1-1-1999

Associated Alloys Pty Ltd v Metropolitan Engineering and Fabrication Pty Ltd and Shirlaw

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Case Commentary:
Associated Alloys Pty Ltd v Metropolitan Engineering And Fabrication Pty Ltd And Shirlaw

By Denis SK Ong[1]

Headings in this case note:

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1. Summary of Facts

{1} In 1981 Associated Alloys Pty Limited (hereinafter the Seller) commenced selling steel to Metropolitan Engineering and Fabrication Pty Limited (hereinafter the Buyer), a manufacturer of steel products. In 1987 or 1988, the Seller started the practice of including the following printed clause (hereinafter the printed clause) on the reverse side of the invoices which it issued to the Buyer:

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

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

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

The vendor is to have power to appropriate payments to such goods and accounts as it thinks fit notwithstanding any appropriation by the purchaser to the contrary.

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."

{2} In 1995 the Seller issued three invoices (Numbers 583, 592 and 598) to the Buyer for sums totalling $US211,911.29. The printed clause did not appear on invoice 583.

{3} In January 1996 the Buyer paid to the Seller the sum of $US14,000 in respect of those three invoices, leaving an unpaid balance of $US197,911.29.

{4} On 9 February 1996 Mr Kevin Shirlaw and another person were appointed the administrators of the Buyer. Subsequently to that date, the Buyer went into liquidation and Mr Kevin Shirlaw (hereinafter the Liquidator) was appointed the liquidator of the Buyer.

{5} By summons, the Seller claimed, inter alia, a declaration that the Liquidator or the Buyer held $US197,911.29 upon trust for the Seller's benefit, and an order that the Liquidator or the Buyer account to it. On 10 May 1996 Bryson J dismissed the Seller's claim. The Seller's appeal to the Court of Appeal of the Supreme Court of New South Wales (Sheller, Beazley and Stein JJA) was unanimously dismissed by that Court on 21 September 1998, where Beazley and Stein JJA concurred in the judgment delivered by Sheller JA.

2. Comments

{6} The Seller's claim of a trust for its benefit was based on the fifth subclause of the printed clause. The Seller's claim was so based because the Buyer had used the steel supplied (under the three invoices amongst others) by the Seller to make steel products which the Buyer subsequently sold to a Korean company called Lucky Goldstar[2] (hereinafter the Third Party).

{7} Neither in the fifth subclause nor in any other part of the printed clause did the Seller claim either partial or sole ownership of, or a charge or other legal security over, the steel products (as distinct from the proceeds of sale of those products) manufactured by the Buyer from steel supplied by the Seller, although under the first subclause the Seller did purport to retain ownership of the steel supplied (as distinct from the manufactured products) until it had been fully paid for. Applying the reasoning in Borden (UK) Ltd v Scottish Timber Products Ltd[3] the first subclause would not entitle the Seller to either the ownership of, or a charge on, the products manufactured from the steel supplied.

{8} Under the fifth subclause, if the Buyer sold steel products in the manufacture of which the Seller's steel was used, then the Buyer would come under an immediate obligation, in respect of those proceeds of sale, to hold in trust for the Seller an amount in those proceeds equal to the invoice price of the steel so used.[4]

{9} Did the fifth subclause create a charge on the proceeds of sale, in favour of the Seller, being a charge which was registrable under section 262(1)(f) of the Corporations Law? The New South Wales Court of Appeal held that the fifth subclause did create such a charge which, because notice of it had not been lodged under section 263 of the Corporations Law, was void as against the Liquidator and Administrators of the Buyer under section 266(1) of that Law.[5] Is this finding by the Court of Appeal, that the fifth subclause created a registrable charge, persuasive? It is respectfully suggested that this finding is not persuasive.

{10.1} Although the trust purportedly created under the fifth subclause, in contradistinction to the trust purportedly created under the third subclause, did not, in terms, continue only "until the liability to the vendor shall have been discharged", the trust under the fifth subclause should nevertheless be construed to be thus defeasible.

{10.2} Suppose, by way of example, the trust created for the benefit of the Seller under the fifth subclause amounted to a trust of $US10,000, because the amount relevantly owing to the

Seller was $US10,000. If this trust for the benefit of the Seller was indefeasible, then it would mean that this trust, of $US10,000, would continue even after the Buyer paid the Seller the sum of $US10,000. If this was to be the case, then the Buyer would be liable to the Seller for $US20,000 (being $US10,000 as trustee and an additional sum of $US10,000 as debtor) in respect of goods the invoice price of which was only $US10,000. The parties could not rationally have intended such a result, nor should such an irrational intention be imputed to them.

{10.3} Would the Seller, in the aforementioned hypothesis, be able to avoid such an irrational result by arguing that, under the fifth subclause, the creation of the trust of $US10,000 would be regarded as the payment to it of the relevant debt by the Buyer, such that the relevant debt would be extinguished by the creation of the trust, and thus the Buyer would not be exposed to a double liability to the Seller? No. Any such argument would not succeed because if the trust money is, in equity, the Seller's own money, and has never been the Buyer's money, then it would be legally impossible for the Buyer to pay its debt to the Seller with the Seller's own money, namely, it would be legally impossible for the Buyer to pay the Seller with money which the Buyer held in trust for the benefit of the Seller. A trustee cannot use trust money to pay to the beneficiary under the trust a debt owed by the trustee to the beneficiary where the debt has arisen antecedently to, and independently of, the trust. Therefore, any trust created under the fifth subclause must be a trust which is defeasible upon the payment by the Buyer to the Seller of the relevant debt, in order to avoid the imposition of a double liability on the Buyer.

{11} Nevertheless, does the mere circumstance that a trust created under the fifth subclause is defeasible upon the payment of the relevant debt to the Seller entail that the Seller has been given, under that subclause, a mere charge on the proceeds of sale, such that those proceeds are solely owned by the Buyer, subject only to the Seller's charge thereon? In other words, does the mere defeasibility of the trust of the relevant part of the proceeds of sale for the benefit of the Seller created under the fifth subclause, unavoidably characterise that trust as a mere charge given to the Seller by the Buyer? It is suggested that the fifth subclause does not create a defeasible trust out of the property of the Buyer, and that it is only a purportedly defeasible trust which is created out of the property of the Buyer that constitutes a mere charge given by the Buyer to the Seller. The fifth subclause does not create a mere charge in favour of the Seller, because the relevant part of the proceeds of sale, being the intended subject-matter of the trust, was not initially acquired beneficially by the Buyer, but was, rather, initially beneficially acquired by the Seller, and the Seller cannot have a charge over its own property.

{12.1} In some contracts, a seller's title to the goods originally supplied by it to a buyer is made defeasible upon the payment of relevant debts by the buyer to the seller. Nevertheless, the defeasible nature of the seller's title to such goods does not make the seller's retention of title to the goods into a mere charge on those goods: Armour v Thyssen Edelstahlwerke AG[6]; Clough Mill Ltd v Martin[7]; Sale of Goods Act 1923 (NSW), s 22.

{12.2} Where a seller retains title to goods until the buyer pays to the seller the relevant debts, the mere defeasibility of the seller's title does not transform that defeasible title into a mere charge on those goods. This is so because it is legally impossible for the buyer to give to the seller a charge on goods owned by the seller. The buyer may give to the seller a charge on goods only if those goods are owned by the buyer. No one is capable of receiving a charge, or

other legal security, over its own property: McEntire v Crossley Brothers Limited[8]; Armour v Thyssen Edelstahlwerke AG[9]; Clough Mill Ltd v Martin.[10]

{12.3} A seller who thus retains title to the goods which it supplies acquires security in the non-legal sense of the term. The seller in such a situation does not acquire security in the legal sense of the term. In a situation where the seller's title has not been created out of the buyer's title, the seller's title, notwithstanding its defeasible nature, is not capable of constituting a mere charge on the relevant property: Armour v Thyssen Edelstahlwerke AG.[11]

{12.4} The issue of whether or not a seller obtains a mere charge on the goods (or on the proceeds of their sale) depends, not on whether or not the seller's title to those goods (or to the proceeds of their sale) is defeasible, but, rather, on whether or not the buyer has the capacity, and the intention, to confer on the seller a charge on those goods (or on the proceeds of their sale). The buyer will lack this capacity if the goods (or the proceeds of their sale) are owned by the seller.

{13} What are the legal consequences where a seller does not merely purport to retain defeasible legal ownership of the goods which it has supplied to the buyer, but additionally purports to acquire defeasible equitable ownership of the proceeds of sale of those goods as soon as those proceeds come into existence, namely, without any intervening act by the buyer? In such a case, not only does the seller retain defeasible legal ownership of the goods, but the proceeds of sale are acquired by the buyer solely in the capacity of a trustee of them for the benefit of the seller (albeit under a defeasible trust). Thus, the buyer does not acquire equitable ownership of the proceeds of sale when those proceeds come into existence. The seller does so. The buyer, never having been the beneficial owner of the proceeds of sale, therefore lacks the capacity to confer a charge on those proceeds in favour of the seller. In such a case, the buyer does not acquire legal and beneficial ownership of the proceeds first, and only afterwards declare a trust over those proceeds for the benefit of the seller: In re Kayford Ltd (in liq)[12] no such declaration of trust is possible because the buyer has received those proceeds as trustee for the benefit of the seller.

{14.1} Where a buyer receives the proceeds of sale in trust for the benefit of the seller, as distinct from the buyer declaring a trust over those proceeds for the benefit of the seller, the buyer does not thereby confer, because it lacks the capacity to confer, on the seller any right (including a charge) in respect of those proceeds. The mere circumstance that the seller's equitable ownership of those proceeds is defeasible does nothing to capacitate the buyer to confer on the seller a charge over those proceeds.

{14.2} When the buyer pays the relevant debts to the seller, the seller's equitable ownership of the proceeds of sale (of which the buyer was the trustee) will be thereby extinguished, leaving the buyer (the former trustee) with the absolute title to those proceeds. In such a situation, the equitable ownership of the proceeds does not revert to the buyer, since it was the seller, and not the buyer, who acquired the equitable ownership of those proceeds as soon as they came into existence. Thus, the buyer's payment to the seller of the relevant debts does not constitute the buyer's redemption of a charge but, rather, constitutes the buyer's acquisition of the absolute title to the proceeds of sale for the first time.

{15} The seller's acquisition of defeasible equitable ownership of the proceeds of sale, otherwise than from the buyer, is totally different from the situation in re Bond Worth Ltd[13] where it was held that the seller, having transferred to the buyer the ownership of the goods, received, from the buyer, defeasible equitable title to those goods. The last-mentioned situation was clearly one in which the buyer had, out of property which it owned, conferred on the seller a right in respect of that property which was defeasible upon the buyer's payment of relevant debts to the seller, namely, a charge.

{16.1} In the instant case, the fifth subclause purports to make the Buyer a trustee for the benefit of the Seller, not of all of the proceeds of sale of the steel products, but of only that proportion of those proceeds which is commensurate with the invoice price of the steel used in the manufacture of those products. Thus, under the fifth subclause the Buyer receives the legal title to the proceeds of sale in the capacity of trustee of them for the Seller's benefit, as to the relevant proportion thereof, and for the Buyer's own benefit, as to the remainder thereof.

{16.2} Since the Buyer does not acquire any equitable title to the Seller's proportionate equitable ownership of the proceeds of sale when the Buyer first receives the legal title to those proceeds, it cannot be said that the Seller's proportionate equitable ownership of those proceeds is conferred on it by the Buyer. Hence, under the fifth subclause, the Buyer does not confer a charge on the proceeds of sale in favour of the Seller. This is so because the Buyer, not having initially acquired the relevant property beneficially, lacks the capacity to create a charge over that relevant property in favour of the Seller.

{16.3} Since the fifth subclause does not create a charge on the Buyer's property in favour of the Seller, that subclause does not create a registrable charge under section 262 of the Corporations Law.

{17.1} Even if the proceeds referred to in the fifth subclause were the book debts (as distinct from the payments made in discharge of those book debts) owed to the Buyer by the Third Party in respect of the sales of the steel products to the Third Party, there would be no conceptual difficulty in the view that the Buyer acquired those book debts solely in the capacity of trustee of them for the benefit, respectively, of the Seller and of the Buyer itself, in the relevant proportions.

{17.2} If and when the Third Party paid any one or more of those book debts to the Buyer, the trust of those book debts so paid will be merely transformed into a trust of the payments so received.

{18} It is therefore difficult to see why there needs to be an issue[14] as to whether the word "proceeds" in the fifth subclause means the book debts themselves or, alternatively, the payments made to the Buyer by the Third Party in discharge of those book debts. Such an issue will arise only if, which is not the case here, the Seller's interest in the proceeds (howsoever construed) constitutes a charge given to it on the Buyer's property.

{19} Nevertheless, in the instant case, the Buyer has not done anything to identify,[15] from the proceeds of sale (whether such proceeds be taken to mean the book debts themselves or the payments made to discharge them), such parts (if any) of those proceeds which reflected the invoice prices of the steel delivered under the three relevant invoices and used in the manufacture of the steel products sold by the Buyer. It therefore appears that any purported trust for the benefit of the Seller under the fifth subclause will fail on the ground of

uncertainty of the subject- matter of the purported trust, in that it does appear that it cannot be established as to which of the existing book debts (or which payments of previously existing book debts) are to constitute the proceeds required by the fifth subclause to be held proportionately in trust by the Buyer for its own benefit and for the benefit of the Seller, respectively.

{20} However, if there be (which is doubtful) any identifiable parts of the proceeds of sale which, under the fifth subclause, are required to be held in trust for the Buyer for the benefit of the Seller, then there is no reason in principle why such parts of the proceeds cannot be held on a defeasible trust (not amounting to a charge) for the Seller, given that such a trust will not be one which is created out of the Buyer's property.

{21} On a different point, it is suggested that, because the course of dealing between the Buyer and the Seller since 1987 or 1988 generally comprised invoices which included the printed clause, the omission[16] of the printed clause from invoice 583 (being one of the three invoices in issue) would not remove the goods supplied under that invoice from the operation of that clause.

{22} Finally, the provision of a period of credit for the Buyer, in each one of the three invoices in issue, is difficult to reconcile with the Buyer's inability to use all of the proceeds of sale of the steel products for its own purposes, since the imposition of a trust on the relevant part of the proceeds for the benefit of the Seller will deprive the Buyer of the benefit (being the Buyer's right to use all of the proceeds for its own purposes) contractually intended by the parties to be conferred on the Buyer through the provision of a credit period for the Buyer.[17] Thus, the possibility of any purported trust under the fifth subclause is negated by the existence of the credit period, thereby making that subclause completely ineffectual for inconsistency with the Buyer's right to use all of the proceeds of sale for its own purposes, a right which is implicit in the Buyer's contractual right to a credit period. Consequently, the observations made in the preceding paragraphs will be relevant only if the mere existence of the credit period is held not to have negated the possibility that the fifth subclause was intended to create a trust in favour of the Seller.

Endnotes

1. Associate Professor of Law, Bond University.

2. Application Book at 24.

3. [1981] 1 Ch 25.

4. Application Book at 25-26 and at 36.

5. Application Book at 33, 40 and 41.

6. [1991] 2 A C 339.

7. [1985] 1 WLR 111.

8. [1895] A C 457 at 466 (per Lord Herschell LC).

9. [1991] 2 A C 339 at 352 (per Lord Keith of Kinkel).

10. [1985] 1 WLR 111 at 116 (per Robert Goff LJ).

11. "I am, however, unable to regard a provision reserving title to the seller until payment of all debts due to him by the buyer as amounting to the creation by the buyer of a right of security in favour of the seller. Such a provision does in a sense give the seller security for the unpaid debts of the buyer. But it does so by way of legitimate retention of title, not by virtue of any right over his own property conferred by the buyer." [1991] 2 AC 339, at 353 (per Lord Keith of Kinkel). Emphasis added.

12. [1975] 1 WLR 279 at 281 (per Megarry J).

13. [1980] 1 Ch 228.

14. Application Book at 35 and 37.

15. Application Book at 36.

16. Application Book at 28.

17. Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd [1984] 1 WLR 485 at 499 (per Staughton J); Re Andrabell Ltd (in liq) [1984] 3 All ER 407, at 416 (per Peter Gibson J); Chattis Nominees Pty Ltd v Norman Ross Homeworks Pty Ltd (1992) 28 NSWLR 338, at 346 - 347 (per Cohen J); Puma Australia Pty Ltd v Sportsman's Australia Limited (No 2) [1994] 2 Qd R 159, at 170 (per Shepherdson J), and at 179 (per Williams J); 1C1 New Zealand Ltd v Agnew [1998] 2 NZLR 129, 135-136 (per Henry J, in delivering the judgment of the New Zealand Court of Appeal).