of the proceeds in trust for [Alloys]."

79 In these circumstances, his Honour concluded that it was necessary to decide first whether the retention of title clause was incorporated into the agreement of the parties. The clause was incorporated by the course of dealings between the parties[104], but Bryson J concluded that the clause could only be effective if it was printed on the back of the relevant invoice. It therefore did not apply to the transaction identified in invoice no 583. But it did apply, according to its terms, to the transactions identified in invoices no 592 and no 598.

80 Secondly, as to the steel referred to in these two invoices, Bryson J concluded that sub-cl (5) had the effect of creating a trust over part of the proceeds received by Metropolitan equal to the amount owing by Metropolitan to Alloys in respect of such products[105]. However, he also concluded that the proceeds of the manufacturing process to which sub-cl (5) applied were "book debts" both before and after any amounts were received. They were thus

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102 (1996) 14 ACLC 952 at 957; 20 ACSR 205 at 211.

103 (1996) 14 ACLC 952 at 956; 20 ACSR 205 at 210-211.

104 (1996) 14 ACLC 952 at 954; 20 ACSR 205 at 208; cf *Henry Kendall & Sons v William Lillico & Sons Ltd* [1969] 2 AC 31 at 90, 104; *Proprietors Strata Plan 30102 v Energy Australia* unreported, Court of Appeal of New South Wales, 29 September 1997.

105 (1996) 14 ACLC 952 at 956-957; 20 ACSR 205 at 211.

within s 266(1) of the Law[106]. Insolvency having supervened, they were void as against the liquidator of Metropolitan.

The decision of the Court of Appeal

81 When the appeal came before it, the Court of Appeal was prepared, like Bryson J, to make a number of assumptions in order to address what it took to be the central flaw in Alloys' argument[107]. The Court affirmed the primary judge's finding that sub-cl (5) of the retention of title clause constituted a charge on Metropolitan's book debts. This is how Sheller JA explained his conclusion[108]:

> "The fifth subclause was designed to protect Alloys from the consequences of Metropolitan's insolvency by charging part of its book debts. This was achieved by using the device of a trust. The trust embraced part of the proceeds of the manufacturing process when the price to be paid for those derived goods became payable either immediately or in the future and continued until Metropolitan paid Alloys for the goods Alloys sold to Metropolitan and Metropolitan used in the manufacturing process. It was one trust and involved as an essential feature a charge on Metropolitan's book debts.
>
> For that reason, in my opinion, subcl (5) was void as against the liquidator and administrators because it created a registrable charge, no notice of which had been lodged by Metropolitan, on property of Metropolitan, namely its book debts. I do not think it is permissible to treat as separate the trust, subject to which moneys received were held, when the book debts were paid and argue that although those moneys were the subject of a trust, whether by charge or otherwise, they were not the subject of a registrable charge within the meaning of s 266(1) of the *Corporations Law*."

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106 (1996) 14 ACLC 952 at 957; 20 ACSR 205 at 211.

107 Such as the liquidator's argument that because Metropolitan had done nothing to set aside and hold any part of the proceeds in trust for Alloys, that fact would, without more, defeat Alloys' right to any remedy: *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrication[s] Pty Ltd (Voluntary Administrators Appointed) (Receivers and Managers Appointed)* (1998) 16 ACLC 1633 at 1639. Like Bryson J, the Court of Appeal was also persuaded that "any charge on the proceeds was not a floating charge" which would require registration under s 262(1)(a). See (1996) 14 ACLC 952 at 957; 20 ACSR 205 at 211-212 per Bryson J and (1998) 16 ACLC 1633 at 1641 per Sheller JA.

108 (1998) 16 ACLC 1633 at 1641.

82 In light of this conclusion, with which the other judges of the Court of Appeal agreed, it was unnecessary for that Court to consider the other issues raised in the appeal, except for a last submission raised on behalf of Alloys that the charge was not void because it was one "arising by operation of law". In such a case, s 262(2)(a) of the Law provides that the charge is not required to be registered. The distinction between charges arising from a contract between the parties and those arising by operation of law has been considered in English cases[109]. By reference to these cases, and taking into account the mischief to which the Law was addressed in this context, Sheller JA adopted the terms used by Phillips J in *Tatung (UK) Ltd v Galex Telesure Ltd*[110]. Expressing his conclusion, Sheller JA said[111]:

> "[T]he nature of the agreement was that the defendants would hold the proceeds of dealing with the goods in trust for the plaintiffs by way of charge … [Phillips J] said[112]:
>
> > 'This submission fails by reason of my finding that the plaintiffs' rights in the present case were the creature of contract and not of law. The charge was directly created by the agreement, to which the defendants were party, that the plaintiffs should have the interest specified in the proceeds of dealing with their property.'
>
> For like reason, in the present case, Alloys' charge over the books debts or the fund consisting of moneys received on the payment of those debts is properly categorised as the creature of contract not of the operation of law."

83 It is from the consequent order dismissing the appeal to the Court of Appeal that Alloys now, by special leave, appeals to this Court.

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109 *In re Bond Worth Ltd* [1980] Ch 228 at 271; *In re Wallis & Simmonds (Builders) Ltd* [1974] 1 WLR 391 at 404; [1974] 1 All ER 561 at 572-573.

110 (1989) 5 BCC 325.

111 (1998) 16 ACLC 1633 at 1642.

112 *Tatung (UK) Ltd v Galex Telesure Ltd* (1989) 5 BCC 325 at 335.

The provisions of the Law

84 The applicable provisions of the Law appeared in Ch 3 dealing with the requirements of the "Internal Administration" of a company[113]. After providing for the registered office and name of the company (Pt 3.1), the officers (Pt 3.2), financial benefits to related parties of public companies (Pt 3.2A), meetings and proceedings (Pt 3.3) and oppressive conduct of the affairs of companies (Pt 3.4), there followed Pt 3.5 of the Law dealing with charges. That Part was followed, in turn, by accounts (Pt 3.6), audit (Pt 3.7) and annual returns (Pt 3.8). Pt 3.5 thus appeared within the central provisions of the Law dealing with the operations, integrity and transparency of corporate governance in Australia. In this context, Pt 3.5 must be read as essential to the protection of the corporation itself, safeguarding those who deal with it (including creditors) and the public interest. The obvious object of Pt 3.5 was to ensure that corporations, creditors and the public generally were aware (or capable of becoming aware) of "charges" over the property of the company which may have influenced their financial dealings with that company.

85 By s 262 of the Law at the relevant time, it was provided that:

> "**262 Charges required to be registered**
>
> (1) Subject to this section, the provisions of this Part relating to the … registration of, and the priorities of, charges apply in relation to the following charges (whether legal or equitable) …:
>
> (a) a floating charge on the whole or a part of the property, business or undertaking of the company;
>
> …
>
> (f) a charge on a book debt; …
>
> (2) The provisions of this Part mentioned in subsection (1) do not apply in relation to:
>
> (a) a charge, or a lien over property, arising by operation of law; …
>
> …

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113 The Law has since been amended by the *Company Law Review Act* 1998 (Cth), Sch 3, items 86-154, together with applicable State law, which placed these provisions within a new Ch 2K entitled "Charges". For a description of how the Law operates see *The Queen v Hughes* [2000] HCA 22.

(11) A charge on property of a company is not invalid merely because of the failure to lodge with the Commission, or give to the company or another person, a notice or other document that is required by this Division to be so lodged or given."

86 By s 263, where a company created a charge, the company was required to ensure that, within 45 days after the creation of the charge, notice of it was lodged with the Australian Securities and Investments Commission ("the Commission"). By s 265(1), the Commission was then to register such charges in the Australian Register of Company Charges. There followed provisions rendering charges void in certain circumstances, including as against a liquidator:

"**266 Certain charges void against liquidator or administrator**

(1) Where:

(a) an order is made … for the winding up of a company; or

(b) an administrator of a company is appointed …;

…

a registrable charge on property of the company is void as a security on that property as against the liquidator, the administrator of the company … as the case may be ...".

87 Although a number of exceptions were stated, none of them is presently relevant. The liquidator asserted that the terms of sub-cl (5) of Alloy's retention of title clause constituted a "charge" which, within these provisions, was void as against him. He therefore contended that Alloys must rank in the winding up of Metropolitan in the same way as any other unsecured creditor with an unregistered charge. The liquidator contested the possibility of any claim by Alloys on the goods still in his possession as assets of Metropolitan. In this respect, he relied on the finding of Bryson J that the steel sold by Alloys no longer existed and had been wholly reconstituted as different goods. As to sub-cl (5), the liquidator asserted that the sub-clause represented an attempt to create a "charge" on book debts owing to Alloys. Because it was unregistered it was void against him. Any entitlement of Alloys arose only out of its contract with Metropolitan and not by "operation of law".

88 The liquidator had other arguments. But if he succeeds on the foregoing, the other arguments become unnecessary and the appeal must be dismissed.

The provision constituted a charge on book debts

89 In my opinion, the Court of Appeal was correct, for the reasons which Sheller JA gave, in its determinations that the proceeds of the sale of the derived products which equalled the amount owing to Alloys were book debts and that they arose from the operation of the contract between the parties. Any other conclusion would be inconsistent with the more recent decisions of courts in countries where retention of title clauses have enjoyed a greater vogue than in Australia[114]. More fundamentally, it would be inconsistent with the will of the legislature as then expressed in Pt 3.5 of the Law as applied to sub-cl (5) of the retention of title clause in question in this case.

90 Why is the interest created by sub-cl (5) a "charge on a book debt" for the purpose of s 262(1)(f) of the Law? The answer to that question is found in a reflection upon the terms of the sub-clause and upon the language and purpose of the provisions of the Law governing registration of "charges" on "a book debt" which it is the duty of this Court to uphold.

91 Once a retention of title clause is purportedly expressed to cover debts, goods manufactured from the goods supplied, or the proceeds of on-sales, the approach to be taken is one that looks beyond legal technique and form to the substance and reality[115]. This was recognised by Mummery J in *Compaq Computer Ltd v Abercorn Group Ltd* when he said[116]:

> "In determining whether any given agreement creates a charge, equity looks to the substance and reality of the transaction. What on the face of it may appear to be an out-and-out disposition of a legal or equitable interest in property by way of assignment or conveyance or an out-and-out disposition of a beneficial interest in property by way of trust, may in fact be by way of security only, with a right of redemption and, therefore, in the nature of a charge."

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114 *In re Bond Worth Ltd* [1980] Ch 228; *Borden (UK) Ltd v Scottish Timber Products Ltd* [1981] Ch 25; *Pongakawa Sawmill Ltd v New Zealand Forest Products Ltd* [1992] 3 NZLR 304; *ICI New Zealand Ltd v Agnew* [1998] 2 NZLR 129; cf *Benjamin's Sale of Goods*, 5th ed (1997) at pars 5.146-5.150. See also *Downey v Aira Pty Ltd* (1996) 14 ACLC 1068.

115 Everett, "Romalpa Clauses: The Fundamental Flaw", (1994) 68 *Australian Law Journal* 404 at 412.

116 [1991] BCC 484 at 493; [1993] BCLC 602 at 612.

92 This is the approach which I would also take. I would do so because Alloys is relying on the law of equity to impose on Metropolitan an obligation, once the goods are changed by manufacture, to hold the proceeds of their sale in trust for Alloys. Mummery J was not, of course, asserting that trusts are, of their nature, securities. But he was cautioning against exclusive concentration on the terms of an instrument purporting to create a trust, to the neglect of an examination of the purpose and effect of that instrument when considered for its substance and not merely its form.

93 Once Bryson J found that the goods sold by Alloys to Metropolitan had ceased to exist[117], there was no basis in the evidence for the process of apportionment envisaged in the language of sub-cl (5). Yet such apportionment is essential to Alloys' argument. The sub-clause is either void for uncertainty or, if it is to have an operation, it can only operate as creating a security interest over the undifferentiated book debts of Metropolitan. Once that is seen as its substantive effect, the sub-clause attracts the registration requirements of the Law.

94 In the absence of the possibility of identifying specific goods, or of payments being made to a particular identifiable fund, the parties must be taken to have agreed by sub-cl (5) to create a form of security for the payment of the moneys owing by Metropolitan to Alloys. By their agreement, such moneys were to be payable from the general funds of Metropolitan. There was no obligation that they be paid from a particular fund. Nor was Metropolitan obliged to pay them when it received payment from anyone else, such as Lucky Goldstar. The trust envisaged in this particular retention of title clause was thus conditional. And it was defeasible. The phrase "[s]uch part shall be deemed to equal in dollar terms the amount owing by the purchaser to the vendor at the time of the receipt of such proceeds" defines, in dollar terms, the relevant "part" of the proceeds of manufacture. Those proceeds appear nowhere else than in the undifferentiated finances of Metropolitan. It is at the point that Metropolitan is entitled to receive the payment of the agreed price (subject to the possibility of separate identification, which is doubtful but assumed) that the relevant proceeds constitute "a book debt", not when these funds are received by Metropolitan.

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117 *Associated Alloys Pty Ltd v Metropolitan Engineering and Fabrications Pty Ltd* (1996) 14 ACLC 952 at 954-955; 20 ACSR 205 at 208-210 per Bryson J as approved by the Court of Appeal in (1998) 16 ACLC 1633 at 1639 per Sheller JA; cf *In re Peachdart Ltd* [1984] Ch 131 at 142-143; *Clough Mill Ltd v Martin* [1985] 1 WLR 111; [1984] 3 All ER 982. See also de Lacy, "Romalpa Theory and Practice under Retention of Title in the Sale of Goods", (1995) 24 *Anglo-American Law Review* 327 at 361.

95 The most that sub-cl 5 can amount to for Alloys is an unregistered charge on a "book debt". Any other construction of the sub-clause would permit the easy defeat of the clear purpose of the Law, namely that creditors of companies which become insolvent must, unless they are secured creditors that are afforded priority, participate *pari passu* in the available assets of the company. It would be contrary to principle to adopt a restrictive or confined construction of the provisions of the Law, which is designed to ensure that a company's charges on book debts are registered and that those which are not registered are unenforceable against the administrator or liquidator of that company. In effect, Alloys seeks, notwithstanding the provisions of Pt 3.5 of the Law regarding unsecured creditors, as it then stood, to have a priority by virtue of its own undisclosed contractual stipulation. In the circumstances of this case, that attempt fails.

The charge did not arise by operation of law

96 If, for the purpose of s 262(1)(f) of the Law, Alloys' interest is classified as constituting a "charge on a book debt", the requirement of registration arises and the consequence of a failure to register is that the charge is void as against the administrator or liquidator of an insolvent company. This follows as a matter of law. However, to avoid any doubt, it is appropriate to make it clear that the Court of Appeal was correct to hold that any "charge" applicable in this case did not arise "by operation of law" but by virtue of the agreement between Alloys and Metropolitan.[118]

97 Cases do exist where, without any specific intervention or express or implied agreement of the parties, the law will give effect to a charge. Examples include an unpaid vendor's lien or a repairer's lien[119]. In such cases the parties may be ignorant of the operation of the law upon their transaction. They ought not to suffer adverse consequences by reason of their failure to register a charge which they may not have known the law had created or imposed. In *In re Wallis & Simmonds (Builders) Ltd*[120], Templeman J illustrated how this might occur. By reference to s 95 of the *Companies Act* 1948 (UK), his Lordship held that an equitable charge on land arising from the deposit of title deeds, although created as a result of a presumption of law, was nonetheless contractual in nature. It was therefore registrable under the section. Being unregistered, it was void against

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118 (1998) 16 ACLC 1633 at 1642.

119 See generally, Australian Law Reform Commission, *Personal Property Securities*, Report No 64 (1993) at 78-79.

120 [1974] 1 WLR 391; [1974] 1 All ER 561.

the liquidator by virtue of s 95. No lien on the title deeds enjoyed a separate existence. In such a case, his Lordship stated[121]:

> "far from its being a profound inconvenience if the charge in the present case were registrable, it would be profoundly inconvenient if it were not, because the object of the section is to give information of incumbrances on the property of a company. If the company could deposit title deeds and create a charge which would not be registrable, then the mischief at which the section is aimed could be largely and easily avoided."

98 The same words apply in the present proceedings. They reinforce the importance of approaching this case with due care to give effect to the high public purposes of the legislature in the provisions which it had adopted in Pt 3.5 of the Law. It was by the agreement of the parties, and only by that agreement, that sub-cl (5) of the retention of title clause had whatever effect it did. There was not, in this case, some overarching principle of law of which the parties might be innocently ignorant. The insertion of the retention of title clause was designed to secure an advantage to Alloys. What merchants reading it would make of it (if read it they could) is anyone's guess. But the advantage sought was deliberate and contractual. It was aimed to defeat a subsequent liquidator. Whatever the possibilities in other circumstances, in the facts found in this case, that endeavour fails. The "charge" arose from the parties' agreement. It did not arise by operation of law.

<u>Conclusion and order</u>

99 The result is that the Court of Appeal came to the correct conclusion upon the essential questions in these proceedings. The appeal from the orders of that Court should therefore be dismissed with costs.

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121 [1974] 1 WLR 391 at 404; [1974] 1 All ER 561 at 573.