CASE COMMENT

PHOTO PRODUCTION LTD. v. *SECURICOR TRANSPORT LTD.*, [1980] 1 All ER 556

The House of Lords in this case once again had an opportunity to clarify an issue which has bedevilled the law of contract for some time, namely the relationship of the doctrine of fundamental breach with discharge by breach, and more particularly its effect on exception or limitation clauses.

The facts which are somewhat amusing may be stated briefly. The plaintiff company, a factory owner, entered into a contract with the defendants, a security firm, whereby the latter were to provide security services at the factory including night patrols, principally to protect the premises from theft or fire. However whilst carrying out such a patrol one night, an employee of the defendant set fire to a pile of cartons with the consequence that the entire factory burnt down. It was not however established whether the latter consequence was an intended one or not. The plaintiff sued for £615,000 damages, being the total value of the factory and stock, on the grounds of breach of contract, and/or negligence, the defendants being vicariously liable for the acts of their servants within the scope of their employment.

There was no doubt that the defendants were prima facie liable but they pleaded (inter alia) both an exception clause and a limitation of liability clause which were as follows:

1. Under no circumstances shall the defendant be responsible for any injurious acts or default by any employee . . . unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the defendant . . . nor in any event shall the company by held responsible for:
   (a) any loss suffered . . . through fire or any other cause, except insofar as such loss is solely attributable to the negligence of the defendant's employees. . . .
2. If notwithstanding the foregoing provision, any liability on the part of the defendant should arise . . . such liability shall be . . . limited to a maximum of £25,000 for the consequences of such incident involving fire. . . .

No negligence was alleged against the defendants. The trial judge

held that the defendants were entitled to rely on the exception clause. The Court of Appeal ([1978] 3 All ER 146) reversed his decision, holding that there had been a fundamental breach of the contract by the defendants which precluded them from relying on the exception clause. It was held by the House of Lords, present Lord Wilberforce, Lord Diplock, Lord Salmon, Lord Keith of Kinkel, and Lord Scarman, that there was no rule of law by which an exception clause in a contract could be eliminated from a consideration of the parties position when there was a breach of contract (whether fundamental or not), or by which an exception clause could be deprived of effect. The question therefore whether an exception clause applied when there was a fundamental breach, breach of a fundamental term, or any other breach, turned on the construction of the whole of the contract, including the exception clauses. Their lordships were thus emphatically restating the view of the majority in *Suisse Atlantique Societe d'Armement Maritime S.A.* v. *Rotterdamsche Kolen Centrale* ([1967] 1 A.C. 361).

To understand the controversy which has raged in this area of the law it is perhaps convenient to start with the decision of Lord Denning in *Harbutt's "Plasticine" Ltd.* v. *Wayne Tank & Pump Co. Ltd.* ([1970] 1 Q.B. 447). That was also a case of fundamental breach, being defined as a breach going to the very root of the contract which either automatically terminates the contract, or at least gives the innocent party the election of discharging it. The Master of the Rolls was of the opinion that where the contract was terminated following a fundamental breach, then it was settled law that the innocent party could sue for the breach unimpeded by the exclusion clause; notwithstanding that on its proper construction the clause concerned would have excluded liability for the breach that occurred. Lord Denning in reaching such a conclusion was purporting to follow the House of Lords in *Suisse Atlantique* but it is clear that this was the view of only a minority of their Lordships in that case, namely Lord Reid and Lord Upjohn.

This so called 'rule of law' that, where the breach is fundamental and the contract is not affirmed, the court will itself deprive the guilty party of the benefit of the exception clause whether it covers the breach or not, has a long and established history. It began with the deviation and quasi-deviation (bailment) cases, and more latterly has been applied to a wide variety of consumer contracts by the English Court of Appeal led by Lord Denning, who has nurtured and developed this rule despite the protestations of the House of Lords.

One of the early authorities for the doctrine is the House of Lords decision in *Hain Steamship Co.* v. *Tate & Lyle Ltd.* ((1936) 41 Com. Cas. 350). Here deviation of a ship was said to be a fundamental

breach giving the injured party the election to terminate or affirm the contract. If terminated the guilty party cannot rely on any exception clause. The rule has always been applied in contracts of bailment whereby if the bailee departs from the 'four corners' of the contract by storing the goods at a place other than that agreed upon then he cannot rely on clauses in the contract designed to protect him against liability only when he is substantially performing the contract: *Lilley* v. *Doubleday* (7 Q.B.D. 510).

The best known example of more recent authority is the decision of Lord Denning's in *Karsales (Harrow) Ltd.* v. *Wallis* ([1956] 1 W.L.R. 936), where the rule was applied to a breach under a hire-purchase agreement over a car. The solution his Lordship stated, was to look at the contract apart from the exception clause to determine what the obligations of the guilty party were, so that if his breach goes to the root of the contract, he cannot rely on any exception clauses.

When the issue came before the House of Lords in *Suisse Atlantique* Viscount Dilhorne, Lord Hodson, and Lord Wilberforce rejected the substantive rule of law approach in favour of construction. That is that the question whether an exception clause was applicable where there was a fundamental breach of the contract is one of the true construction of the contract, and that this is the case whether the contract is affirmed or disaffirmed by the innocent party after the breach.

The Master of the Rolls was not beaten yet however. Mindful of the fact that their Lordship's comments in *Suisse Atlantique* were obiter in respect of a breach causing the discharge of the contract (because (i) the contract had been affirmed; (ii) the majority were of the opinion that the clause in question was not a limitation clause but a liquidated damages clause inserted for the benefit of both parties and which has its own jurisprudence), Lord Denning has striven to restate the law as he perceived it to be prior to that case. This occurred first in *Harbutt's "Plasticine" Ltd.* v. *Wayne Tank & Pump Co.* (a contract to design and erect and new pipeline and storage system for styrene), and then in *Farnsworth Finance Facilities Ltd.* v. *Attryde* ([1970] 1 W.L.R. 1053), (a hire purchase agreement over a motor-cycle). In both these cases the Court of Appeal held that a party guilty of a fundamental breach of a contract which had not been affirmed was disentitled, as a matter of law, from relying on an exception clause, whether on its proper construction the clause excluded the breach or not.

This then was the background of law confronting Lord Denning when *Photo Production Ltd.* v. *Securicor Transport Ltd.* came before him on appeal. Notwithstanding that he found as a fact that the exclusion clause given its natural and ordinary meaning exempted or at least limited the defendant's liability, he found in favour of the plain-

tiffs for two reasons. First, relying on the cases cited above he restated the substantive rule of law approach that because a fundamental breach had been committed by the defendant he was disentitled from relying on the exemption clause. Secondly, construing the clause in the wide context of the "presumed intention" of the parties to see whether or not, in the situation that has arisen, the parties can reasonably be supposed to have intended that the party in breach should be able to avail himself of the exception clause, he decided that it would not have been intended to apply.

This latter principle is entirely in accord with the majority decision in *Suisse Atlantique,* particularly that of Lord Wilberforce. Consequently insofar as Lord Denning is saying that, as a matter of construction, the exception clause cannot have been intended to apply to the particular breach complained of, his approach is the correct one in law. However when the case reached the House of Lords it was decided that on its proper construction the parties would have contemplated that the clause would apply to exclude liability for this breach. Of course in attempting to restate the rule of law approach Lord Denning is at variance with the House of Lords. In *Photo Production Ltd.* v. *Securicor Transport Ltd.* their Lordships unequivocally rejected this doctrine. There can be no doubt now that whether the breach is fundamental or otherwise, and whether the breach was affirmed or discharged, it is always a matter of construction, that is of the intention of the parties at the time the contract was entered into, whether the particular breach complained of was covered by the exception clause pleaded.

The question arises as to whether it is unfair that the defendant here should be able to burn the factory down causing £615,000 damage and yet plead an exception clause leaving the plaintiff without a remedy and seemingly out of pocket? Perhaps a number of observations should be made at this point. First the parties here were of equal bargaining power. This is not a case where a party or superior bargaining power has sought to impose upon an unsuspecting member of the public with whom he contracts a wide and grossly unfair "standard form" type exclusion clause. It is largely this latter type of case which has provided the impetus for the development of the doctrine of fundamental breach. Excellent examples of this are the *Karsales* and *Farnsworth* cases. It should be noted that the British have corrected the problem by statute in the passing of the Unfair Contract Terms Act 1977. This applies to consumer contracts including standard forms and enables exception clauses to be applied with regard to what is just and reasonable. Secondly, this case was really litigated by the parties' respective insurance companies. As Lord Wilberforce pointed out (at page 561):

> In commercial matters generally, when the parties are not of unequal bargaining power, and when risks have normally been borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said . . . for leaving the parties free to apportion the risks as they think fit and for respecting their decision.

Furthermore the decision does not mean that the courts are reduced to a state of impotence when confronted with widely drawn and possibly unfair exclusion clauses. As was pointed out by Coote ((1970) C.L.J. 221, at 238) there is in existence an imprecise array of interpretative devices for containing exclusion clauses, including the contra preferentum rule, the repugnancy rule, and the exclusion of negligence from the operation of such clauses. It must also be remembered that as a matter of construction (adopting the wide concept of 'construction' enunciated by Lord Denning in *Photo Production* v. *Securicor Transport Ltd.*) it will not often be the case that the parties can be said to have intended that the exclusion clause would excuse liability for a fundamental breach of the contract, or a performance totally different from that contemplated.

While it is clear that *Suisse Atlantique* and *Photo Production Ltd.* v. *Securicor Transport Ltd.* have over-ruled cases such as *Karsales (Harrow) Ltd.* v. *Wallis, Harbutt's "Plasticine" Ltd.* v. *Wayne Tank & Pump Co. Ltd.*, and *Farnsworth Finance Facilities Ltd.* v. *Attryde,* there remains the problem of what to do with the deviation cases. Have they also been over-ruled so that the application of an exception clause after a deviation is also a matter of construction, or are they sui generis and should therefore be allowed to stand as a special case for historical reasons? Lord Atkin in *Hain Steamship Co.* v. *Tate & Lyle Ltd.* felt that deviation fell within the ordinary law of contract. This view seems to be echoed by Lord Wilberforce in *Photo Productions Ltd.* v. *Securicor Transport Ltd.* Perhaps these cases can be reconciled with the construction rule by saying that, since the deviation is such a gross misperformance of the contract (as often insurance contracts will no longer cover the voyage), it cannot have been contemplated by the parties that the exclusion clauses would apply to the new adventure.

I will conclude this article by discussing briefly how the two approaches, construction and rule of law, stand with the theory of contract law, and in particular discharge by breach. Now it is clear that the discharge of the contract following a breach (whether fundamental or not) occurs after the breach and does not operate retrospectively to some time before the breach. This means that at the time of the breach the contract, including any exception clause, was valid and subsisting. Consequently it is hard to see how there can exist a rule of law that the guilty party cannot rely on an exception clause in the case of a fundamental breach leading to the discharge of the contract,

because at the very point in time the breach occurred the contract was still operative. It must be further borne in mind that even where the contract is not affirmed, it is only discharged in respect of future obligations, and not terminated or ended absolutely. Even Lord Denning conceded the point in *Harbutt's "Plasticine"*.

Furthermore the effect of discharge by breach may depend on what the courts conceive to be the function of an exclusion clause. If it is to operate merely as a procedural obstacle to a suit for damages then it has been argued that it cannot be relied upon since the contract together with the exception clause has been discharged after the breach. However this analysis assumes that when the parties exclude or limit liability for breach, the liability is one imposed at the point of adjudication. But a much more natural interpretation is that the liability concerned accrues at the moment of the breach (See Coote, *loc. cit.* at 232). At the moment the contract is still in existence, and even on the view that exception clauses are mere procedural bars to recovery of damages, it is hard to see why the clause would not be operative.

Another view is that exception or limitation clauses modify the obligations of the contracting parties. Thus an exception clause will modify the primary obligation of the contracting party for whose benefit it was inserted, and a limitation clause will modify the secondary obligations of the guilty party to pay damages in the event of a breach of one of the primary obligations. On this theory the exclusion clause will have the effect of preventing what would otherwise be a breach of a promise (or primary obligation) entitling the innocent party to discharge the contract from being a breach at all. This accords with the comments of Lord Wilberforce in *Suisse Atlantique* where he said: (at 431)

> An act which, apart from the exception clause, might be a breach sufficiently serious to justify refusal of further performance, may be reduced in effect, or made not a breach at all by the terms of the contract.

It is this approach which found favour with Lord Diplock in *Photo Productions Ltd.* v. *Securicor Transport Ltd.* His Lordship recognised that the contracting parties are free to determine for themselves what primary obligations they will accept. He further recognised that the secondary obligation to pay damages in the event of a breach of a primary obligation can be modified by agreement between the parties. Discussing exclusion clauses he was of the opinion that they could exclude or modify obligations whether primary or secondary, that would otherwise arise under a contract or by implication of law.

Applying the above theory in the instant case Lord Diplock found that the exclusion clause modified the primary obligation of the defendant to liability only for a failure to exercise due diligence in

their capacity as employers. Since this was not alleged the claim of the plaintiffs had to fail. It will be seen therefore that this theoretical view of the function of exception clauses squares nicely with the construction approach to fundamental breach and its effect on such clauses. If accepted that these clauses modify the obligations of the parties, it is clear that this would be inconsistent with any rule of law disentitling the guilty party from relying on the exclusion clause in the event of a fundamanental breach, since on a proper construction of the clause it is possible that the event complained of may not be a breach at all.

It is submitted that there can be no doubt that the rule of law approach has been over-ruled in favour of the proper construction of the exception clause. However the deviation cases may have to remain as an anomalous exception for whatever reasons. It is hoped that their Lordships latest pronouncements will sound the death knell of the doctrine of fundamental breach, that is the substantive rule of law that in the case of such breaches an exclusion clause cannot be relied on by the guilty party. Coote submits that the doctrine should remain where *Suisse Atlantique* left it, decently interred (*loc. cit.* at 238). The ball is now in Lord Denning's court.

DAVID PLUNKETT

JOHNSON v. *AGNEW,* [1979] 2 W.L.R. 487.

The plaintiffs contracted to sell properties to the defendant purchaser, in order to pay their mortgagees. The defendant failed to complete, and although the plaintiff obtained an order for specific performance, it proved abortive. The plaintiffs' mortgagees enforced their security by selling the properties, but as the proceeds were insufficient to discharge the mortgagees, the plaintiffs now sought an order that the defendant pay the balance (the difference between the price the defendants had agreed to pay and the actual price received on the sale) to the mortgagees.

The Court of Appeal discharged the order for specific performance and awarded damages in lieu. The House of Lords however said that damages were available at common law.

Specific Performance and Discharge for Breach

Lord Wilberforce who delivered the Lords' judgement overruled the unfortunate decision of *Capital & Suburban Properties* v. *Swycher* ([1976] Ch. 319) and affirmed the older and more sensible decision of *Austins of Eastham Ltd.* v. *Macey* ([1941] Ch. 338). A plaintiff who

obtains a decree of specific performance, which proves abortive because of the defendant's persistent default, is not then precluded from treating himself as discharged from the duty to perform his part of the contract as a result of the defendant's breach. Thus, common law damages are available.

It is submitted that this position is eminently logical, and though not referred to by Lord Wilberforce, Dawson has strongly argued for this in his article ((1977) 93 L.Q.R. 232). The plaintiff is not precluded by the doctrine of merger, because unlike damages, the order for specific performance does not merge into the judgment. Nor is the plaintiff precluded by the doctrine of election—a persistent refusal by the defendant to perform represents either a continuing, or a new cause of action.

Assessment of Equitable Damages

In what must be considered a strongly worded obiter statement (in view of the concurrence of the rest of their Lordships) Lord Wilberforce said that when equitable damages are awarded they will generally be assessed in the same manner as damages at law. Cases such as *Wroth* v. *Tyler* ([1974] Ch. 30) are said to be explicable on the basis that there is no universal principle that damages at law are to be assessed as at the date of the breach. (This point had earlier been made in *Radford* v. *de Frobervilee* ([1977] 1 W.L.R. 1262). Thus in a proper case damages at law or in equity, may be assessed at a later date, say, the date that specific performance proves abortive, and the order is discharged.

Of course, there are cases in which equitable damages will be exceptional. Lord Wilberforce recognises this—there are situations for example where damages would not be available at law at all, e.g. where specific performance has been ordered of a contract, required by law to be in writing, but proved in equity by parol evidence and part performance.

It is submitted that again, Lord Wilberforce's pronouncements are sensible—as Jolowitz pointed out in his article ((1975) 34 C.L.J. 224) the purpose of "Lord Cairns" Act was simply to avoid the circuitry of action involved by a plaintiff having to bring actions both in law and in equity. It would probably be reading too much into the judgment however, to say that it represents another attempt by the House of Lords to fuse the jurisdictions of law and equity. (see also *United Scientific Holdings* v. *Burnley B.C.* [1977] 2 W.L.R. 806 (HL).)

Discharge for Breach and Rescission

Amidst all this, Lord Wilberforce cast some observations upon the

vexed question of rescission of contracts. It is submitted that this is one aspect where his Lordship's pronouncements lack precision.

Lord Wilberforce said that unlike the case of rescission, where the contract is treated as never having been in existence, upon a discharge for breach, the contract is simply ended or discharged. This is an unfortunate conception, particularly in view of the fact that Lord Wilberforce had already cited a clear and correct statement by Lord Porter in *Heymans* v. *Darwins* ([1942] A.C. 352 at 399). When a contract is discharged for breach, there is no rescission, or termination, or ending of the contract. Because promises in a bilateral contract are presumed to be dependant, the duty of one party to perform his promises is conditional upon the other party performing his promises also, or if he has to perform last, being ready and willing to perform. If that party fails to perform or is not ready and willing to perform, and this goes to the root of the contract, the first party is excused from the duty to perform his promise. Providing he himself is ready and willing to perform, he may enforce the contract (by seeking damages at law for example) even though he has not actually performed himself. This excuse is what discharge for breach is all about, and it can be readily seen by those who understand the doctrine, that there is no magical rescission or termination of the contract itself, and that there is no excuse for the confusion between rescission and discharge for breach. (A confusion which does not exist in the United States because there the concepts are clearly taught and understood.)

A second point here is that Lord Wilberforce states that rescission ab initio is not a remedy for breach of contract at all (a point argued for by Albery in ((1975) 91 L.Q.R. 337). With respect, this is incorrect historically. Rescission was long a remedy for repudiatory breaches of contract before discharge for breach became a remedy. (See e.g. Nicnaber's article in (1962) C.L.J. 213). If one party repudiated the contract, the courts were prepared to regard this as a (fictional) offer to rescind, which the innocent party could accept or reject. If he accepted the offer the contract was rescinded and he had an action in quasi-contract. It was not until *Hochster* v. *de la Tour* ((1853) 2 Ex.B. 678) that the concept of discharge for breach was born, so that while rescission may not be a remedy for breach of contract generally (unless the parties expressly contract for it) it is historically available for repudiatory breaches.

Finally on rescission, Lord Wilberforce overrules the famous case of *Henty* v. *Schroeder* (12 Ch. D. 666 at 667) where Sir George Jessel MR stated that a party could not at the same time rescind a contract and obtain damages for breach. It is submitted that Lord Wilberforce fails to distinguish between what that case concerned and the principle

for which it stands. His Lordship overrules the case because it was in fact a case for discharge for breach and not rescission, and therefore damages should have been available. While this may be correct, the principle of the case as it has been subsequently understood must be correct, i.e. where a contract is rescinded ab initio, damages for breach are not a possibility because there is no longer any contract to refer to. This is surely logical and is accepted without question in America.

Note: Mr David Poole is presently writing a dissertation on Equitable Damages, and the present writer is completing a thesis on conditions, which includes a chapter of some forty pages on discharge for breach.

STEVEN DUKESON

Ed. Note: The House of Lords has recently reconsidered the question of discharge for breach in *Photo Productions Ltd.* v. *Securicor Transport Ltd.* as to which see the previous case note. Mr Dukeson has asked that his comments on this area of the law be considered in the light of the decision in that case.

Re BOND WORTH LTD [1979] 3 All ER 919.

This case although only at High Court level has important implications for commercial lawyers attempting to secure "purchase-money" finance without the necessity for registration; and also serves as a warning against poor drafting.

Monsanto Ltd. supplied synthetic fibre on credit to Bond Worth Ltd., the buyers, each separate delivery to constitute a separate contract. The terms were that risk passed on delivery but "equitable and beneficial ownership" was to remain with the sellers until full payment or prior resale. In the latter event beneficial entitlement was to attach to the proceeds. Further if fibre was made a constituent of or converted into other products, the seller was to have the same "beneficial" ownership of the goods or proceeds thereof. The buyer spun the purchased fibre to produce yarn, which in turn was processed and woven into carpet. Once spun it was inseparable and indistinguishable from other fibre. Bond Worth Ltd. became insolvent owing £587,000 under contracts with Monsanto Ltd. The latter claimed to be able to trace into the yarn and carpet and the proceeds therefrom. Moreover they contended that they were a beneficiary under a trust, or alternatively they held an equitable charge which they did not "create", and which was not registrable under section 95 Companies Act 1948 (U.K.), (section 102 Companies Act 1955 (N.Z.)). The buyer claimed that Monsanto Ltd. had only a charge which was void in the cir-

cumstances of section 95.

Slade J dealt first with the incorporation of the "special conditions" including the "beneficial ownership" clause into the separate contracts. The importance of his judgment arises when he turned to consideration of that clause, and the legal effect, if any, it was capable of having. Several points were clear: (a) they were absolute contracts for sale; (b) legal property passed when the fibre was delivered and not just a special property; (c) risk also passed then; (d) it was not intended to reserve to the seller all rights enjoyed by a *sui juris* person having sole beneficial title to property as against a trustee, e.g. the seller couldn't call for redelivery while the buyer had far reaching rights to deal which were not normally possessed by a trustee; (e) the buyer could resell and pass good title. This goes beyond section 27(1) Sale of Goods Act 1908 (N.Z.) which does not authorise the sale between the buyer in possession and his vendor; (f) it was intended that on sale the equitable ownership would attach to the proceeds; (g) the buyer was entitled to use them for manufacture; (h) it was intended that on manufacture the seller would have equitable ownership in the new goods, but that the buyer could resell them and pass good title. The equitable ownership would then attach to the proceeds.

Since property had passed the contract could not constitute a bailment or agency, but had to confer on the seller an equitable interest if any. Obviously the rights conferred on Monsanto Ltd. were not hypothec or *in re aliena* but were *in re propria* under a split ownership. Equity has never recognised that where total ownership is vested in one person he has a "dual" ownership, in the sense that he may transmit his equitable interest free of the legal *dominium*. An equitable claim is recognised in equity because of the relationship which exists between two persons, and while equity will recognise a "split" ownership to effect good conscience, e.g. the mortgagor's equity of redemption, or purchaser's equitable interest, nonetheless it is only by a declaration of trust that a full owner may consensually cause equitable recognition of his transmission of beneficial rights to another. (Where a person already owns the beneficial but not a legal ownership he is free to alienate it without the necessity of trust since here equity follows the law.)

Thus the contract here must have been a declaration of trust, and on the plain meaning a trust whereby the seller was the sole beneficiary. Slade J felt however that he was entitled to regard the contract as a whole, and since the whole purpose of the clause, when viewed objectively, was to afford security for the payment of the purchase price, the plain meaning was displaced. Since a person may create a charge over assets by declaring he holds them in trust for a creditor by way of security for a specified debt that alternative possibility seemed more

likely. This conclusion was supported by two arguments; first that any contract which by way of security for payment of debt confers an interest in property defeasible on repayment must necessarily be regarded as creating a mortgage or charge. The existence of the equity of redemption is quite inconsistent with the existence of a bare trustee-beneficiary relationship. Secondly all the characteristics of a mortgage or charge as enumerated by Romer LJ in *Re George Inglefield Ltd.* ([1933] Ch. 1, at 27-28) were present. The mortgagor was entitled to get property back by repaying money (the right to redeem); the mortgagee where he realises more on the sale of the property than owed has to account for the surplus; the mortgagee where he realises less than owed on sale may sue the mortgagor for the balance.

Slade J then considered whether the trust by way of security was to take effect as an equitable mortgage or a charge, but while considering the latter more likely felt that there was no practical distinction here since both were a charge within the meaning of section 95. Logically he should have considered the next point first, that is, was this a simple disposal of the legal title and the equity of redemption so that the balance of the beneficial ownership always remained in the seller, and thus he did not "create" the charge under section 95. Slade J distinguished *Re Connelly Bros Ltd. (No.2)* ([1912] 2 Ch. 25) on the grounds that it was not concerned with a buyer-seller reservation of title but was a case where the buyer took the ownership of the goods on trust to give effect to a third party's rights; and where the real issue was equitable priorities. After considering the authorities Slade J found that there was no authority to the effect that on a sale the buyer can expressly exempt an equitable title or charge to secure unpaid purchase money; and following *Capital Finance Co. Ltd.* v. *Stokes* ([1969] 1 Ch. 261 at 277) he held that the correct conveyancing procedure was a sale and grant back. *Wilson* v. *Kelland* ([1910] 2 Ch. 306) which was not cited may have been an authority in favour of reservation, but the judgment of Eve J is so short and difficult to fathom that grave difficulties exist in contending that he went further than finding a bone fide purchaser of a legal interest takes free of prior equitable interests without notice.

At least in the case of a charge it is obvious that reservation is not possible since the hypothec rights are not ownership rights and only arise because a charge has been given. Thus the seller only has a charge by definition when he has rights *against* not *in* another's property and while that property is not *in* the chargor he can have no rights *against* it. He may of course have a contractual obligation to have or give a charge but this goes to the question of competing equities with third parties and not "split ownership" questions. With a mortgage the mortgagee's rights are of a mixed hypothec character but to some

extent there is a conveyance of ownership rights. Thus while it is easier conceptually to speak of the intended mortgagee reserving these *in re propria* rights which he would enjoy if there was a sale and regrant, clearly that has not happened here, since the declaration of trust could only have been effective if the buyer had first owned all the beneficial interest.

An interesting question would have arisen if the "beneficial ownership" clause had been reworded so that instead of the entire beneficial ownership being in the seller, it had been limited to the ownership only of those rights which equity normally recognises in a mortgagee. In such a situation it may be that a declaration of trust would still be required for equity to recognise the seller's interest, or the buyer would have to give an equitable mortgage (by an ineffectual conveyance of the legal mortgage under the doctrine equity looks upon that as done which ought to be done). In either event a transfer of the complete ownership first to the buyer would be necessary. This avoids the misconception that *dominium* consists of dual ownership in law and equity and that the owner may deal with his beneficial ownership without the intervention of equity.

Nor could it be argued that the doctrine that equity looks upon that as done which ought to be done will give the seller the equitable mortgage before conveyance of the property to the buyer, since the conferment of a mortgage upon him by the buyer cannot, far less ought to be done until the latter has something to give, and the former something to receive. Of course the seller may have a present contractual right to the mortgage when the future property comes into the ownership of the buyer, but that raises the problem which Slade J later confronts of who in such a situation "creates" the charge.

Bond Worth Ltd. while accepting the possibility that a trust for the purpose of creating a charge may exist, argued that it was negated here since (a) the chattels were not likely to retain their identity; (b) there was no obligation on the buyer to preserve their safety or identity; (c) there was no obligation to safeguard the seller's security or to keep the unpaid fibre separate from other fibre.

They submitted two reasons for this. First that there was no certainty of object. The judge held however that it was never intended that it should also apply to the new product. Secondly they said it was inconsistent with a trust or fiduciary relationship that the buyer should be free to use the fibre for the purpose of their own business. Slade J agreed that freedom to employ assets or proceeds for the buyer's own purposes was not only inconsistent with the relationship of trustee and beneficiary solely entitled, but also with a declaration of trust by way of equitable mortgage or charge to secure money where this was immediate and specific. However this objection would be

removed if the charge was a floating charge since it was an incident to the latter that no property would be appropriated to the security until some future contingency occurs.

In arriving at this conclusion it was necessary to distinguish *Aluminium Industrie Vaassen BV* v. *Rompalpa Aluminium Ltd.* ([1976] 2 All ER 552) which appeared to be at variance with earlier authorities that where an alleged trustee has a right to mix tangibles with other assets and deal with them as he pleases, this is incompatible with a presently subsisting fiduciary relationship. At least with regard to the present case the following differences were vital: (a) full legal ownership passed to Romalpa and the court was not precluded from finding a bailor/bailee relationship; (b) in that case there was a further clause that if required the seller could require the mixed goods be kept separate from the others; (c) there was no difficulty there of ascertaining the money liable to account; (d) the parties mentioned the word 'fiduciary'.

Having found these differences Slade J was able to avoid the problem of reconciling the decision in *Romalpa's* case with the earlier cases against fiduciary relationships where there was a right to mix. Whether such a situation gives rise to a bailment was recently doubted in *Borden (U.K.) Ltd.* v. *Scottish Timber Products Ltd* ([1978] 3 All ER per Bridge LJ at 970 and at 971). Quite apart from that, academic opinion is divided as to whether a bailment gives rise to a fiduciary relationship at all. It may be that *Romalpa* is best explained on the grounds that while no fiduciary relationship existed in relation to the goods sold, there was an express declaration of trust over the proceeds of re-sale. The fact that *Rompala* was a Court of Appeal decision may have prevented Slade J from doing more than questioning how a fiduciary relationship could have been held to exist in that case.

Having found it was a trust for a floating charge the last question was whether it was void for lack of registration. The judge distinguished a charge arising by operation of law (e.g. an equitable lien which the seller had waived here by relying on his contractual remedy) as not requiring registration, and those charges which though created as a result of presumption in law are none-the-less contractual in nature (e.g. equitable mortgage by deposit) which did. A floating charge is even more evidently "created" by the parties since unlike an equitable mortgage there is no presumption of charge but an express contractual charge, albeit only enforceable in equity because of the law's failure to recognise future interests. The argument never arose that in such a situation "equity" creates the charge not the parties; but it is submitted that the attraction of such a view is superficial only. The contract of charge (and the right to appropriation on a future contingency) is a present subsisting right, and equity when the time

arrives for conveyance gives effect to the parties intentions no more nor no less than the law would.

Although the finding of a floating charge appears "conceptually" correct it is an open question whether on the words of the contract the parties intended or even considered that they were creating a floating charge. Further as Slade J points out even if the charge had not been avoided the following difficulties would have remained: (a) the dispositions were authorised and the seller may not have been able to crystallise his security in time to secure himself against the liquidator: (b) can a beneficiary under an alleged trust seek the remedy of declaration of an equitable charge on mixed funds or assets when he authorised the mixture?

The moral of this case is clear. If commercial lawyers wish to provide clients with a "safe" means of securing purchase-money finance without registration they should reserve the entire ownership in the seller until payment with an express trust over the proceeds of resale, and not attempt to transmit the equitable rights in a manner that equity hasn't recognised.

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