RETENTION OF TITLE IN THE EUROPEAN UNION: IS THERE POSSIBILITY FOR HARMONIZATION

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Abstract: *Although there are 28 national jurisdictions in the European Union, due to the extensive process of harmonization their national rules in public domain have much in common. Private law area, on the other hand, remains mainly unaffected by this process, especially in the area of property law.*
Retention of title clause is one of the most important tools for protection of the seller's rights under the sales contract, but it arises from the nucleus of property law. It means, among other things, that it remains heavily influenced by local legal tradition. As such it can be one of the obstacles for the free movement of goods and services.
Having this in mind it is of no surprise that for the last three decades the EU has been trying to come up with the European notion of the retention of title clause. Different advantages as well as disadvantages of the cross-border relations in the area of contract law with the implications on the property law would best be met by the autonomous notion of this clause.
Despite the obvious willingness of the EU in regulating the subject matter, question remains whether the EU competences include this area. What about article 295 of the EC Treaty which seems to prevent the EU from legislative actions in the area of property law? What about numerus clauses?
Also, it may be argued that this issue has already been dealt with on the level of UNIDROIT as well as UNCITRAL, with not much success. Thus, the intention of the authors is to explore reasons for the failure of the attempted unification at global level and to explain how common European retention of title clause could lead to more secure and more certain transactions within the internal market.

Keywords: *Retention of title, European Union, harmonization, property law*

1. INTRODUCTION

In a world as globalized as we are living in an absence of a cross-border element in business transactions is more often exception than the rule. It means that in most cases bussiness transactions will be subject to more than one legal order. While it might not be a problem regarding contractual matters due to unified European system of conflict rules, when transactions include proprietary aspects, which are still under the exclusive domain of Member States legal issues, become more complex.

Why is it so? Almost universally, rights *in rem* in cross-border cases are subject to the *lex rei sitae* rule [1]. It means that the content and the extent of rights *in rem* regarding immovables as well as movables will be judged according to the law of the state in which respective property is situated [2]. While it is obvious that this rule secures great certainty with respect to

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immovable property, this might present a big problem regarding movable property [3]. Namely, universal application of *lex rei sitae* means that each time this property moves across borders different property law applies. Since national property laws may vary greatly, this may result in a complete loss or only partial recognition of property rights acquired in the state of origin. Thus, property law is national law *par excellance* [4].

One of the most common tools in international business transactions is so called retention of title clause (RoT), closely associated with property law. This institute is well known since the ancient Romans time (*pactum reserve domini*) [6] and all European legislations are familiar with it. It is used for protection of rights of the seller in business transactions, as one of the clauses in a sale contract, which secures the seller by postponing the transfer of ownership until the buyer has paid the full price [5]. Due to its roots in the „coercive national dogmatic of property law" it differs in many ways from one country to another [4]. As such it can be one of the obstacles to the free movement of goods and services.

Having this in mind it is of no surprise that for the last three decades the EU has been trying to come up with the European notion of the retention of title clause. Different advantages as well as disadvantages of the cross-border relations in the area of contract law with the implications on the property law would best be met by the autonomous notion of this clause.

On the other hand, some previous attempts of unification failed, such as those from UNIDROIT or UNCITRAL. Has anything changed since then? Do EU competences include the competence to unify this area of law?

The intention of the authors of this article is to explore these questions and to explain how common European retention of title clause could lead to more secure and more certain transactions within the internal market. In order to do so, we will first present some legislations which we consider typical enough to serve as a reference for our further considerations.

2. RETENTION OF TITLE IN GERMAN LAW

German law is a perfect example for research and study of retention of title clause. Interestingly, German law has scarce statutory regulation of this institute, but very rich court practice and legal doctrine, which have actually developed and shaped this institute [12].

Retention of title is commonly used tool in business transactions in Germany and most of the general terms and conditions contain this clause. It has a big importance in business transactions, and contractual practice is trying on a daily basis to make it even more useful.

The clause is articulated in Article 449 of the German Civil Code which states the following: "If the seller of a movable good has retained title until payment of the purchase price, than in the case of doubt it is to be assumed that ownership is transferred subject to the condition precedent that the purchase price is paid in full (retention of title)" [17]. However, this is not the main rule that governs retention of title [5]. In Germany, retention of title is based on general principles of civil law, especially law of obligations and property law [5]. Contractual practice as well as court practice have developed detailed and different types of this clauses.

First type is simple or ordinary retention of title (*einfacher Eigentumsvorbehalt)*. If this type of clause is agreed by the parties' condition precedent is full payment of the purchase price [5]. This type of clause is used when buyer is also a final consumer of the sold item. However, an

insight into contractual practice shows more than obvious that simple retention of title is rarely used, while enlarged or comprehensive retention of title (*erwiterter Eigentumsvorbehalt*) occur more often [12].

Enlarged retention of title means clause which secures all the obligations which the buyer has towards the seller [9]. This means that sold item is the ownership of the seller until buyer has paid all his obligations to the seller and not just the purchase price of the sold good.

The most common situation is that buyer purchases goods for its own business, but this opens the question what if good on which title is retained has been sold to a third party. Does this situation lead to the loss of retained property? According to the German court and contractual practice this is not the case.

Third type of this clause is so called extended retention of title clause (*verlängerter Eigentumsvorbehalt*). If the contract contains this type of clause it means that the buyer transfers their claims for the purchase price, which he can demand from his buyers to the seller [5]. If the business relations between the seller and the buyer have an ordinary course, the buyer will usually inform seller about all sales contracts and third-party buyers [5]. This clause has been developed according to construction of the right in anticipation (*Anwartschaftsrecht)* [12], which presupposes transfer of the anticipated right (in this case right of ownership) on the third-party buyer.

Besides these types of the retention of title clause, German law also recognizes some sub-types of this clause, which have also been developed by the contractual and court practice, such as secondary or subsequent retention of title, forwarded retention of title or retention of title for sales to different companies belonging to seller (*Konzernvorbehalt*) [14].

Speaking about court practice, it is important to keep in mind that these clauses need to be precisely drafted because in case of any doubts courts will interpret it restrictively [14]. Since clause is commonly used in international sales contract, it is important to know when it will take effect according to the German law. If the seller is domiciled abroad and the buyer is domiciled in German, the clause will take effect when goods are on German territory according to the principle of the *lex rei sitae* [14].

However, one of the most important effects of the retention of title clause is in the case of insolvency of the buyer. It has been changed in 1999 when new Insolvency act entered into force [5], [15]. Depending on type of retention of title clause, the seller may have right on segregation or separation of the item sold. If the sale contract contains simple or ordinary retention of title clause, then the seller has the right on the segregation of its property [15]. On the other hand, when other types of the retention of title clauses are in question, the seller has separation right [15].

The seller is granted segregation right only if the purchase price is not paid in full until the beginning of the insolvency procedure [5]. After the insolvency proceeding has started, the insolvency receiver decides whether the contract is going to be continued and executed or terminated. According to art. 107 of the Insolvency act, the insolvency receiver is not empowered to make such decision before the first meeting of the creditors [15], and the seller is not entitled to start legal proceedings for surrender of the sold item before the first meeting of the creditors [5]. After the first meeting of the creditors, the insolvency receiver makes declaration and he can pay the purchase price or terminate the contract. If he pays the purchase

price, he becomes proprietor of the sold item, and if he decides to terminate the contract, he is obliged to surrender the sold item to the seller [5].

This solution may be good for the rest of the creditors, since they have the opportunity to discuss about the destiny of the item over which the title is retained, but on the other hand one has to keep in mind that the seller has the title over the sold product, and actually, he is the real owner of the sold item until the full purchase price is paid. Hence, this German solution could be contrary to the nature of the right of ownership. Since the seller is the owner of the sold item, he should have the right to decide whether to execute or to terminate the contract and not the insolvency receiver whose duty is to handle the insolvency estate.

On the other hand, in the case of complex retention of title clauses (extended or enlarged retention of title), the seller will have separation right in case of bankruptcy of the buyer. The seller's duty is to inform insolvency receiver about his right, and after that he becomes separate creditor [9] and the insolvency receiver is obliged to pay the seller proceeds on which he has right upon the liquidation of the sold item [9].

Having in mind the nature of the ownership this solution may also be contrary to it. Since current solution deprives the seller of the possibility to decide the future of his property there is also a room for some improvement. On the other hand, keeping in mind interest of the business, some future solution should make the balance between the right of ownership and the interest of the business (e.g. when sold product is almost paid and very important for course of business, the insolvency receiver should have power to decide upon it together with the owner/seller).

However, German solution has served as the role model for more than one civil legal system. It has proved its value and it achieves its goal.

3. RETENTION OF TITLE IN ITALY

Compared to German law, Italy as a representative of the Romanic legal circle has different solutions, which are more statutory based and more complicated. In Italy retention of title is regulated by Chapter 3, Title III, Book IV of the Italian Civil code [5], [16]. Whereas art. 1523 regulates only retention of title in case of instalment sales, the court practice has extended the possibility for contracting this clause. According to the case law of Italian Court of Cassation, retention of title may also be agreed in case of partially or entirely differed price [17]. With regard to formal requirements, written form is of essence if the seller wants to enforce the retention of title against third persons (e.g. creditors of the buyer). On top of that, the document containing the clause has to bear a certain date (*data certa*) prior to any kind of procedure against the buyer [5]. Finally, according to paragraph 3 of the same provision, the sale of goods must be recorded in public registry [5].

Beside the Civil code rules, there are also other statutory instruments, such as the Law of 28th November 1965, No. 1329 (so called *legge Sabatini*) [5], which deals with sales of machines and machine tools. According to this Law, the seller may agree and enforce retention of title against buyer's creditor only if the sold machine has been marked with a label which states the seller's name, the type of machine, serial number, production date and the court which has jurisdiction over the contract [5].

There is also a Legislative Decree of 9th October 2002, No. 231 whose aim is to implement the Late payment Directive [5]. This same act was object of scrutiny before the ECJ. Namely, some

provisions of this Decree have set rather hard conditions upon the sellers. It requires that the retention of title clause is agreed in written form, confirmed in every individual invoice issued for subsequent supplies, bearing a certain date prior to any procedure and duly entered into accounting records. From what has already been said, it is obvious that the Italian approach to regulation of retention of title is very formalistic which is a reason why it eventually came under the scrutiny of the ECJ. The question was whether this provision is in accordance with the art. 4 of the Late payment Directive. In its case *Commission v Italy* ECJ held that this solution is consistent with the Late payment Directive [8].

Besides the ECJ's ruling, there are number of judgments of Italian courts regarding formal requirements for contracting retention of title. First of all, Italian courts have ruled that Italian provisions on retention of title are part of the public policy rules (*norme di ordine pubblico*) [18], which means that they cannot be derogated by any kind of agreement. According to Italian statutory law, as well as the court practice, the retention of title clause is an object of the mutual agreement and *„a mere confirmation of the RoT clause on the individual sales invoices would not suffice to be enforced against the creditors of the buyer and the receiver. In fact, a RoT clause must be subject of consensus, which would be lacking if the provision was included in an invoice...“* [5],[19].

With regard to private international law aspect of retention of title clause Italian courts apply *locus situs* principle and confirm that Italian law is to be applied if the sold item is located in Italy [18].

With regard to buyer's bankruptcy Italian law, similar to the German law, gives some important powers to the insolvency receiver. According to the Italian Bankruptcy Act, a mere judicial declaration of the insolvency proceeding against buyer does not cause termination of the contract. Actually, the insolvency receiver is empowered to decide on termination or execution of the contract [5], [20]. Courts have ruled that in case of termination of the contract, seller must return all previously paid instalments, but he has the right to fair compensation for the use of the item sold. Also, if insolvency receiver decides to terminate the contract, seller may file a claim (*rei vindicatio*) against the insolvency receiver in order to recover the price or the sold item [5].

As obvious, Italian approach to retention of title clause is rather restrictive, subject to the extensive court practice of Italian courts, as well as the ECJ's. Speaking about its flaws, the Italian law gives similar powers to the insolvency receiver as does the German law. The difference is that the Italian court practice did not express its view with regard to the receiver's powers with the nature of right of ownership.

4. RETENTION OF TITLE IN UNITED KINGDOM

Compared to civil law systems, *common law* systems show some differences in regulating this institute. The main representative of this legal circle is United Kingdom. English law, much like German law, has only one statutory provision which is the main source of the seller's right to retain the title over the sold item, but the effects of the clause are defined by case law.

Moreover, retention of title clause in England was first introduced by the *Romalpa* case [22] in which English court allowed the seller to retain the ownership of the sold item until the buyer has paid the full price. Regarding the statutory regulation, Sale of Goods Act, enacted in 1979, contains the most important provision which authorizes the seller to retain the title over the sold

item under the specific circumstances. Based on that provision, contractual and court practice have developed different forms of retention of title clause whose effects are governed by the case law [5]. Today this legislation recognizes simple retention of title clause, all monies retention of title clause, mixed goods retention of title clause and proceeds of sale clause [23].

Contractual practice uses retention of title clause in different contractual relations, such as hire-purchase agreement or conditional sale agreement, most often related to consumer protection [21]. On the other hand, there are some industries and some contract forms in which the use of retention of title clause is customary, e.g. clothing industry or record industry [26].

Under the English law retention of title is not a subject to public registration and it can exist without any kind of publicity. Still, some scholars recommend registration of the retention of title clause, just as with any other secured interest [12], [25].

With regard to enforceability of retention of title clause, UK law proscribes some additional conditions to be fulfilled. Namely, every sold item over which the seller has retained the title has to be identifiable. Usual method is to mark products or to put their serial number on unpaid invoices [26]. If the item is not identifiable, the court will hold that the product has lost its identity and retention of title clause ceases.

In the absence of the statutory regulation, the court practice has developed the effects of the retention of title clause with respect to third parties. According to the view of the House of Lords in the *Armour* case a mere retention of title clause in the seller's General Terms and Conditions of sale is not sufficient to create a security form [24].

Likewise, in other legislations under UK law also, the most important effect of the retention of title clause is a special status granted to the seller in the case of bankruptcy of the buyer. According to the Insolvency Act from 1986, in case of insolvency proceeding against the buyer, retention of title clause goes into moratorium and the seller doesn't have any possibility to repossess the sold item [5]. Insolvency receiver (*administrator/official* receiver) is empowered to decide about repossession of the sold item by the seller. The same power has the competent court. Here, the same as in other previously presented legislations one could see the contradiction between the rights of the insolvency receiver (or under UK law administrator) and the right of ownership.

5. CURRENT STATE OF PLAY AT GLOBAL AND EU LEVEL

As it can be seen from the previous discussions, up until recently most of the global legislative efforts with regard to RoT did get stuck in the middle of „national prerogatives“ debate, until recently. Retention of title is now regulated by the UNCITRAL Model Law on Secured Transactions (the "Model Law"), enacted in 2016. For the treatment of security interests in insolvency, the Model Law relies on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions which implies the same set of rules or at least the same principles for regulating all secured transactions [14] and the UNCITRAL Legislative Guide on Insolvency Law [44].

With regard to EU level, functioning of internal market is based on the country of origin principle as well as mutual recognition principle. So, when there is a clash of different national legal systems, as it might happen in case of „imported“ retention of title clauses, it could potentially be considered a quantitative restriction on imports, which Art. 34 TFEU strictly

forbids [27]. Thus, any measure which directly, indirectly, actually or potentially hinders the functioning of internal market may be prevented, unless proven justified and proportional or, according to Art. 36 TFEU, justified by other „overriding reason of public interest“ [28]. It is quite clear that „internal“ considerations do not necessarily make sense within the internal market and that diversity of property law rules may potentially lead to the infringement of Art. 34 TFEU [30].

Yet, despite (sometimes) wide disparities of national property laws in Europe, the question remains whether the EU has the competence to act and on which basis?!

There is of course an Art. 114 TFEU, the most important legal basis for harmonized measures relating to the internal market [30]. It has already been used by the European legislator for the adoption of measures in an array of private law (e.g. consumer contract law) but not without controversy [33]. Due to its rather extensive use, settled case law has set some boundaries. Therefore, there must be differences between Member States provisions because mere finding of disparities between national rules is not sufficient to justify having recourse to Article 114 TFEU. The differences between Member States provisions should be such as to obstruct the fundamental freedoms (have to have a direct effect on the internal market) [33]. Intended measures must aim to prevent the emergence of future obstacles to trade, resulting from differences in the way national laws have developed [31].

On the other hand, there is also an Art. 345 TFEU (ex Art. 295 TEC) which seems to forbid EU's legislative action. Namely, respective provision expressly states that: „the Treaties shall not prejudice the rules of the Member States governing the system of property ownership“, i.e. that the rules governing ownership rights are reserved to the exclusive competence of the Member States. Strict linguistic interpretation would lead to a conclusion that the EU has no competences whatsoever regarding the property law. However, from the point of view of the ECJ, this interpretation might not be so strict. The article was relied at in different cases [34] and it may be inferred that „it cannot be construed as granting the local legislator the competence to adopt legal measures which could violate the free flow of goods in the common market“ [34]. Thus, although the rules governing property rights are generally reserved to the exclusive competence of Member States, this particular provision does not exempt such rights from the scrutiny of basic Treaty rules. Moreover, it may be inferred that this provision does not concern the content of the right of ownership nor the objects of this right, since article 345 TFEU expressly refers, not to right of ownership itself but, to „system of property ownership“ [35]. Finally, in 2013 ECJ has passed the ruling (Case Essent) in which it expressly confirms that Article 345 TFEU does not stand in the way of making EU property legislation [36]. So, what is EU plan in this area? Is there one?

Looking into the past it is easy to establish that EU's legislative activity in this area forgoes many of the late ECJ's decisions. Namely, intellectual property rights are regulated on EU-level [37], cultural property rights are also regulated on EU-level [38], as well as financial collateral arrangements [39] and some other special fields of property law [40]. Regarding the retention of title clause, this institute has been harmonized by the Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (hereinafter: Late Payment Directive) [12]. European Union has also enacted Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) [13] which regulates the effects of the insolvency proceeding on the retention of title clause.

Thus, the EU has tried to unify RoT clause, but with not much success. Namely, RoT clauses are a bit specific since they function as a security but dogmatically remain an ownership [12]. Due to their diversity and their strong foundations in national property law the outcome of the intended harmonization, at least with regard to Late Payment Directive was much less than satisfactory. Unlike the Draft produced in 1998, in the final version of the Directive standard of the RoT clause has been significantly lowered [41]. Thereby, apart for the simplest RoT clauses, others do not have to be recognized in a cross-border cases if national requirements have not been met. According to Art. 9 of the recast Directive, it should be expressly agreed and conditions of the validity remain determined by the *lex rei sitae* principle. Directive remains silent on the effects in case of debtor's insolvency, effects against third parties and the effect of stricter national conditions.

With regard to Insolvency Regulation, question of the RoT clauses has been observed primarily with regard to the principle of *paritas creditorum*, basic principle of insolvency law [42]. The idea was to introduce more predictability with regard to ranking of individual creditors in a cross-border cases (general creditors, preferential creditors to the estate or „super-priority creditors“). However, according to Recital 22 of the recast Regulation, although the differences in ranking classes of secured creditors may lead to discrimination and insolvency tourism, the application without exception of the law of the state of opening of proceedings (*lex fori concursus*) would frequently lead to difficulties. Thus, as in case of Art. 10 (Reservation of Title), Regulation excludes from the effects of the insolvency proceedings certain rights located abroad. „By means of 'negative' conflict of laws rule it treats the rights as if there was no insolvency“ [43]. Those are the areas where the Regulation provides for exceptions from the application of the *lex fori concursus*, in favor of national law. Fundamental problem lies in the fact that such different national treatment of secured creditors may lead to the opening of secondary insolvency proceedings, which may endanger successful restructuring of the debtor's business [42].

6. CONCLUSION

Looking from a comparative perspective, legal regimes on the validity and effects of RoT vary significantly among European countries. More or less, the only common denominator is the express contract term which states the particular effect of the RoT, i.e. the transfer of title of the goods sold at the time of the full payment of the purchase price. All the other requirements, like: the type of system of transfer of property (consensual or abstract), the systems of security rights (possessory or non-possessory), the claims that can be secured, the object of security, the presence of registration requirements in connection with the third-party protection, passing of the risk, etc. vary from state to state [45]. While the transfer of possession and passing of risks are often coincident with the transfer of ownership and usually governed by harmonized sources of law (e.g. CISG) or commonly adopted standard terms (e.g. INCOTERMS), the transfer of title is ruled by the national laws applicable to the secured goods. Thus, this is the area for which better solution has to be found. Namely, in order to achieve legal certainty in cross-border cases the same set of rules would have to be applicable universally.

Although, it is obvious from our analysis that there are no legal obstacles for the EU to legislate in this area, so far it is not likely that the EU will develop a full property law. It is because it is crystal-clear that despite the goals of harmonization being decided on the EU level, achievement of these goals depends entirely on the Member States. On the other hand, the EU integration process continues and there is increasingly more movement between EU Member States. So, what would be the feasible path for the EU legislator? Definitely harmonization with the view

of unification of RoT clause effects. Its unique nature (contractual, proprietary and procedural effects) as well as its potential impact on fundamental freedoms may be used as the justification for such intervention.

Inspiration may be found in different legislative acts, like Art. 9 of United States Uniform Commercial Code or Book IX of the Draft Common Frame of Reference or EBRD Model Law on secured transaction, etc. There is also UNCITRAL's Model law on secured transactions, so the inspiration and guidance should not be a problem. For the start it would be encouraging to consider the least disputed questions and to move from minimum to maximum harmonization directives. With regard to Insolvency Regulation, in order to avoid the possibility of opening the secondary insolvency proceedings creditors may be given an opportunity to obtain satisfaction according to the ranking of their national law, but only under the condition that it is not detrimental to the creditor of the main insolvency proceedings.

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