

The Law Commission
Consultation Paper No 164

**REGISTRATION OF SECURITY INTERESTS:
COMPANY CHARGES AND PROPERTY
OTHER THAN LAND**

A Consultation Paper

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The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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This consultation paper, completed on 14 June 2002, is circulated for comment and criticism only. It does not represent the final views of the Law Commission.

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THE LAW COMMISSION

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PART I

INTRODUCTION

- 1.1 This Consultation Paper considers reform to the scheme of registration of company charges and to security over property other than land created by individuals and unincorporated businesses.¹
- 1.2 Credit is of great importance to business, whether carried out by a company, a partnership or a sole trader. A business will incur operating costs in relation to its staff, its premises, and in the various stages of dealing with the products or services it wishes to market or deal in. It will be rare that all these costs can be covered by the business without some form of credit:

Enterprises live (and sometimes die) by credit. In any developed economy an essential feature of commerce is the provision of suitable media for the extension of credit.²

Businesses may need credit to purchase capital equipment and also to finance day-to-day operations. Thus they may want to obtain stock-in-trade or raw materials on credit; and they may also want to borrow to finance the gap between the time at which they supply goods or services to their customers and the time when the customers pay.

- 1.3 Credit is also of importance for consumers, whether this be for the purchase of a house or car, or through the use of the credit card or other forms of credit agreement. The Committee on Consumer Credit, chaired by Lord Crowther, said that, on balance, it thought consumer credit to be beneficial:

since it makes a useful contribution to the living standards and the economic and social well-being of the majority of the British people. Individual consumers derive a variety of advantages from its use Loans ... to buy durable goods ... make it possible for consumers to substitute cheaper inside services for more expensive outside services. ... [T]hey enable them to accumulate a stock of consumer capital which might otherwise be impossible and to enjoy a more satisfactory 'mix' of goods and services over time. Shorter-term forms of credit ... confer real benefits, particularly on low income consumers, by making it easier for them to make room in their budgets for the purchase of household necessities³

- 1.4 Those who supply finance to businesses or individuals will often seek a means of protecting themselves against the risk of the business becoming insolvent or the individual becoming bankrupt. This protection is usually sought through the taking of security, which can be either possessory (as where goods are pledged, or

¹ In this Consultation Paper we refer to individuals and unincorporated businesses (such as partnerships and sole traders) as 'non-corporate debtors'.

² R Goode, *Commercial Law* (2nd ed 1995) p 635.

³ Report of the Committee on Consumer Credit (1971) Cmnd 4596 (the 'Crowther report'), para 3.7.1.

pawned, to the creditor) or non-possessory (as where the creditor takes a mortgage or 'charge' over the asset; the asset usually remains in the possession of the borrower). The assets may be pledged, mortgaged or charged, or may be the subject of various other legal transactions that are not currently recognised by the law as creating a security but that serve the same purpose. For example, goods may be bought on credit by using forms of 'title finance', such as hire-purchase, conditional sale or a finance lease, that effectively enable the purchase of goods on credit using the goods as security for the loan. These are often termed 'quasi-securities'.

- 1.5 A business may offer as 'security' not only land or other capital assets but also stock-in-trade and, increasingly, its expected income ('receivables'). Private borrowers most commonly provide security by mortgaging their houses (security created by non-corporate borrowers over land is outside the scope of this project), but they can also use goods as 'security'. Mortgages of goods are uncommon but the other transactions that can serve a similar purpose, such as hire-purchase, are very common indeed.
- 1.6 In the case of possessory security, because by definition the creditor takes possession of the debtor's asset or assets, it will be clear to third parties (such as other potential lenders) that the debtor does not own the asset outright.⁴ However, where the loan is secured on a non-possessory basis - a method that is generally more useful for either commercial or private purposes, because the debtor can continue to use the asset - there are two problems.
- 1.7 First, the impression may be given that the asset is still owned outright by the debtor concerned. This carries the risk of misleading someone contemplating supplying credit (whether on a secured or unsecured basis) to that debtor. How is a third party who might be contemplating making a further loan to the debtor against security over the debtor's assets to know that a particular asset or class of assets is already subject to a non-possessory security? Similarly, how is someone thinking of buying the property from the debtor to know that it is mortgaged or charged to the creditor? As we will see, this problem arises whether the transaction is in the form of a traditional mortgage or charge, or is done by a transaction such as a finance lease or hire-purchase agreement that the law does not currently recognise as a security but that serves the same purpose.
- 1.8 Secondly, how can the creditor who has taken a non-possessory security over the asset be confident that, if the debtor does charge the same asset again to another creditor, that other creditor will not be able to claim the asset before the first security has been paid off? This is the question of which creditor will have 'priority'.
- 1.9 The risk of the impression of 'false wealth' and the lack of a means whereby the existence of non-possessory secured lending could be discovered resulted in the introduction of the requirement to register the existence of many non-possessory securities, whether created by companies or by individuals. Registration of certain

⁴ Although this may be less clear in the case of constructive possession: see further below, para 4.15.

charges⁵ created by companies is required under the Companies Act 1985.⁶ Mortgages and charges over goods created by individuals (whether for business or for private purposes) require registration under the Bills of Sale Acts 1878 and 1882.⁷

- 1.10 These enactments are designed to provide information to other potential creditors. We will see that they do not cover the ground fully. Not all forms of security are required to be registered, and the rules differ significantly depending on the statutory scheme applicable, which in turn depends on the legal personality of the debtor. The legislation does not address fully either the interests of potential purchasers or questions of priority. In addition, there are, as we have mentioned, many transactions that are in fact used for the purpose of securing indebtedness but which are not treated as coming within the law of security - including forms of 'title finance' - and which are consequently not registrable either as a company charge or a bill of sale. We discuss in this Consultation Paper whether such methods should become subject to registration requirements.
- 1.11 In this Consultation Paper we discuss reform to the registration requirements. We start with those for companies and then consider those applying to individuals and non-corporate debtors.

BACKGROUND TO THE CONSULTATION PAPER

- 1.12 In July 2001 the Company Law Review Steering Group (the 'Steering Group') published its Final Report on *Modern Company Law for a Competitive Economy*.⁸ This wide-ranging and fundamental review had been launched by the Secretary of State for Trade and Industry in 1998. Its Final Report contained many recommendations for a major re-working of the whole framework of company law. In Chapter 12 of the Final Report the Steering Group proposed to replace the current scheme of registration under Part XII of the Companies Act 1985 by a system of 'notice-filing'.⁹ In essence, the proposal was that the current system under which particulars of each registrable charge, and the charge document itself, are lodged with the Companies Registry should be replaced by the filing of a notice called a 'financing statement'. This would indicate that the creditor has taken or intends to take security over a given item or class of property. The

⁵ The term 'charge' is not generally defined by the Companies Act 1985, other than to provide that, for the purposes of the registration provisions, it includes a mortgage: Companies Act 1985, s 396(4). Subject to this, the meaning of 'charge' has therefore to be found in the common law. The question of whether a transaction has in fact created a charge has been one often raised in the courts in respect of 'reservation of title' clauses: see below, para 5.11.

⁶ Possessory securities do not generally require registration. Possession, as regards tangible goods at least, is the clearest form of publicity to other creditors that the debtor's assets are allocated to a particular creditor: it therefore meets both the false wealth and the notice issue.

⁷ In addition, security over certain assets must be registered in specialist registries: see below, paras 2.49-2.55.

⁸ *Modern Company Law for a Competitive Economy: Final Report* URN 01/942 ('Final Report').

⁹ The Final Report contained many other suggestions for reform, some of which are not relevant to this Consultation Paper, and was preceded by a number of consultation documents on various aspects of reform. We refer to other proposals, such as in relation to overseas companies, where relevant.

financing statement could be ‘filed’ electronically and would appear on the register without further human intervention. The relative priority of registrable charges would be determined not, as at present, by a complex series of rules referring principally to the date of creation of the charge but instead by the date of filing.

- 1.13 The concept of a notice-filing system is not new. In the United States Article 9 of the Uniform Commercial Code (‘UCC’) adopted notice-filing in 1952,¹⁰ and in 1971 the Crowther report recommended the adoption of such a system in the United Kingdom.¹¹ Notice-filing was also considered in the 1986 report of a working party on security over moveable property set up by the Scottish Law Commission, chaired by Professor Halliday,¹² and by Professor Diamond’s *Review of Security Interests in Property*, carried out for the DTI and published in 1989.¹³ Outside the United Kingdom, many common-law jurisdictions now operate notice-filing systems.¹⁴
- 1.14 However, all the systems mentioned (both proposed and operational) apply not only to charges created by companies but also to security over personal property created by individuals and unincorporated businesses. They also apply more widely than to charges. They adopt what is often termed a ‘functional approach’¹⁵ and require registration of transactions that do not take the form of a charge but which function to create a secured transaction (the ‘quasi-securities’ referred to earlier¹⁶). Moreover, nearly all the existing or proposed schemes not only cover the registration of security interests but also provide a revision and partial codification of the law governing the creation and enforcement of security interests.
- 1.15 The Steering Group reported that it had not had sufficient time to consult fully on its proposals for notice-filing, nor on the question of quasi-securities, while securities not created by companies raised issues outside its terms of reference. It therefore concluded:

Given the lack of opportunity to discuss our new and more radical proposals and given that their implications for the law of security and ‘quasi-security’ over property other than land are outside our remit, we have recommended that DTI consult with the Lord Chancellor’s Department and the Scottish Executive with a view to the Law Commissions being requested to examine the system for registering company charges and security and ‘quasi-security’ generally over property other than land. We hope that the Law Commissions will make recommendations for reform to both company law and security over property

¹⁰ See further below, para 1.38.

¹¹ See below, para 1.29.

¹² Report by Working Party on Security over Moveable Property (1986) (the ‘Halliday report’). See below, para 1.30.

¹³ A L Diamond, *A Review of Security Interests in Property* (1989) (the ‘Diamond report’). See below, para 1.31.

¹⁴ See below, paras 1.37-1.44.

¹⁵ This ‘functional approach’ is explored further later in this Consultation Paper: see below, Part VII.

¹⁶ See above, para 1.4.

other than land in both England and Wales and in Scotland, and in doing so will take account of our provisional conclusions on the company law aspects of this issue, as set out in this Chapter.¹⁷

That recommendation led to a Ministerial reference from the DTI to the Law Commission.

TERMS OF REFERENCE

- 1.16 The terms of reference to the Law Commission¹⁸ request that we:
- (1) examine the law on the registration, perfection and priority of company charges;
 - (2) consider the case for a new scheme of registration and priority of company charges, including charges created by
 - (a) companies having their registered office in England or Wales, wherever the assets charged are located; and
 - (b) overseas companies and companies having their registered office in Scotland, where the charge is subject to English law;
 - (3) consider whether such a scheme should apply both to security in the strict sense and to ‘quasi-security’ interests such as conditional sales, retention of title clauses, hire-purchase agreements and finance leases, including the extent to and means by which such interests should be made subject to the law governing securities;
 - (4) examine the law relating to the granting of security and ‘quasi-security’ interests by unincorporated businesses and individuals over property other than land, including the feasibility of extending any new scheme for company charges to such interests, and the extent to and means by which such ‘quasi-security’ interests should be made subject to the law governing securities; and
 - (5) make recommendations for reform.
- 1.17 We have noted that this reference arose as part of the Steering Group’s wider proposals for reform to company law, but it goes wider than this. In its Final Report, the Steering Group recognised that if reform of company charges is to take place as part of a wider reform of the registration of security interests, it might more appropriately be addressed through separate provision outside any new Companies Act.¹⁹ However, we understand that it is more likely that any proposals

¹⁷ Final Report para 12.8.

¹⁸ Separate references were made to the Law Commission and to the Scottish Law Commission. The reference to the Scottish Law Commission will be in more limited terms although we understand that this does not necessarily preclude a more wide-ranging review of the law of security in Scotland in the future.

¹⁹ Final Report para 5.10.

we might ultimately make for the reform of the company charges registration scheme would be introduced by way of secondary legislation under any forthcoming Companies Bill. Such a method could not realistically be used to introduce the wider reform of the law of security over personal property of the sort that we also propose in this Consultation Paper. These would have to await implementation in separate primary legislation.

- 1.18 In the light of this, we decided that we would have to split the treatment we gave to this project. First, we formulate proposals that could be introduced initially in respect of companies. Secondly, we consider reform applying to non-corporate debtors which would have to be implemented through primary legislation at a later stage. This would entail amending reforms already introduced under any Companies Bill. We provisionally recommend that in this second phase the law relating to the creation and use of security interests for both corporate and non-corporate debtors be restated in statutory form. It is this reasoning that compels the divided structure of this Consultation Paper, rather than it being our preferred approach.²⁰

STRUCTURE OF THE CONSULTATION PAPER

- 1.19 In the following sections of Part I we outline the recommendations made by previous reports and their fate; note other jurisdictions in which notice-filing systems have been adopted or proposed, and summarise our provisional conclusions.
- 1.20 In Part II we outline the types of security that can be granted over property other than land and the current system for registration of company charges under the Companies Act 1985. In Part III we explain why we have reached the provisional conclusion that there is a need for reform of the system of registration of charges created by companies.
- 1.21 In Part IV we first set out briefly a series of minor amendments to the existing company charges registration scheme which were proposed by the Steering Group as an alternative to notice-filing, but which the Steering Group rejected in favour of the more radical approach.²¹ We go on to consider in detail a notice-filing system for charges created by companies, and we explain our provisional view of how such a scheme would operate. In Part V we consider whether certain types of charge should be exempt from registration or filing.
- 1.22 In Part VI we give a brief description of types of quasi-security interest, and in Part VII we ask whether quasi-security interests should be brought within the scheme of notice-filing, and, if so, which ones.
- 1.23 We then turn to security interests created by non-corporate debtors. The current law applying to security and quasi-security interests created by such debtors is outlined in Part VIII, and the alleged defects in the law are examined in Part IX. In

²⁰ We have already noted that the recommendations in the Crowther and Diamond reports were for a system that applied regardless of the legal personality of the debtor, and that this method is the one used by all the overseas notice-filing systems we have considered.

²¹ We explain these points more fully in Appendix A.

Part X we consider whether notice-filing and the other proposals for reform of the law applying to security interests created by companies should apply also to security interests created by non-corporate debtors.

- 1.24 In Part XI we consider the implications that the extension of the law to cover quasi-security interests might have for the law of security generally. We ask whether, for reasons of clarity and certainty, it would be necessary or desirable to set out the relevant rules in the form of a statutory code and briefly indicate how this question has been addressed in other jurisdictions.²²
- 1.25 Part XII contains a list of all our provisional proposals and questions for consultation. Appendix A develops the proposals outlined in the first section of Part IV on amending the company charges registration scheme in a less radical way than through the introduction of a notice-filing system. Appendix B sets out in more detail various questions that would need to be decided were the law applying to the creation and enforcement of security interests to be set out in the form of a statutory code.

TERMINOLOGY: SECURITY AND SECURITY INTERESTS

- 1.26 In this Consultation Paper we use the term ‘security’ to mean something recognised as being subject to the existing law of security. We use the term ‘security interest’ to include both traditional forms of security (which we discuss in Part II) and the wider functional-equivalent of ‘quasi-security’ interests (which we discuss in Parts VI and VII).

PREVIOUS RECOMMENDATIONS AND ATTEMPTS AT REFORM

- 1.27 We indicated earlier that reform of the scheme for registration of company charges has been considered directly or indirectly by several previous reports. After one of these, the Diamond report, amendments to the scheme were included in the Companies Act 1989; but for reasons that we will note later²³ the relevant Part of that Act has never been brought into force. In addition, the DTI issued a consultation document in 1994; and, before it issued its Final Report, the Steering Group had issued a consultation document exploring possible amendments to the current scheme of registration of company charges.²⁴
- 1.28 In this section we outline briefly the reports and consultation documents concerned, and the unimplemented provisions of the Companies Act 1989. We have relied heavily on the reports and the consultation that preceded them in preparing this Consultation Paper.

The Crowther report

- 1.29 The Committee on Consumer Credit, chaired by Lord Crowther, presented its report to Parliament in 1971. This Committee had been charged with looking into

²² We explain the provisions found in the other jurisdictions in rather more detail in Appendix B.

²³ See below, para 4.38 n 60.

²⁴ See below, para 1.34.

the law and practice relating to consumer credit for the purposes of financing goods and services for personal consumption.²⁵ In addition to suggesting legislation to increase consumer protection, the Crowther report recommended a sweeping change to the law: a new legal framework of security over moveable property should be introduced, which would include a notice-filing system that would take a functional approach to commercial transactions, including within its scope quasi-securities. The system would be based on Article 9 of the UCC. Instead of a copy of the instrument itself being sent to the registrar, a financing statement would be filed, giving certain details of the security interest. Filing would be voluntary, not mandatory. Securities created by companies²⁶ and by other debtors would be included within the scheme, as would some quasi-security transactions. It was recommended that the new system should apply both to England and Wales and (through separate legislation) to Scotland. These recommendations were partly outside the terms of reference of the Committee²⁷ and although the Crowther report resulted in the enactment of the Consumer Credit Act 1974, the proposed new system of security and notice-filing was not implemented.

The Halliday report

- 1.30 Following the publication of the Crowther report, concerns were raised that the reforms it suggested might be applied to Scotland without regard to the significant differences between Scots law on security and that of England and Wales.²⁸ The Scottish Law Commission set up a working party on security over moveable property, chaired by Professor Halliday, to consider the problems that would be likely to arise in creating a system of security over moveable property in Scotland. The Halliday report, published in 1986,²⁹ recommended the introduction of a system for creating security over moveable property based upon the establishment of a register of security interests with notice-filing. However, it was suggested that reform should be restricted to the area where reform of the existing law of Scotland was most required, and the Halliday report drew selectively on the Crowther report proposals and differed from it on some points. It also avoided recommendations that would introduce into Scots law concepts which were alien to its tradition and which might result in confusion.³⁰ As this Consultation Paper covers only the law of England and Wales, we do not consider the Halliday report's individual proposals in depth.

²⁵ For the full terms of reference of the Committee and the scope of its enquiry, see the Crowther report p iii and paras 1.1.1-1.1.23.

²⁶ Which the Crowther report termed "corporate securities", although it is clear that this phrase was meant to refer to securities created by companies rather than shares. It was suggested that particulars of company charges should still be filed at Companies House, in addition to the requirement to file under the new scheme. However, failure to file at Companies House would not affect the validity of the charge. See the Crowther report paras 5.7.44-5.7.45.

²⁷ Crowther report para 1.1.4.

²⁸ Halliday report Foreword para 4.

²⁹ The views expressed in the report were those of the members of the working party and did not necessarily represent the views of the Scottish Law Commission: Halliday report Foreword para 12.

³⁰ Halliday report para 22.

The Diamond report

- 1.31 In 1989, following a consultation process, a report was produced and published for the DTI by Professor Diamond, reviewing the law on security interests over property. Drawing on the Crowther and Halliday reports, the Diamond report also recommended that the law should be reformed by the introduction of a new law of security and the creation of a notice-filing system. Again, the recommendation was that the system should apply to all debtors (including companies) and to all transactions that are functionally equivalent to security; and that such filing should be voluntary, not mandatory. It was recommended that the system should apply both to England and Wales and to Scotland, as far as the objectives to be achieved were concerned, although separate legislation would be needed. The Diamond report also proposed a number of specific changes to the company charges registration system, as an interim measure pending the introduction of any new notice-filing system.³¹ As with the Crowther report, the new law of security and the comprehensive notice-filing system were not introduced, but some of the Diamond report's interim proposals were enacted in the Companies Act 1989.

The Companies Act 1989

- 1.32 An attempt was made to change the scheme of registration of company charges by Part IV of the Companies Act 1989: new sections were introduced into the Companies Act 1985, but the relevant provisions have never been brought into force.³² Under these reforms, changes were made to the list of charges that would be registrable³³ and to the requirement to file the instrument of charge itself. Some of the problems that had arisen with respect to charges created by overseas companies as a result of the decision in *NV Slavenburg's Bank v Intercontinental Natural Resources Ltd*³⁴ were to be overcome by requiring registration of charges only in the case of registered overseas companies.³⁵ However, it emerged that there were difficulties with some of the new provisions, in part because the certificate of registration issued by the Companies Registrar would no longer be conclusive.³⁶ As a result it is unlikely that these provisions will ever be brought into force in their current form.

³¹ See below, para 5.3.

³² The Companies Act 1989, ss 92-104 substituted new ss 395-420 into the Companies Act 1985, which would have resulted in a single regime applicable to companies registered in England and Wales and in Scotland (with necessary differences), in place of the existing ss 395-408 (for England and Wales) and ss 410-423 (for Scotland). (The Companies Act 1985, ss 409 and 424 were replaced by the insertion of a new Part XXIII, Chapter III by the Companies Act 1989, ss 92(b) and 105 and Schedule 15.)

³³ See below, para 5.3 n 5.

³⁴ [1980] 1 WLR 1076.

³⁵ See below, paras 3.35-3.40 and 5.88. Reference to the Companies Act 1989 should be made for detail of all the proposed changes.

³⁶ The relationship between the conclusive certificate and the Land Registry was seen as a particular problem: see below, paras 4.37-4.38.

DTI consultations

- 1.33 In November 1994 the DTI published a consultation document, *Company Law Review: Proposals for Reform of Part XII of the Companies Act 1985*,³⁷ in which it advanced several options for future legislation, including one of retaining the main provisions of the current law but incorporating into it some of the reforms that would have been achieved by the unimplemented provisions of the Companies Act 1989. A notice-filing system was also advanced as a possible option. However, consultees to that document were strongly in favour of retaining the main provisions of the current law.
- 1.34 In October 2000 the Steering Group published its consultation document *Modern Company Law for a Competitive Economy: Registration of Company Charges*.³⁸ In this document it raised the possibility of adopting the “radical option” of changing the current system to one of notice-filing; but it noted the lack of support for such a system in previous consultation and instead made provisional proposals for a number of amendments to the present scheme.³⁹ However on this occasion the response to consultation was different. In its Final Report the Steering Group stated that:

About half of the respondents favoured developing a system of notice-filing, and opposition to it was much weaker than in previous consultations.⁴⁰

The Steering Group therefore changed its position to recommend the introduction of a notice-filing system.⁴¹

- 1.35 In addition to the above consultation processes, the Enterprise Bill currently before Parliament contains proposals relating to insolvency that are relevant to our project, which we note at various points in later Parts of this Consultation Paper.⁴²

European proposals

- 1.36 Proposals relating to the validity of financial collateral arrangements are contained in a draft European Union Collateral Directive, which we return to later in this Consultation Paper.⁴³

³⁷ *Company Law Review: Proposals for Reform of Part XII of the Companies Act 1985* URN 94/635.

³⁸ *Modern Company Law for a Competitive Economy: Registration of Company Charges* URN 00/1213 ('Registration of Company Charges'). We have kindly been permitted to see the responses that the Steering Group received and have found them very helpful.

³⁹ Registration of Company Charges paras 1.13 and 3.1.

⁴⁰ Final Report para 12.15.

⁴¹ Final Report para 12.19. It was as a result of this recommendation that a reference was made to the Law Commission to consider the matter further.

⁴² See below, paras 2.19 and 4.131-4.132.

⁴³ See below, paras 2.72 and 5.25-5.27.

Reforms overseas

The United States of America

- 1.37 In making their recommendations for the introduction of a new law on security and a new system of notice-filing applicable to all debtors and based on a functional approach, the Crowther and Diamond reports drew heavily on the UCC.
- 1.38 A notice-filing system was introduced by UCC Article 9 in 1952.⁴⁴ The 1962 UCC introduced a “unitary” security device, incorporating all of the security interests that previously had been dealt with separately.⁴⁵ This had the effect of simplifying the law by treating as alike all transactions that had the same effect even though they were different in their form.⁴⁶ Article 9 applied whoever held the title to the collateral.⁴⁷
- 1.39 In July 2001 a Revised Article 9 effected a number of changes.⁴⁸ The scope of Revised Article 9 is set out in Section 9-109(a), which provides that (in general) it applies to a transaction (regardless of its form) that by contract creates a security interest⁴⁹ in personal property or fixtures.⁵⁰ The UCC Revised Article 9 has been adopted by all States (and the District of Columbia).
- 1.40 It has been said that the UCC has adopted a “simple and uncomplicated procedure” for notice-filing (contained now in Revised Article 9, Part 5).⁵¹ The notice-filing procedure acts as one method of perfecting the security interest,⁵² and Revised Article 9, Part 3 sets out how priorities between competing interests are to be settled. The priority of the interests is dependent upon which security interests are in issue. Article 9 has generally been viewed as a successful piece of legislation.

⁴⁴ Between that version and the 1962 Official version all states, with the exception of Louisiana, adopted Article 9. Many amendments were made to the official text by the individual states, and amendments were made to Article 9 in 1972.

⁴⁵ See J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) p 710.

⁴⁶ There is no distinction made between securities which take the form of a charge or mortgage and those taking the form of retention of title.

⁴⁷ UCC, Section 9-202.

⁴⁸ The revised version was adopted by the National Conference of Commissioners on Uniform State Laws in 1998. Reference to specialist works should be made for full details of the changes made: see, eg, J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000).

⁴⁹ The definition of a security interest is found in UCC Article 1: Section 1-201(37) defines it as including “an interest in personal property or fixtures which secures payment or performance of an obligation.”

⁵⁰ It also applies to an agricultural lien; a sale of accounts, chattel paper, payment intangibles or promissory notes; a consignment; and various security interests arising under other Articles of the UCC.

⁵¹ I Davies, “The Reform of Personal Property Security Law: Can Article 9 of the US Uniform Commercial Code be a precedent?” [1988] ICLQ 465, 478.

⁵² Ie, making it effective against third parties: see below, para 2.5.

Canada

- 1.41 Nine of the ten Canadian Provinces⁵³ as well as the three territories⁵⁴ have also moved to a notice-filing system for security over property other than land.⁵⁵ Although each province and territory has its own Personal Property Security Act ('PPSA'),⁵⁶ these are based to some degree on the Model PPSA which was adopted by the Canadian Conference on Personal Property Security Law.⁵⁷ The Model PPSA was in turn based upon UCC Article 9.⁵⁸ We understand that the Model PPSA has not been published, although the Saskatchewan Personal Property Security Act 1993 ('SPPSA') is said to be virtually identical.⁵⁹ It seems that the Canadian systems have been well received by users and are enthusiastically supported by the various provincial governments.⁶⁰
- 1.42 Although the Canadian versions of the PPSA vary from one another (sometimes by little, sometimes in more significant ways), to avoid a multiplicity of references when we discuss the Canadian approach in this Consultation Paper, we have concentrated on the Saskatchewan version because it is the closest to the Model PPSA. We sometimes make reference to other versions to show consistency of approach or to illustrate diverging views.⁶¹

New Zealand

- 1.43 The New Zealand Personal Property Securities Act 1999⁶² ('NZPPSA') has also adopted a notice-filing system which came into force on 1 May 2002 and replaced several other registers, including those relating to company charges and to chattels. Like UCC Revised Article 9 and the SPPSA, the New Zealand system takes a functional approach to security, and applies both to companies and to non-corporate debtors. The Personal Property Securities Register created under the

⁵³ Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan.

⁵⁴ Northwest Territories, Nunavut and Yukon Territory.

⁵⁵ The Civil Code of Quebec also provides a system for taking security interests in moveable property.

⁵⁶ The first was enacted in Ontario in 1967 but this did not come into force until 1976.

⁵⁷ Professors Catherine Walsh and Ron Cuming QC are currently examining possible changes to the Model PPSA as part of a project by the Uniform Law Conference of Canada, in the light of the introduction of UCC Revised Article 9, and developments in case law since the Model PPSA was adopted.

⁵⁸ The legislation in Western Canada is primarily based upon the earlier Uniform Personal Property Security Act 1971, which was published in 1969, so the Acts in the western provinces are broadly similar.

⁵⁹ RCC Cuming and C Walsh, "A Discussion Paper On Possible Changes to the Model Personal Property Security Act of the Canadian Conference on Personal Property Security Law Part 1" p 3 (available at http://www.bcli.org/ulcc/PPSA_Final.htm).

⁶⁰ RCC Cuming, "An Overview of a Canadian Personal Property Security System" (available at <http://www.natlaw.com/pubs/overview.htm>).

⁶¹ For a recent review of reform proposals made in Canada's most populous province - Ontario - see G McCormack, "Personal Property Security Law Reform in England and Canada" [2002] JBL 113.

⁶² As amended by the Personal Property Securities Amendment Act 2000 and the Personal Property Securities Amendment Act 2001.

legislation is a centralised, wholly electronic register available for searching at all times.⁶³

Australia

- 1.44 The Australian Law Reform Commission published a report on personal property securities in 1993, attaching a draft bill.⁶⁴ Again, a functional approach was recommended, as was a system of registration based on the submission of a financing statement.⁶⁵ Although at the time it apparently received little support from relevant industry and legal sectors, in 1995 the Federal Attorney-General's Department sought to revive the report by publishing a discussion paper. Subsequent workshops resulted in substantial support for reform and the need for a new draft bill: the Australian Personal Property Security Law Reform Committee⁶⁶ is currently considering reforms to the law of security, including notice-filing, and a new draft bill has been produced by the committee and circulated to a number of interested parties for discussion. This bill is very similar to the SPPSA.⁶⁷

Other systems

- 1.45 In November 2001, a Diplomatic Conference in Cape Town held under the joint auspices of the International Institute for the Unification of Private Law ('UNIDROIT') and the International Civil Aviation Organization ('ICAO') concluded a Convention on International Interests in Mobile Equipment and a Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment. The Convention establishes an international legal order for the creation, registration and enforcement of security and title retention interests (including leasing agreements) in high value, uniquely identifiable mobile equipment. The Convention applies to interests in airframes, aircraft engines, helicopters, railway rolling stock and space assets, as designated in the relevant Protocol.⁶⁸ These interests will be protected by registration in an international public registry.⁶⁹ The registration system, which will be operational 24 hours a day and will be wholly electronic, will allow for the registration of international interests,⁷⁰ and assignments and subordinations of such interests, as well as certain other types of interest.⁷¹ Registration will be against the asset, not the debtor. The holder of a registered international interest will have priority over

⁶³ The register is run by the Ministry of Economic Development: for further details see the Personal Property Securities Register website at <http://www.ppsr.govt.nz/search/cad/dbssiten.main>.

⁶⁴ ALRC 64, *Personal Property Securities*.

⁶⁵ ALRC 64, *Personal Property Securities* paras 5.10 and 13.4.

⁶⁶ This is a committee established by the New Zealand and Australian Banking and Financial Services Law Association and the Law Council of Australia to prepare proposals for the reform of the law of security over personal property.

⁶⁷ We are indebted to Professor David Allan for supplying us with a copy.

⁶⁸ Article 2(2)-(3).

⁶⁹ Article 16.

⁷⁰ As defined by Articles 1(o) and 2(2).

⁷¹ Article 16(1).

the holder of a subsequently registered interest and over unregistered interests, whether or not registrable.⁷² The United Kingdom signed both the Convention and the Aircraft Equipment Protocol (with reservations to the signatures). Work continues in this area in relation to the Supervisory Authority, the appointment of the Registrar and the establishment of the International Registry, and additional Protocols relating to railway rolling stock and space assets have been drafted and are currently under examination with a view, we understand, to the adoption of final texts at a second (and possibly third) Diplomatic Conference.

- 1.46 There are several other international bodies that have considered the law on secured transactions in some form or another. Following the production of a preparatory note,⁷³ the United Nations Commission on International Trade Law ('UNCITRAL') decided to establish a working group to develop a regime for security rights.⁷⁴ At the time of producing this Consultation Paper, this working group has yet to report back; it was scheduled to hold its first session in May 2002. In addition, UNCITRAL also published a draft Convention on the Assignment of Receivables in International Trade, part of which relates to the creation of a register of assignments, which would affect priority. In December 2001 the General Assembly of the United Nations adopted the draft Convention and opened it for signature or accession.⁷⁵
- 1.47 The European Bank of Reconstruction and Development ('EBRD') published a Model Law on Secured Transactions in 1994. Principles were drawn from Common Law and Civil Law systems in order to produce a text compatible with the civil law concepts which underlie many of the legal systems of Central and Eastern Europe.⁷⁶ The EBRD's Model Law is noted to be less comprehensive than UCC Article 9,⁷⁷ but it provides for a filing system that is intended as a basis upon which legislators can build their own domestic laws on secured transactions.⁷⁸

ACKNOWLEDGEMENTS

- 1.48 We have relied heavily on the work done by those involved in the reports and recommendations mentioned above, and would like to acknowledge our great debt

⁷² Article 29(1).

⁷³ A/CN.9/496.

⁷⁴ See the Report of the United Nations Commission on International Trade Law on its 34th Session, A/56/17, ch 10. Working Group VI is mandated, amongst other things, to look at the issues to be addressed, such as the form of the instrument; the scope of the assets that can serve as collateral; perfection; compliance with formalities; enforcement; publication of the existence of security rights, and the certainty and predictability of the creditor's priority over competing interests. See, *ibid*, para 358.

⁷⁵ A/RES/56/81.

⁷⁶ See the Introduction to the Model Law on Secured Transactions.

⁷⁷ F Dahan and G McCormack, "Secured Transactions in Countries in Transition (The Case of Poland): From Model to Assessment" [1999] EBLR 85, 88.

⁷⁸ The EBRD's website (<http://www.ebrd.com>) states that "Since it was published in early 1994 the Model law has been widely circulated and has served as a catalyst for defining the essential requirements of a collateral law in a modern market economy. It is not intended as detailed legislation for direct incorporation into local legal systems but has been widely used by the Bank and others to support reform projects."

to them. We would also like to thank the members of a small Advisory Group - Professor Sir Roy Goode QC, Mr Guy Morton of Freshfields Bruckhaus Deringer, Mr Richard Sykes QC and Mr Philip Wood of Allen & Overy - for their invaluable guidance. Ms Catherine Beahan of Allen & Overy also gave us a great deal of valuable information about systems overseas. Further valuable advice was received from Professor David Allan, Professor Michael Bridge, Mr Julian Burling of Lloyds, Mr Graham Crane of Ince & Co, Dr John de Lacy, Mrs Louise Gullifer, Professor Gerard McCormack, Mr Richard Nolan, Professor Dan Prentice, and Dr Sarah Worthington. In addition, we also received assistance from Shearman & Sterling and the staff at Companies House and HM Land Registry. We are most grateful to them all. The contents of this Consultation Paper are, of course, our responsibility and ours alone.

SUMMARY OF PROVISIONAL CONCLUSIONS⁷⁹

- 1.49 In Part III we reach the provisional conclusion that the current system for registration of company charges has a number of serious weaknesses and that reform is needed. After exploring how a system of notice-filing might operate in Part IV, we conclude that a notice-filing system would have very significant advantages over any amended version of the current system.
- 1.50 It may be helpful to summarise our reasons for this conclusion. A system of notice-filing would make it substantially easier for companies (or, more realistically, their creditors) to register security interests. Filing could be done electronically by the completion of a simple on-screen form and the information filed would appear on the public register without imposing on registry staff the burden of checking the information submitted. The register could be searched easily and accurately on-line. Although less information would have to be submitted, there would be little reduction in the practical value of the register as a source of information about the company's financial affairs. The inter-relationship between the register of company charges and the various 'specialist registers' applying to land, aircraft, ships and other assets would be simplified.
- 1.51 Further, a potential creditor could have confidence that any charge it filed would have priority over any earlier charge that does not appear on the register and any subsequent charge (other than a purchase-money interest⁸⁰). The system would permit filing in advance of the creation of the security, in order to preserve priority during negotiations; and a single financing statement could be filed to cover future transactions, thus obviating the need to register successive security interests as and when they are created. This might lead to an increase in the amount of information available to the public, as it would be possible to register charges that, under the present system, have to be excluded from registration requirements because registration of each charge is impractical.⁸¹ Determining priority as between registered charges would become significantly easier as it would generally be determined by the date of filing, although this would be subject to the special

⁷⁹ A full list of provisional proposals will be found in Part XII.

⁸⁰ See below, paras 4.155-4.162.

⁸¹ The question of which types of charge should be exempt from filing requirements is considered in Part V.

priority position enjoyed by the 'purchase-money security'. The position of purchasers of charged property would also be rationalised.

- 1.52 Some of these advantages could be achieved by amending the present system but others could not. Moreover, to retain even a modified version of the present system would be out of step with developments not only in the United States of America and many Commonwealth jurisdictions but also in modern international instruments. It is our provisional view that there would be significant advantages in adopting a system that is broadly similar to that which seems to be becoming a standard in many common-law jurisdictions of the world and will thus be familiar to and easily useable by foreign lawyers and business people wishing to do business in England and Wales.
- 1.53 In Part IV we also consider a change that would make the law fairer to creditors who have provided the company with the finance to purchase new assets ('vendor credit') and secure their loan by a charge over the new asset. Sometimes under the present law they may find that their charge is subordinated to those of more general secured creditors, so that the general creditor benefits at the expense of the provider of 'vendor credit'. We propose that such 'purchase-money-interests' should be given priority.
- 1.54 We think that the notice-filing system described in Part IV could be applied just to the charges that are currently registrable under the Companies Act 1985. However, in Part VII we provisionally conclude that there would also be advantages in following the functional approach to what amounts to a security thereby bringing into the scheme at least those quasi-securities that, without a system of registration, may be misleading to potential creditors or purchasers.
- 1.55 Under the present law holders of quasi-security interests have priority over earlier 'securities', and to remove this might hinder businesses in obtaining vendor credit in future. In Part VII we argue that this priority should in most cases be preserved by giving priority to purchase-money interests over other security interests, as proposed in Part IV.
- 1.56 In Part IX we provisionally conclude that the rules governing security interests created by non-corporate debtors over property other than land, and in particular the Bills of Sale Acts 1878 and 1882, are seriously defective. Although in theory non-corporate debtors can create fixed charges over most types of property, the present legislation makes this a practical impossibility, while no business other than a company can create a floating charge.⁸² These rules prevent business people from using forms of security that in some circumstances would be very useful. In Part X we reach the provisional conclusion that the scheme provisionally proposed for company securities should be extended to security interests created by non-corporate debtors. It would be simple to do this and the only reason for not recommending that it be done at the same time as the scheme for companies is that there is a more immediate prospect of legislation dealing with companies.

⁸² With the exception of farmers, who can create floating agricultural charges under the Agricultural Credits Act 1928: see below, paras 8.40-8.44. See also the Industrial and Provident Societies Act 1967.

- 1.57 In Part XI we consider whether bringing quasi-securities created by companies within the scheme would mean having to subject them to many of the same rules as apply to securities of the traditional type, and we consider how the overseas systems have dealt with this. We conclude that in principle they should be subjected to much of the security regime, and that the only practical way to make it quite clear which rules apply would be to state the rules in the form of a statutory code. Whilst in the longer-term we think this is very desirable, we provisionally conclude that it is not necessary for a new scheme applying only to security and quasi-security interests created by companies. Any 'codification' may be done if and when the scheme is extended to security interests created by non-corporate debtors. We develop these points in Appendix B.

THE CONSULTATION PROCESS

- 1.58 In order to meet the legislative time-scale imposed on the project by the DTI's reference, we have had to prepare this Consultation Paper in a much shorter time than would be normal. Consequently we have not been able to do as much research into some issues, particularly the operation of other notice-filing systems, as we would have wished. We believe that we have covered the principal issues but we would be particularly grateful to consultees for information on any point we appear to have missed or not to have taken fully into account.
- 1.59 We recognise that the changes we are provisionally proposing would represent a major change to the current law. Whilst the Law Commission has a clear interest in improving the law, and indeed a statutory duty to review all the law with which it is concerned with a view to its systematic development and reform,⁸³ we have no wish to recommend reform for its own sake. In the field of security and security interests we think that any law reform should be justifiable in terms of costs and benefits. The benefits long accepted in the United States of America and Canada as flowing from the new regimes they have introduced are several: there is an integrated treatment of the various forms of transaction intended as security but which are (under English law) currently subject to differences in legal treatment that have little policy sense; there is a gathering together in one place of the main principles and rules, making them more accessible; and there is a legal regime which reflects modern financing practice and produces results which in the typical case commend themselves to the commercial world as fair and sensible.

THE IMPACT OF OUR PROVISIONAL PROPOSALS

- 1.60 As we indicate in Parts III and IX, we believe that there is a real need for reform. It appears to us that in the long term the changes we propose would therefore be of considerable benefit, in particular to business, but we have no detailed information on the costs (including either the costs of moving from the current system to the new one or the likely operating costs of the new system compared to the old once any transitional period is over). The time allowed for the preparation of this Consultation Paper has not been sufficient for us to make detailed investigations. In order to assist us in evaluating our provisional proposals, we would welcome consultees' comments and evidence - in as much detail as reasonably possible - about their benefits and costs. We invite comments about the main practical and

⁸³ See the Law Commissions Act 1965, s 3.

economic impact upon the parties involved, including small businesses in particular. Our final consultation question given in Part XII will ask specifically about the practical and economic impact of our provisional proposals. Any factual information may also assist the DTI in due course in evaluating our proposals and will therefore be passed to the DTI, unless consultees ask us not to pass it on.

- 1.61 At least as far as company securities are concerned there is a real prospect that any changes we finally recommend could be implemented as part of the more general reforms of company law that are expected to give effect to the recommendations of the Final Report of the Steering Group.⁸⁴ This means that the consultation period must be limited. We ask for responses to reach us by 2 October 2002. We regret that we may be unable to accept or consider responses that are made after this deadline.

⁸⁴ See above, paras 1.17-1.18.

PART II

SECURITY AND THE REGISTRATION OF COMPANY CHARGES

INTRODUCTION

- 2.1 In this Part we first describe the various types of security that can exist over property other than land, whether the security is created on a consensual basis or arises by operation of law.¹ We limit our discussion to interests over property other than land because, as we make clear in Part IV, our provisional reform proposals would mean that registration or non-registration would not affect either the validity or the priority of company charges over land.²
- 2.2 We then examine the registration of company charges under the Companies Act 1985³ and the role registration plays in the priority of competing charges and other claims over the same asset.

SECURITY

- 2.3 This topic is complex, leading one commentator to state that:

The nature of security rights in property is an issue that has engendered countless debates and declarations over the years and contributed to the creation of countless paper mountains.⁴

This Part does not attempt to do more than provide an outline of the law and explain the points that are directly relevant to the choice between the current scheme of registration and a system of notice-filing.⁵ It is merely descriptive, so readers who are familiar with the types of security available and the registration procedure for company charges may wish to turn to the next Part.

¹ Although we go on to suggest that the system of notice-filing we provisionally propose should not apply in the case of security arising by operation of law: see below, para 4.18.

² See below, para 4.208. We consider whether, if there is to be a notice-filing system, charges over land should be registrable in the Companies Register for public notice purposes only: see below, paras 4.209-4.210.

³ As we noted in Part I, substantial amendments to the scheme of registration were made under the Companies Act 1989, ss 92-104 but the relevant provisions have never been brought into force. These changes are not considered in great detail in this Part: reference to them can be found in many of the published works on company law, eg, *Palmer's Company Law* (25th ed) paras 13.337-13.337.2, and *Butterworths Company Law Handbook* (15th ed 2001).

⁴ G McCormack, *Registration of Company Charges* (1994) p 1.

⁵ For further reading in this area, see, eg, W J Gough, *Company Charges* (2nd ed 1996) pp 3-9 and 16-32. Other specific works on the registration of company charges include G McCormack, *Registration of Company Charges* (1994), although most of the major works on company law include registration within their scope. See *Palmer's Company Law* (25th ed) para 13.401 ff for a discussion of the position in Scotland.

The purpose of security

- 2.4 It has been noted that a financier who insists on security is not content with the normal remedy for breach of the debtor's obligation to pay.⁶ As the Diamond report stated, the purpose of security is to improve the creditor's chances of obtaining performance of the contract with the debtor.⁷ Simply the threat to the debtor of the creditor enforcing its security may be sufficient to secure performance. However, if the debtor becomes insolvent without having paid, the creditor who has taken security should be able to ensure that the debtor's monetary obligations are met, since the creditor will have a more favourable claim to the assets charged than most unsecured creditors⁸ and may be able to prevent other creditors seizing the assets by way of execution following judgment. Other advantages are the ability to exercise self-help remedies rather than having to rely on judicial intervention; the right of the security holder to follow the asset or its products or proceeds, and, in the case of companies, the measure of control given to the chargee over the chargor company.⁹

Creation, attachment and perfection

- 2.5 In this and the following Parts we will refer regularly to the 'creation', 'attachment' and 'perfection' of securities. These concepts are not new to the law of security of England and Wales, although the terminology is not in as widespread use as it is in the overseas legislative systems that deal with security and notice-filing. The creation of a security refers simply to the agreement for a security itself. By itself, an agreement to grant security may not be sufficient to ensure that the security holder can rely on it as being fully effective: the security must also attach and be perfected. Attachment and perfection may not occur until later. Attachment occurs when a security fastens on an asset so as to be enforceable against the debtor.¹⁰ So, for example, a charge created over a debtor's 'present and after-acquired property' may attach to the property then owned by the debtor immediately, but will not attach to any other property unless and until it comes into the debtor's ownership. Perfection occurs when third parties are also bound; for example, when the additional steps are taken to give public notice of the security or when the creditor takes possession of the asset.¹¹ This Consultation Paper is by-and-large not concerned with the mechanics of particular security devices or when they are

⁶ F Oditah, *Legal Aspects of Receivables Financing* (1991) p 4.

⁷ Diamond report para 3.3.

⁸ On preferential creditors see below, para 4.131.

⁹ See, eg, *Gower's Principles of Modern Company Law* (6th ed 1997) p 361; G McCormack, *Registration of Company Charges* (1994) p 2, and M Bridge, "The Quistclose Trust in a World of Secured Transactions" (1992) 12 *Ox J LS* 333, 334-342.

¹⁰ Goode describes four conditions which are necessary in order for an interest to attach: (1) there must be an agreement between debtor and creditor that the interest shall attach; (2) the asset must be identifiable as falling within the scope of the agreement; (3) the debtor must have a present interest in the asset, or power to give the asset as security; and (4) there must be some current obligation of debtor to creditor which the asset is designed to secure. However, he also notes that for the purposes of the Companies Act 1985 a charge is treated as created on the date of the execution of the charge instrument. See R Goode, *Commercial Law* (2nd ed 1995) p 678.

¹¹ See R Goode, *Commercial Law* (2nd ed 1995) pp 673-674.

created, although we do discuss some aspects of attachment.¹² Perfection interacts closely with the question of registration (whether under a scheme of registration of the type currently used or a system of notice-filing) with which we are concerned, and will be referred to more frequently. The overseas notice-filing systems generally set out provisions dealing with the creation, attachment and perfection of security interests: this is something that could be considered as part of the general codification that we discuss below, in Part XI and Appendix B.

Traditional forms of security

Pledge

2.6 A pledge is a bailment of an asset by way of security. A pledge can be of goods, of documents of title to goods (such as a bill of lading) or of instruments that embody a monetary obligation (such as a bill of exchange). Possession by the creditor is essential for attachment and also perfects the pledge against other parties. Possession can be actual or constructive, as where the goods are under the control of a third party who attorns to the creditor.¹³ Ownership of the asset remains with the debtor but the pledgee's possession gives it a legal title to its interest (which will be good against third parties),¹⁴ with an implied power of sale on default.¹⁵ It is possible for the goods to be returned to the debtor for limited purposes without destroying the pledge.¹⁶ A pledgee who takes possession of goods or the documents of title to them may release them to the debtor so that the debtor holds them as a trustee-agent for the creditor.¹⁷

2.7 Goode has described the pledge as:

the most powerful form of security interest known to English law.¹⁸

¹² There may be some change as to when a floating charge attaches, vis-à-vis an execution creditor: see below, para 4.141. For a general discussion of the law on attachment, see R Goode, *Commercial Law* (2nd ed 1995) pp 678-689.

¹³ The courts have held that a pledge may even be created by the debtor himself attorning to the creditor. However if the attornment is in writing it will have to be registered, under the Bills of Sale Acts 1878 and 1882 if the debtor is an individual or under the Companies Act 1985 if the debtor is a company. See R Goode, *Commercial Law* (2nd ed 1995) pp 701 and 703. See below, paras 4.15 and 8.6 n 5.

¹⁴ The pledgee acquires a 'special property' (or interest), whilst the pledgor retains the general property in the asset.

¹⁵ It is possible for the pledgee to re-pledge the goods without the consent of the pledgor and thus transmit its interest to a third party, as long as this power has not been expressly excluded. The amount must not exceed that of the original debt.

¹⁶ R Goode, *Commercial Law* (2nd ed 1995) pp 701 and 1029. On the problems created by this see further below, para 4.15.

¹⁷ Eg, the buyer of imported goods which are pledged to a bank, by a pledge of the shipping documents, may be allowed to take the shipping documents in order to sell them and thus pay the bank. This takes the form of a trust receipt by which the buyer agrees to hold the documents, the goods, and (if sold) the proceeds, on trust for the bank, thus preserving the bank's notional possession of the pledge. See R Goode, *Commercial Law* (2nd ed 1995) p 1029, and see below, para 4.16.

¹⁸ R Goode, *Commercial Law* (2nd ed 1995) p 644.

However, he also notes the limitations of the pledge as a security device. These limitations are the inconvenience to the creditor in having to hold the pledged asset, the inability of the debtor to pledge an asset that may be needed in its business to generate income, and the confinement of the pledge to physical assets¹⁹ rather than intangibles.²⁰

Lien

2.8 In simple terms, a lien is a right to keep possession of property until a claim has been met. Liens can take several forms, and can arise either by agreement or by operation of common law, equity or statute.²¹ A lien differs from a pledge in that possession is given for a purpose other than security (for example, goods may have been delivered for custody or repair) and the holder of a lien, unlike a pledgee, generally has no implied power of sale on default, although such a power can arise through agreement or operation of law.²²

2.9 Liens may be legal or equitable. The legal lien is:

a right at common law in one man to retain that which is rightfully and continuously in his possession belonging to another until the present and accrued claims of the person in possession are satisfied.²³

2.10 In contrast, the equitable lien is not dependent upon possession. The equitable lien is exercisable as a charge upon personal and real property until such time as specific claims have been met. Although equitable liens do arise in circumstances where there is a contract, this is not a prerequisite for the creation of an equitable lien.²⁴

Mortgage

2.11 A mortgage of property other than land²⁵ is a transfer of ownership to the creditor, with an express or implied condition that the asset will be reconveyed to the debtor

¹⁹ Goode suggests that the subject matter of a pledge may be “documents embodying title to goods, money or securities such that the right to these assets is vested in the holder of the document for the time being and can be transferred by delivery of the document with any necessary indorsement.” See R Goode, *Legal Problems of Credit and Security* (2nd ed 1988) p 11.

²⁰ R Goode, *Commercial Law* (2nd ed 1995) p 644. We will see that certain forms of transactions involving intangibles (such as shares) are in some ways analogous to a pledge and to some extent may be treated similarly: see below, para 5.18 ff.

²¹ These liens are sometimes known as legal, equitable, non-possessory, general, particular, contractual, statutory, judicial and subrogatory. For discussion of the different categories of lien, see, eg, R Goode, *Commercial Law* (2nd ed 1995) pp 668-670.

²² See, eg, the unpaid seller’s lien arising under the Sale of Goods Act 1979: see ss 39, 41-43, and 47-48. See also the comments of Millett LJ, as he then was, in *Re Cosslett (Contractors) Ltd* [1998] Ch 495, 508.

²³ *Halsbury’s Laws* vol 28 para 702.

²⁴ *Halsbury’s Laws* vol 28 para 704.

²⁵ A legal mortgage over land no longer involves the outright transfer of ownership. It can be created in one of three ways: by demise, sub-demise or a legal charge. See the Law of Property Act 1925, ss 85-87.

when the amount secured by the asset has been paid (the right of redemption). Delivery of possession of the mortgaged asset to the creditor is not a requirement, and this is one aspect of its flexibility that has led the mortgage to be widely used: a mortgage can be taken over all types of asset.

- 2.12 An equitable mortgage²⁶ creates a charge on the property but no legal estate or interest is conveyed to the creditor. An equitable mortgage transfers equitable ownership to the creditor by way of security, with an express or implied retransfer to the debtor when the secured obligations have been discharged. An agreement to create a legal mortgage may constitute an equitable mortgage and it is this that makes it possible for a debtor to mortgage after-acquired property (that is, property that it does not yet own but may acquire at a later date). The debtor cannot transfer legal title until it acquires ownership but an equitable mortgage can attach to the property the moment the property is acquired by the debtor.
- 2.13 The two main characteristics of a mortgage are a personal contract for the payment of a debt and a disposition or charge of the mortgagor's estate or interest for the purpose of securing payment of that debt.²⁷ A legal mortgage may be taken over land or over personal property. Where the mortgage is taken over personal property the mortgagor's legal interest is made on a conditional assignment. It is a general rule that all property, either personal or real, which can be the subject of a legal mortgage can equally be charged in equity: an equitable mortgage is a specifically enforceable contract to create a legal mortgage.²⁸ The delivery of possession is not an essential feature of the mortgage but it is not incompatible with a mortgage.

Equitable charge

- 2.14 The main difference between a mortgage and a charge is that a mortgage involves a conveyance of property, which is subject to a right of redemption, whereas in the case of a charge there is no conveyance and the chargee is given rights over the property as security for the loan.
- 2.15 A charge does not involve a conveyance or assignment at law,²⁹ and can only exist in equity³⁰ or by statute.³¹ A charge constitutes the right of a creditor to have a designated asset appropriated to the discharge of the indebtedness, the right being satisfied out of the proceeds of sale of the asset.³² A charge can be either fixed or

²⁶ There are three ways by which an equitable mortgage may be created: (1) where a mortgage has failed to comply with the formalities for a legal mortgage; (2) where an equitable interest is mortgaged; or (3) by an agreement to create a legal mortgage.

²⁷ *Halsbury's Laws* vol 32 para 302.

²⁸ *Halsbury's Laws* vol 32 para 305.

²⁹ However, see the Companies Act 1985, s 396(4), where 'charge' is defined as including a mortgage: see below, para 2.26 n 61.

³⁰ See, eg, the comments of Lord Hoffmann in *Re Bank of Credit and Commerce International SA* [1998] AC 214, 226.

³¹ See the Law of Property Act 1925, s 87.

³² R Goode, *Commercial Law* (2nd ed 1995) p 646.

floating.³³ A fixed charge attaches as soon as the charge has been created or the debtor has acquired rights in the asset to be charged, whichever is the later. Therefore without the consent of the chargee the debtor cannot dispose of the asset free from the charge, except by satisfying the secured indebtedness.

2.16 In the case of a floating charge - which can only be created by companies³⁴ - the chargee's interest is over a changing fund of assets, not in any fixed asset in particular.³⁵ The three characteristics of a floating charge are that the charge is over a class of present and future assets of a company; that the class of assets is one which would be changing from time to time in the ordinary course of the business; and that it must be contemplated by the parties, as evidenced in the charge, that the company may continue to use the assets in the ordinary way until some future event occurs.³⁶

2.17 If and when certain events occur the charge will 'crystallize'. This means that from that point the charge is converted from a floating charge into a fixed charge. There are three general categories into which crystallizing events can be placed.³⁷ The first category is where the company commences winding up or ceases trading in some other way.³⁸ The second category is where, in order to protect or enforce the security, the chargee can enforce the floating charge using the powers of intervention contained in the charge. This is generally enforced by obtaining the appointment of an administrative receiver or by the chargee taking possession, in which case the company is no longer able to deal with the charged assets for the purpose of its business.³⁹ The floating chargee also has the right to prevent an administration order being made by the court without consent being given by the chargee, through its own appointment of an administrative receiver (although, as we discuss below, it is proposed under the Enterprise Bill to remove the power of floating charge-holders to appoint administrative receivers⁴⁰).⁴¹ The third category is where crystallization occurs as a result of an express term contained in the

³³ It is possible for a creditor to take a fixed as well as a floating charge over the same asset. However this must be to secure different liabilities, not the same liability.

³⁴ Although there is a statutory exception allowing farmers to create floating charges: see the Agricultural Credits Act 1928, and see below, paras 8.40 ff.

³⁵ R Goode, *Commercial Law* (2nd ed 1995) p 646.

³⁶ See *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284, 295. See also the Privy Council decision in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710.

³⁷ W J Gough, *Company Charges* (2nd ed 1996) p 137.

³⁸ This includes the company ceasing to trade or carry on business but where it has not yet commenced winding up and the company disposes of its trading assets with a view to cessation of trading. The mere presentation of a winding up petition does not cause crystallisation: it crystallises at the time when the legal steps giving rise to liquidation are completed (upon the passing of a resolution or, if no resolution, upon the making of a winding up order): see W J Gough, *Company Charges* (2nd ed 1996) p 143, and the cases cited therein.

³⁹ W J Gough, *Company Charges* (2nd ed 1996) p 160.

⁴⁰ Although there would be exceptions to this proposed removal of power: see below, para 2.19.

⁴¹ For further reading in this area, see, eg, W J Gough, *Company Charges* (2nd ed 1996) pp 954-955. The Insolvency Act 1986, s 19(5) allows an administrator to subordinate the priority of the floating charge to new monies advanced to finance the administration.

contract,⁴² which specifies that upon occurrence of a certain event the charge is to crystallize.

- 2.18 In the case of the fixed charge the debtor is not free to dispose of the asset without the creditor's consent at the time (consent 'in advance' would make the charge floating). Thus fixed charges are useful for land and capital equipment but are not practical for charges over assets that will be constantly traded such as stock-in-trade. However it was held in 1978 that it is possible to create a fixed charge over a company's book debts, although these debts will be coming into existence and being paid all the time, provided that the creditor retains control over the proceeds (for example because the debtor has to pay the proceeds into a blocked account with the creditor).⁴³ This principle has recently been confirmed by the Privy Council in *Agnew v Commissioner of Inland Revenue*.⁴⁴
- 2.19 Because of concern about an administrative receiver's lack of accountability, the DTI recently recommended the abolition of administrative receivership,⁴⁵ and the Enterprise Bill currently before Parliament proposes to prohibit the appointment of an administrative receiver by floating charge holders. Floating charges granted in respect of certain capital market and other transactions would be exempt.⁴⁶ In all other cases, the veto of the floating charge-holder to an administration petition would be removed. In addition, it was proposed that Crown preference should be abolished, with the benefit going to unsecured creditors even where there is a floating charge.⁴⁷ The Enterprise Bill contains similar provisions.⁴⁸

REGISTRATION OF COMPANY CHARGES

- 2.20 A scheme for the registration of company charges dates back to 1900.⁴⁹ The registration scheme was originally developed to give public notice of certain charges and to penalise the concealment of secured credit. The current provisions

⁴² The contract may also provide for partial crystallization over part of the assets of the company. This means that the remainder of the assets may continue to be subject to a security using a floating charge. The assets that are the subject of the partial floating charge must be clearly identified in the charge agreement. See R Goode, *Commercial Law* (2nd ed 1995) p 740.

⁴³ See *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142. See also Lord Millett in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 722.

⁴⁴ [2001] 2 AC 710.

⁴⁵ Productivity and Enterprise – Insolvency: A Second Chance (2001) Cm 5234 paras 2.2-2.3. A receiver does not have a duty to maximise the return on the sale of assets nor a duty to minimise her incurred costs. Instead, administration would be used more widely with concessions for the principal creditors on issues such as entitlement to administration orders, time limits for notices and choosing the identity of the administrator: *ibid*, paras 2.8-2.11.

⁴⁶ The proposed exceptions to the prohibition relate to capital market arrangements; public-private partnership projects; utility projects; where the company is a 'financed project' company, and certain financial market transactions: see cl 241 of the Enterprise Bill.

⁴⁷ Productivity and Enterprise – Insolvency: A Second Chance (2001) Cm 5234 paras 2.15 and 2.18-2.19.

⁴⁸ See cls 242-243 of the Enterprise Bill.

⁴⁹ The process began with the Companies Act 1900, s 14. See G McCormack, *Registration of Company Charges* (1994) pp 23-25 and the Diamond report para 21.1.

are set out in sections 395-409 (Part XII, Chapter I) of the Companies Act 1985. This Act imposes various obligations both on the registrar of companies (the 'registrar') and on companies themselves and lays down the consequences of failure to comply with those requirements.

2.21 The registration scheme was not developed as a deliberate means of determining priorities between competing charges, and the Companies Act 1985 does not address the question of priority in express terms. However, the requirement to register certain charges, with the sanction that an unregistered charge will be invalid as against the administrator, liquidator and other creditors,⁵⁰ does have an incidental effect on the priority of a registrable charge, and this aspect will be considered later in this Part.⁵¹ Commentators now recognise that registration fulfils several purposes:⁵²

- (1) it provides information on the state of the encumbrances on a company's property to those who may be interested (for example, creditors and those considering or advising on dealing with the company, including credit reference agencies, financial analysts and potential investors);
- (2) it assists companies in enabling them to give some form of assurance to potential lenders that their property is unencumbered;
- (3) it provides a degree of protection to a chargee, in relation to the validity and priority of its registered charge; and
- (4) it assists receivers and liquidators in deciding whether or not to acknowledge the validity of a mortgage or charge.

The duty to register charges

2.22 It is the duty of a company to send to the registrar for registration:

the particulars of every charge created by the company and of the issues of debentures of a series requiring registration under sections 395 to 398.⁵³

Section 397 provides for formalities of registration in the case of debentures.⁵⁴ Although the duty is on the company, registration may also be effected on the

⁵⁰ See below, paras 2.27-2.28.

⁵¹ See below, para 2.37. Registration can also give constructive notice; failure to register results in invalidity.

⁵² See the Diamond report para 21.2. See also *Gower's Principles of Modern Company Law* (6th ed 1997) p 376.

⁵³ Companies Act 1985, s 399(1). Charges that arise by operation of law - and thus which are not "created" by the company - are not included within this provision.

⁵⁴ In the case of a series of debentures containing (or giving by reference to another instrument) any created charge to the benefit of which the debenture holders are entitled *pari passu*, it is sufficient for the purposes of the Companies Act 1985, s 395(1) to deliver to the registrar certain specified particulars in a prescribed form together with the deed containing the charge or one of the debentures in the series (if there is no deed). The particulars are the total amount secured by the whole series; the dates of the resolutions authorising the issue of the series and the date of the covering deed (if any) by which the

application of any person interested in it (in practice it is often the secured creditor who will send the particulars).⁵⁵

- 2.23 The duty to send particulars to the registrar is not limited just to charges that a company *creates*. A company may also *acquire* property that is already subject to a pre-existing charge. If the charge is one that would have required registration if it had been created by the company after the acquisition of the property, then the company has to cause to be delivered to the registrar for registration the prescribed particulars and a certified copy of the instrument (if any) creating or evidencing the charge. This must generally be done within 21 days after the date on which the acquisition is completed.⁵⁶ However, it should be noted that failure to comply with this requirement to register a charge already existing on property acquired by a company does not invalidate the charge in the way that, as we will see later, non-registration of a charge created by a company would.⁵⁷

The register of charges and the certificate of registration

- 2.24 The registrar is required to keep, with respect to each company, a register of all the charges requiring registration under Part XII, Chapter I, and is required to enter certain particulars in that register. The register is open to inspection by any person.⁵⁸
- 2.25 Where a charge is registered pursuant to Part XII, Chapter I, the registrar is required to give a signed or sealed certificate of the registration, which states the

security is created or defined; a general description of the property charged, and the names of any trustees for the debenture holders. For the prescribed form, see the Companies (Forms) Regulations 1985, SI 1985 No 854. See generally the Companies Act 1985, s 397.

⁵⁵ Where this is done, that person is entitled under the Companies Act 1985, s 399(2) to recover from the company the amount of any fees properly paid by her to the registrar. The consequences of a charge being void for non-registration are likely to be of more importance for the chargee trying to recover her debts against an insolvent company than for the company itself. Failure to comply with the duty renders the company and every defaulting officer liable to a fine (as well as to a daily default fine for continued contravention) unless the registration has been effected by some other interested person: Companies Act 1985, s 399(3). This is in addition to the invalidity consequences under s 395: see below, para 2.27.

⁵⁶ Companies Act 1985, ss 400(1)-(2). Where a company acquires property situated outside (and the property was already subject to a charge created outside) Great Britain, the period of 21 days after the date on which the copy of the instrument could in due course of post (having been despatched with due diligence) have been received in the United Kingdom is substituted: *ibid*, s 400(3).

⁵⁷ Again, default in compliance renders the company and every defaulting officer liable to a fine (and a daily default fine for continued contravention): Companies Act 1985, s 400(4).

⁵⁸ Companies Act 1985, ss 401(1) and (3). For the charges that require registration, see below, para 2.26. The register is required to be in the prescribed form: see the Companies (Forms) Regulations 1985, SI 1985 No 854. The particulars that must be entered vary, depending on the nature of the charge. In the case of a charge to the benefit of which the holders of a series of debentures are entitled, the particulars are those specified in s 397(1) (see above, para 2.22 n 54). For other charges, the particulars are the date the company created the charge or acquired the property subject to a pre-existing charge (as appropriate); the amount secured by the charge; short particulars of the property charged, and the persons entitled to the charge: see s 401(1). With respect to a different obligation under the Companies Act 1985, providing the required particulars *in the* prescribed form did not mean that it had to be *on a* prescribed form: see the judgment of Harman J in *Re NL Electrical Ltd* [1994] 1 BCLC 22.

amount secured. The certificate is conclusive evidence that the requirements of Part XII, Chapter I as to registration have been satisfied.⁵⁹ The conclusive nature of the certificate is considered to be an important element of the registration scheme in its present form.⁶⁰

Registrable charges and the consequences of non-registration

2.26 The list of charges to which the registration provisions of the Companies Act 1985 applies is set out in section 396. The charges which have to be registered are:⁶¹

- (1) a charge for the purpose of securing any issue of debentures,⁶²
- (2) a charge on uncalled share capital of the company,
- (3) a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale,⁶³
- (4) a charge on land (wherever situated) or any interest in it,⁶⁴ but not including a charge for any rent or other periodical sum issuing out of the land,⁶⁵
- (5) a charge on book debts of the company,⁶⁶

⁵⁹ Companies Act 1985, s 401(2). For the requirement to endorse certain debentures or certificates of debenture stock with a copy of the certificate of registration, and the penalty for non-compliance, see *ibid*, s 402.

⁶⁰ See, eg, W J Gough, *Company Charges* (2nd ed 1996) pp 717-725. The non-conclusive nature of the certificate under the proposed reforms under Part IV of the Companies Act 1989 appears to have been a significant factor in the decision not to implement those reforms: see, eg, Registration of Company Charges para 3.14.

⁶¹ Companies Act 1985, s 396(1)(a)-(j). Charges not on the list do not have to be registered although they would have to be entered into the company's own register of charges kept at its registered office: see below, paras 2.30-2.31. We have noted that the scheme applies to 'charges'. 'Charge' is defined to include mortgage: Companies Act 1985, s 396(4). The Companies Act 1989, s 93 inserted a new Companies Act 1985, s 395, under which 'charge' was defined as meaning any form of security interest (fixed or floating) over property, other than an interest arising by operation of law. However, this provision has not been brought into force.

⁶² A debenture is defined by the Companies Act 1985, s 744 as including "debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not". For fuller reference to the meaning and nature of debentures, see, eg, G McCormack, *Registration of Company Charges* (1994) pp 34-35; *Gower's Principles of Modern Company Law* (6th ed 1997) pp 321-327; R Pennington, *Company Law* (7th ed 1995) pp 556-561, and W J Gough, *Company Charges* (2nd ed 1996) pp 645-655.

⁶³ For the law relating to the registration of bills of sale, see below, paras 8.7-8.34 and Halsbury's Laws, vol 4(1). In practice this provision means that charges over most goods are registrable (the exceptions can be found in the Bills of Sale Acts 1878 and 1882: see below, paras 8.12-8.13).

⁶⁴ The holding of debentures entitling the holder to a charge on land is not for the purposes of the Companies Act 1985, s 396 deemed to be an interest in land: *ibid*, s 396(3).

⁶⁵ Certain charges over land must also be registered at the Land Charges Department for unregistered land and the Land Registry for registered land: see below, paras 2.51-2.52.

⁶⁶ For the purposes of the Companies Act 1985, s 395, the deposit of a negotiable instrument given to secure the payment of any book debts of a company, for the purpose of securing an advance to the company, is not to be treated as a charge on those book debts: *ibid*, s 396(2).

- (6) a floating charge on the company's undertaking or property,
- (7) a charge on calls made but not paid,
- (8) a charge on a ship or aircraft, or any share in a ship,⁶⁷
- (9) a charge on goodwill, or on any intellectual property.⁶⁸

2.27 The Companies Act 1985, s 395(1) sets out the consequences of failing to comply with the registration provisions:

Subject to the provisions of this Chapter, a charge created by a company registered in England and Wales and being a charge to which this section applies is, so far as any security on the company's property or undertaking is conferred by the charge, void against the liquidator or administrator and any creditor of the company, unless the prescribed particulars of the charge⁶⁹ together with the instrument (if any)⁷⁰ by which the charge is created or evidenced, are delivered to or received by the registrar of companies for registration in the manner required by this Chapter within 21 days after the date of the charge's creation.⁷¹

2.28 The charge is invalid only as against the liquidator, administrator⁷² and creditors of the company, rather than for all purposes: section 395(2) states that section 395(1) is without prejudice to any contract or obligation for repayment of the money secured by the charge and that when a charge becomes void under section 395, the money secured by it immediately becomes payable.⁷³

⁶⁷ As with charges over land, mortgages on ships and aircraft are also registrable at specialist registries: see below, paras 2.49 ff.

⁶⁸ The Companies Act 1985, s 396(3A) provides that the following are "intellectual property" for the purposes of this section: any patent, trade mark, registered design, copyright or design right; and any licence under or in respect of any such right.

⁶⁹ The particulars are prescribed by the Companies (Forms) Regulations 1985, SI 1985 No 854. The Companies Act 1985, s 397 provides details of what particulars must be supplied in relation to debentures: see above, para 2.22 n 54. Footnote not in original.

⁷⁰ Where a charge is created outside the United Kingdom comprising property situated outside the United Kingdom a verified copy of the instrument rather than the original is sufficient: Companies Act 1985, s 398(1). Footnote not in original.

⁷¹ Where a charge is created by a company outside (and on property outside) the United Kingdom and a verified copy is supplied, a period of 21 days after the date on which the instrument or copy could, in due course of post (and despatched with due diligence), have been received in the United Kingdom is substituted: see the Companies Act 1985, s 398(2). For additional provisions relating to the verification of charges on property, including that outside the United Kingdom, see *ibid*, ss 398(2)-(4).

⁷² Lord Hoffmann has said that "'void against the administrator' means void against the company in administration or (another way of saying the same thing) against the company when acting by its administrator." See *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 1 All ER 292, 300.

⁷³ Cf a bill of sale given by way of security, where non-registration or non-compliance with the statutory form renders the bill void as against the holder: see below, paras 8.18-8.19 and 8.32-8.33.

Late registration and rectification of the register

- 2.29 There is a time limit of 21 days after the date of the charge's creation for delivery to the registrar of the particulars of a registrable charge.⁷⁴ However, a court may order that the time for registration be extended, or that there be rectification of an omission or mis-statement of any particular with respect to such a charge or in a memorandum of satisfaction.⁷⁵ The order may be made on such terms and conditions that seem to it to be just and expedient, but a normal term is that registration is without prejudice to the rights of parties acquired during the period between the date of creation and the date of its actual registration. An order can be made on the application of the company or a person interested. The court must be satisfied that the omission to register or the omission or mis-statement of the particular was accidental, or due to inadvertence or to some other sufficient cause; or that it is not of a nature to prejudice the position of creditors or shareholders in the company; or that on other grounds it is just and equitable to grant relief.⁷⁶ Failure to register in time is not uncommon, and leave to register out of time will almost invariably be given if there is no pending winding up petition or meeting to pass a resolution for voluntary winding up.⁷⁷

The company's own register of charges and copies of instruments creating charges

- 2.30 In addition to the requirements set out in Part XII, Chapter I in relation to the registration of certain charges, a company is required to keep additional records at its registered office.⁷⁸ A copy of every instrument creating a charge requiring registration under Part XII, Chapter I must be kept there,⁷⁹ as must, in the case of a limited company, a register of charges, into which the company is required to enter all charges specifically affecting property of the company and all floating charges on the company's undertaking or property.⁸⁰ The entry should give a short

⁷⁴ Companies Act 1985, s 395(1). See above, para 2.27.

⁷⁵ Companies Act 1985, s 404(2).

⁷⁶ Companies Act 1985, s 404(1).

⁷⁷ See WJ Gough, *Company Charges* (2nd ed 1996) pp 786-787 and generally ch 31. See, eg, *Re Fablehill Ltd* [1991] BCLC 830, and, for a recent example of the application of this section, *Barclays Bank plc v Stuart Landon Ltd* [2001] 2 BCLC 316. The granting of leave subject to the proviso that the intervening rights of secured creditors are not to be prejudiced would not assist unsecured creditors, since until the company is in winding up or administration they have no legal interest in the application of its assets.

⁷⁸ In the case of a company incorporated outside Great Britain which has an established place of business in England and Wales, the Companies Act 1985, s 409(2) substitutes "its principal place of business in England and Wales" in place of "registered office".

⁷⁹ Companies Act 1985, s 406(1). In the case of a series of uniform debentures, a copy of one debenture of the series is sufficient: see *ibid*, s 406(2).

⁸⁰ Companies Act 1985, s 407(1). The scope of this requirement is wider than s 395(1): thus some charges that are not registrable at Companies House under s 395(1) may be required to be registered in the company's register of charges. For this reason, the company's own register may - at least in theory - be more informative for a creditor or interested person than that kept by the registrar. See *Palmer's Company Law* (25th ed) para 13.301.

description of the property charged, the amount of the charge, and (except in the case of securities to bearer) the names of the persons entitled to it.⁸¹

- 2.31 The copies of instruments kept and the company's register of charges are required to be open to the inspection of any creditor or member of the company without a fee. Any person can inspect the company's register of charges (but not copies of the instruments) on payment of a nominal fee.⁸² It should be noted that, unlike failure to register in accordance with section 395(1), failure to comply with the requirements of section 407 does not render the charge void against anyone.

Memoranda of satisfaction

- 2.32 Following the receipt of certain information, the registrar may enter on the register a memorandum of satisfaction in whole or in part, or of the fact that part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking (as the case may be). The entry in the register can be made where the registrar has received a statutory declaration in the prescribed form⁸³ to the above effect, as appropriate.⁸⁴

Registration of enforcement of security

- 2.33 A person obtaining an order for the appointment of a receiver or manager of a company's property, or appointing such a receiver or manager under powers contained in an instrument, has to give notice in the prescribed form to the registrar of that fact within seven days of the order or appointment, and the registrar is required to enter the fact in the register of charges. Notice must be given, and an entry recorded, where the receiver or manager ceases to act.⁸⁵

⁸¹ An officer of the company who knowingly and wilfully authorises or permits the omission of a required entry is liable to a fine: Companies Act 1985, ss 407(2)-(3). The requirement for a company to keep some form of register of charges has a longer provenance than the requirement to send charges for registration with the registrar, which dates back to the Companies Act 1900 (see above, para 2.20). The requirement for a company to keep its own register of charges goes back to the Companies Clauses Consolidation Act 1845, s 45 and the Companies Act 1862, s 43: see W J Gough, *Company Charges* (2nd ed 1996) pp 450-451.

⁸² The refusal to allow inspection can render the defaulting officer of the company liable to a fine, and to a daily default fine. A court can also order immediate inspection if there has been such a refusal in relation to a company registered in England and Wales: see the Companies Act 1985, ss 408(1)-(4).

⁸³ For that prescribed information, see the Companies Act 1985, s 403(1A). Alternatively, if no statutory declaration is received, the entry can still be made where the registrar receives a statement containing prescribed information made by a director, secretary, administrator or administrative receiver of the company which is contained in an electronic communication: Companies Act 1985, s 403(1A). A person making a false statement in such an electronic communication which she knows to be false or does not believe to be true is liable to imprisonment, a fine, or both: *ibid*, s 403(2A).

⁸⁴ Companies Act 1985, s 403(1). Where the memorandum is of satisfaction in whole, the registrar must, if required, furnish the company with a copy of it: Companies Act 1985, s 403(2).

⁸⁵ Default in compliance with these provisions renders the person liable to a fine, and to a daily default fine for continued contravention: Companies Act 1985, ss 405(1)-(3).

Charges on property in England and Wales created by an ‘oversea’ company

- 2.34 Section 409(1) extends the provisions of Part XII, Chapter I to charges on property in England and Wales which are created by a company incorporated outside Great Britain (an ‘oversea’ company) which has an established place of business in England and Wales.⁸⁶ The provisions also apply to charges on property in England and Wales that is acquired by such a company.⁸⁷ In practice, the interpretation of this provision has given rise to some difficulties that will be considered later in this Consultation Paper.⁸⁸

Charges created by an English company over property situated outside the United Kingdom or in Scotland

- 2.35 The requirements for a company registered in England and Wales apply to charges it creates either inside or outside the United Kingdom, wherever the property is situated. Thus a registrable charge created by such a company will be subject to registration in the Companies Register whether the charged asset is located in England, Scotland or overseas (although where the property is outside the United Kingdom this may give rise to dual - or multiple - registration requirements, depending on the local registration schemes operating in the jurisdiction where the charged property is located). For the purposes of English law, Scots companies are not regarded as ‘oversea’ companies under the Companies Act 1985,⁸⁹ and thus are not subject to the requirements of Part XXIII outlined above. There are separate provisions in the Companies Act 1985 for registration of charges created by companies registered in Scotland and the list of registrable charges is different.⁹⁰ For example, non-possessory charges over goods are not listed as registrable even if the goods charged by the Scots company are in England or Wales.⁹¹

Priority and the registration scheme

- 2.36 It is possible - indeed likely - that a company may be indebted to a number of different people or organisations. Some of these people or organisations may have been given some form of secured interest over an asset or group of assets of the company; others may have an absolute interest in an asset that is in the company’s

⁸⁶ Even if the company has not registered under Part XXIII, Chapter I as an ‘oversea’ company (defined by the Companies Act 1985, s 744), it is still required to register its charges if it has an established place of business in England and Wales: see *NV Slavenburg’s Bank v Intercontinental Natural Resources Ltd* [1980] 1 WLR 1076. We do not consider Part XXIII registration in this Part. For the problems associated with the *Slavenburg* decision, see below, paras 3.37-3.40.

⁸⁷ The requirements for a company to keep copies of instruments creating charges and a register of all its charges (see above, paras 2.30-2.31) also apply to such companies: see the Companies Act 1985, s 409(2).

⁸⁸ See below, paras 3.37-3.40. For a discussion of the problems of oversea companies see, eg, G McCormack, *Registration of Company Charges* (1994) pp 151-157.

⁸⁹ Nor are English companies so regarded for the purposes of Scots law.

⁹⁰ See the Companies Act 1985, ss 410-424.

⁹¹ This is presumably because Scots law does not recognise non-possessory charges over goods; but the validity of the charge will depend on the law of the place where the goods are, so that the secured party will be able to enforce the charge.

possession; yet others may have no security at all in respect of the money or obligation they are owed. In the event of insolvency a company is unlikely to be able to satisfy all its creditors from its available assets. The question of the validity and priority of competing interests in the same asset or group of assets is therefore an important one.

- 2.37 Registration of a registrable charge under section 395 of the Companies Act 1985 is required to perfect the charge⁹² in that, as we saw earlier, a charge that is not duly registered will be invalid against certain other parties. However, registration does not of itself guarantee priority over other interests. This is determined by the application of common law rules. The principal rule is that priority of competing charges is determined by the order of their creation. The combination of this and the 21-day period allowed for registration has given rise to what has been called the ‘21-day invisibility’ problem. A person who searches the Companies Register, finds no record of an earlier charge and takes and registers her own charge immediately, may nevertheless be postponed to an earlier chargee who registers after the taking, or even the registration, of the second charge but within the 21 days allowed. But while registration is not itself a priority point, failure to register has priority effects in that an unregistered charge will be subordinate to a second charge taken after expiry of the time allowed for registration of the earlier charge and will be void against the liquidator, administrator and creditors in a winding up or administration. Where registration has taken place, it will amount to constructive notice of a charge affecting the asset.⁹³

An outline of priority of company charges

- 2.38 While there is neither the space nor the need in this Consultation Paper for a full account of the rules governing the priority as between registrable company charges, a brief explanation may help the non-specialist reader to understand the complexity of the present system.
- 2.39 It will be recalled that registrable charges may be either fixed or floating. ‘Fixed charge’ for this purpose includes both legal and equitable charges and mortgages; floating charges are necessarily equitable.

FLOATING CHARGES

- 2.40 It is the nature of a floating charge that, until crystallisation, it leaves the company free to dispose of assets in the ordinary course of business. This means not only that a buyer of property subject to a properly registered floating charge will take free of it even if the buyer knows of the charge, but that (unless otherwise provided) the company may create fixed charges that will rank ahead of the floating charge.⁹⁴ This is treated as being part of the ordinary course of business.⁹⁵

⁹² Perfection is the process of putting third parties on notice of the security interest, and may be achieved in different ways: see above, para 2.5. The consequences of perfecting an interest vary: see R Goode, *Commercial Law* (2nd ed 1995) pp 699-705.

⁹³ See, eg, *Wilson v Kelland* [1910] 2 Ch 306, 313.

⁹⁴ See, eg, *Wheatley v Silkstone and Haigh Moor Coal Co* (1885) 29 ChD 715.

- 2.41 Further, a receiver appointed under the floating charge or, in insolvency, the liquidator, is under a statutory duty to pay preferential creditors before meeting the claims of the floating charge holder: these are basically debts owed to relevant public authorities, claims for salary and wages and certain benefits.⁹⁶ Thus in insolvency the order of priority generally will be (1) holders of fixed charges; (2) preferential creditors⁹⁷ and (3) the holder of the floating charge. Further an uncrystallised floating charge has no priority against execution creditors, landlord's distress, set-offs and possessory liens.
- 2.42 Floating charge holders employ strengthening clauses to try to improve their position. We will describe two. The first is the negative pledge clause, forbidding the company to create any charge that will rank ahead of or equally (*'pari passu'*) with the floating charge. The clause works simply by limiting the company's authority. A creditor who with knowledge of this provision takes a fixed charge will take subject to it - in other words, will not gain priority over the floating charge.⁹⁸ However, a negative pledge clause is itself not registrable, and even if particulars of it are included in the registration, subsequent creditors will not have constructive notice of it, as the doctrine of constructive notice applies only to those items which must be registered.⁹⁹ Thus the clause does not provide reliable protection to the floating charge-holder.¹⁰⁰
- 2.43 The second is the automatic crystallisation clause. Until the Insolvency Act 1986 came into force, what mattered vis-à-vis the preferential creditors was whether the charge had crystallised at the moment the receiver was appointed or the company went into liquidation. Clauses were inserted which either gave the right to the floating charge-holder to crystallise the charge by notice (by withdrawing the company's authority to dispose of its assets in the ordinary course of business) or

⁹⁵ In contrast, it has been held that creating a second floating charge over the same assets was not, on the wording of the charge, in the ordinary course of business and thus the second floating charge was postponed to the first: *Re Benjamin Cope and Sons Ltd* [1914] 1 Ch 800. But a floating charge on a specific class of the assets within the first floating charge may be authorised: *Re Automatic Bottle Makers Ltd* [1926] Ch 412.

⁹⁶ Insolvency Act 1986, ss 40 and 175.

⁹⁷ For the categories of preferential debts, see the Insolvency Act 1986, ss 328(1) and 386 and Schedule 6. Clause 242 of the Enterprise Bill proposes to abolish Crown preference in part, but cl 243 will require that a certain proportion of the company's net property (that is, property available for distribution after taking into account liabilities secured by fixed charges, preferential debts and various other matters) shall be distributed to unsecured creditors. See below, para 4.132.

⁹⁸ See R Goode, *Commercial Law* (2nd ed 1995) p 742.

⁹⁹ See the discussion in R Goode, *Commercial Law* (2nd ed 1995) pp 715-720. Cf the position in Scotland, where the negative pledge clause is registrable: consequently, subsequent creditors will have constructive notice of it.

¹⁰⁰ We are grateful to Dr John de Lacy for supplying us with a proof copy of his chapter on "Reflections on the ambit and reform of Part 12 of the Companies Act 1985 and the doctrine of constructive notice", in a forthcoming book edited by him, *The Reform of United Kingdom Company Law* ('de Lacy'). At pp 376-379 he argues that entry of the charge in the company's own register might also put persons dealing with the company on constructive notice; and in particular that as creditors and members of the company have the right to inspect the charge instrument itself, this might put them on constructive notice of a negative pledge clause in the instrument. The last argument would not appear to apply to those who were not members of the company nor creditors before they took their charges.

provided that this should happen automatically in certain events, for example, if the company's debts exceeded a certain level. As between the charge-holder and the company such clauses were held to be effective, and (if the crystallising event occurred before the appointment of the receiver) to achieve the result that the charge-holder's claims were no longer postponed to those of the preferential creditors, as the receiver was not appointed under a floating charge.¹⁰¹

- 2.44 This result was reversed by the Insolvency Act 1986, which now requires that the preferential creditors be paid before the holder of any charge that was a floating charge "as created".¹⁰² This might seem to make automatic crystallisation clauses redundant, but we understand that they are still sometimes employed. Presumably the aim is now different: to preserve the priority of a floating charge as against subsequent fixed charges. If the floating charge is made to crystallise on any attempt by the company to create a charge that would rank above or *pari passu* with the floating charge, that might seem to withdraw the company's authority to create subsequent fixed charges. However, it is extremely unlikely that such a device will be effective unless the subsequent chargee has actual knowledge of the automatic crystallisation clause. If she does not, the company will still have apparent authority to dispose of its assets in the ordinary course of business.¹⁰³ Nor will the subsequent chargee be fixed with constructive notice of the clause, even if particulars of it are on the Companies Register.¹⁰⁴

FIXED CHARGES

- 2.45 The priority as between different fixed charges over personal property depends on the nature of the charge and the doctrine of notice. In general a fixed charge has priority over a subsequent fixed charge so long as the first charge was registered (a) within 21 days of its creation or (b) within any extended period allowed by the court and before the grant of the subsequent fixed charge. Even if the second chargee did not know of the first charge she is treated as having constructive notice of it by virtue of the registration. Conversely, if the first charge is not registered at the time of the second charge, and was created more than 21 days earlier, it will be void as against the second chargee even if the latter knows of it.¹⁰⁵ The second charge will therefore gain priority. Thus registration is necessary to protect the first charge against third persons ('perfection').

¹⁰¹ *Re Brightlife* [1987] Ch 200.

¹⁰² Insolvency Act 1986, ss 40, 175 and 251. It was because of this redefinition of a floating charge so as to include a crystallised charge that Rimer J held in *Re Leyland Daf Ltd* [2001] 1 BCLC 419 that a liquidator could have recourse to assets covered by a crystallised floating charge to reimburse properly incurred liquidation expenses.

¹⁰³ R Goode, *Commercial Law* (2nd ed 1995) pp 743-744.

¹⁰⁴ Under the amendments which the Companies Act 1989, s 100 would have made to Part XII of the Companies Act 1985, the Secretary of State would have had power to require notice of automatic crystallisation. However, these amendments have not been brought into effect.

¹⁰⁵ *Re Monolithic Building Co, Tacon v Monolithic Building Co* [1915] Ch 643.

- 2.46 However, the 21-day period allowed for registration has the result that registration is not sufficient to ensure priority. This is shown by the ‘21-day invisibility’ problem that we have referred to above.¹⁰⁶
- 2.47 Conversely, the first chargee who registers within the 21-day period cannot be sure that her charge will always prevail. If the first charge is only equitable and the second charge is a legal charge or mortgage, it is probable that the second charge will have priority. This is because the second chargee will not have constructive notice of the first charge, as it was not registered at the time. The rule that an earlier equitable interest may be defeated by a subsequent purchaser (or chargee) of a legal estate who takes for value and without notice of the earlier interest will apply and the second, legal charge will have priority.

Exceptions to the general rules regarding priorities

- 2.48 These general rules do not apply to charges over all types of property. Where the assets charged are debts, provided again that the charge is registered in the Companies Register within 21 days of its creation, priority depends on the date of notice to the debtor.¹⁰⁷ Nor do the general rules apply to charges over certain assets that can be registered in specialist asset registers.

CHARGES THAT ARE REGISTERED IN SPECIALIST REGISTERS

- 2.49 The Companies Register is not the only register of interests. There are a number of specialist asset-based registers, wherein details of ownership of, or charges over, particular assets have to be recorded.¹⁰⁸ Some of the specialist registers are registers of title, rather than just of charges or other encumbrances, and failure to register therein can affect the validity of the title or charge itself (unlike failure to register in the Companies Register).
- 2.50 Under the current company charges registration scheme, a charge taken over many of the assets that would feature in a specialist register would also be registrable in the company charges register.¹⁰⁹ However, the specialist registers have their own rules on priority, although invalidity caused by failing to register in the Companies Register will affect a charge that would otherwise be validly registered in the other registers.

¹⁰⁶ See above, para 2.37.

¹⁰⁷ *Dearle v Hall* (1828) 3 Russ 1. However a subsequent assignee cannot gain priority over an earlier assignee by giving the first notice to the debtor if she had notice of the earlier assignment when she took her own assignment. Thus if the first one has been registered by this date it will be protected. See R Goode, *Commercial Law* (2nd ed 1995) p 705.

¹⁰⁸ These relate to registered land, unregistered land, ships (including fishing vessels), aircraft, patents, trademarks and registered designs. There is also the register of agricultural charges kept at the Land Registry, although this does not affect companies: see below, paras 8.40 ff.

¹⁰⁹ See, eg, the Companies Act 1985, s 396(1)(h), which makes registrable a charge on a ship or aircraft, or any share in a ship, and s 396(1)(j), which relates to a charge on any intellectual property.

- 2.51 Where a charge over land is created by a company, it must be registered under the Companies Act 1985.¹¹⁰ Where the property is registered land, a charge by way of legal mortgage must be registered at the Land Registry in accordance with the Land Registration Act 1925.¹¹¹ Until it is registered, such a charge operates as a minor interest and can be protected by way of notice or caution being entered on the register.¹¹² Fixed charges that do not constitute a charge by way of legal mortgage, and floating charges, can only be minor interests and therefore need to be protected by entry of a notice or caution on that register. Where a charge created by a company is over registered land, an application to register at the Land Registry must be accompanied by the conclusive certificate issued by the Companies Registry.¹¹³ However, where no conclusive certificate accompanies such an application, the Land Registrar will still register the charge, but will make a note on the register that it is subject to the Companies Act 1985, section 395.¹¹⁴
- 2.52 Where the charge relates to unregistered land, it needs to be registered as a land charge under the Land Charges Act 1972 in the Land Charges Register if it is to be effective against a purchaser or subsequent chargee.¹¹⁵ However, if the charge is, as created, a floating charge it need not be registered in the Land Charges Register if it is registered in the Companies Register (it will be treated as having been registered in the Land Charges Register).¹¹⁶
- 2.53 Where the asset is a ship, a charge can be created but a legal mortgage can only be acquired through registration. Otherwise it exists as an equitable interest and is not registrable. We understand that floating charges will not be registered in the Shipping Register. A charge can be created over an aircraft,¹¹⁷ and the mortgage or charge may be registered on the Register of Aircraft Mortgages.¹¹⁸ However, a

¹¹⁰ However it is not void against purchasers, so a charge registered in the specialist asset register but not validly registered in the Companies Register will still bind purchasers. See further below, paras 2.58-2.61.

¹¹¹ Land Registration Act 1925, s 26. Registration will also be required when the Land Registration Act 2002, s 27 is brought into force. The Land Registration Act 1925, s 60 states that it is not sufficient in the case of registered land for the charge to be registered under the Companies Act 1985 only.

¹¹² Land Registration Act 1925, ss 106(2) and 49(1)(f).

¹¹³ Land Registration Rules 1925, SI 1925 No 1093 r 145(1).

¹¹⁴ Land Registration Rules 1925, SI 1925 No 1093 r 145(2). It seems to be the case that there is no reliable way of creditors protecting charges over land that are acquired by the debtor after the date of the charge and which should be subject to the same fixed charge because of an after-acquired property clause. Although the charge may be registered validly at Companies House, the creditor will not necessarily know of the acquisition in order to register the charge at the Land Registry. It seems all that the creditor can do is to take a contractual stipulation from the debtor to inform the creditor of future acquisitions. As registration is by title, not by owner, there is no way of placing a caution on the register. See also Registration of Company Charges paras 3.12-3.29, and Ruoff and Roper, *The Law and Practice of Registered Conveyancing* para 34-08.

¹¹⁵ Land Charges Act 1972, ss 2 and 4.

¹¹⁶ Land Charges Act 1972, s 3(7).

¹¹⁷ Mortgaging of Aircraft Order 1972, SI 1972 No 1268 art 3.

¹¹⁸ Mortgaging of Aircraft Order 1972, SI 1972 No 1268 art 4.

mortgage created as a floating charge cannot be registered in that register.¹¹⁹ All charges, including floating charges, over patents, trademarks or registered designs are registrable transactions at the Patent Office.¹²⁰

- 2.54 Under each system priority will depend on its own rules. For land, priority between registered charges is determined by date of registration rather than date of creation.¹²¹ For mortgages of ships and aircraft, priority is by date of registration irrespective of the date of creation of the security agreement.¹²² A registered mortgage will take priority over any other mortgage or charge that is not registered or is subsequently registered.¹²³ It is irrelevant whether the mortgagee has had constructive notice of an earlier charge through registration of it at the Companies Registry because the doctrine of constructive notice is excluded by the legislation.¹²⁴
- 2.55 With the patent and trademark registers, actual knowledge of an earlier registered charge in the Companies Register will prevent a subsequent chargee from taking priority, even if the earlier charge is the second to be registered (or is not registered at all) in the patent and trademark registers. The question of constructive notice is less than clear and seems to vary as between the registers.¹²⁵

¹¹⁹ Mortgaging of Aircraft Order 1972, SI 1972 No 1268 art 2(2).

¹²⁰ Patents Act 1977, s 33(3)(b); Trade Marks Act 1994, s 25(2)(c); Registered Designs Act 1949, s 19.

¹²¹ For registered land, this is the order of registration: Land Registration Act 1925, s 29 (which provision is continued by the Land Registration Act 2002, s 48). Section 29 states that an interest subject to a notice will take priority. The exact position for mortgages of legal interests in unregistered land seems to be in dispute as the Law of Property Act 1925, s 97 states that priority is in order of registration, and the Land Charges Act 1972, s 4(5) indicates it to be in order of creation subject to displacement of an earlier unregistered interest by a second purchaser. See R Goode, *Commercial Law* (2nd ed, 1995) p 711. The practical difference is in the case where the second charge is taken before the first is registered but registered after the first.

¹²² See R Goode, *Commercial Law* (2nd ed 1995) p 723.

¹²³ Mortgaging of Aircraft Order 1972, SI 1972 No 1268 art 14 and Merchant Shipping Act 1995, Schedule 1 para 8.

¹²⁴ See the Mortgaging of Aircraft Order 1972, SI 1972 No 1268 art 14(4) and the Merchant Shipping Act 1995, Schedule 1, para 8(1). The priority rules mean that a registered mortgage will take priority over unregistrable charges as well as registrable charges that have not in fact been registered. The position for ships appears to be different. The Merchant Shipping Act 1995, Schedule 1 para 14 provides that “‘mortgage’ shall be construed in accordance with paragraph 7(2) above”; para 7(2) provides that “The instrument creating any such security (referred to in the following provisions of the is Schedule as a ‘mortgage’) shall be in the form prescribed by or approved under registration regulations”. Unlike with the Mortgaging of Aircraft Order 1972, floating charges are not specifically excluded (although we understand that they are not registered). However it seems unlikely that a chargee would attempt to rely on a floating charge over a ship or aircraft.

¹²⁵ Under the Patents Act 1977, s 33(1) priority is determined by the date of registration, but a later transaction will have priority over an earlier transaction if (a) it is not registered (b) notice has not been given to the comptroller, or (c) in any case the party to the later transaction was unaware of the earlier one. The Trade Marks Act 1994, s 25(3) provides that a later transaction will have priority over an earlier one if the party to the later transaction is ignorant of the earlier one. Thus neither set of legislation explicitly excludes constructive notice. They do not refer to the Companies Act 1985 as a means of constructive notice. The Registered Designs Act 1949 does not specifically refer to priority. It must be assumed that

Security for further advances

- 2.56 Where two charges exist over an asset, the chargee with priority cannot necessarily make further secured advances that will add to the amount covered by security¹²⁶ (for example, by extending further credit on an overdraft which is secured by the charge) once she knows of the second charge. At common law, once the first chargee had been given notice of the second charge, any further advances by the first chargee would rank behind the second charge.¹²⁷ This rigid rule was unfortunate because it applied even if the first chargee had a contractual obligation to make further advances to the debtor. It was altered by the Law of Property Act 1925, section 94(1), which provides that if the first chargee is under a contractual obligation to make further advances, these may be added to the secured sum despite knowledge of the second charge.
- 2.57 Section 94(1) provides two other exceptions to the 'no tacking' rule. One is where there is agreement with the subsequent mortgagee. The other confirms the common law rule that tacking is permitted where the prior mortgagee had no notice of the subsequent mortgage.¹²⁸

Charges and purchasers of company property

- 2.58 Although a charge that is not properly registered under the Companies Act 1985 will be invalid as against the administrator, liquidator or creditors, other parties are not affected. Thus it will be valid against a purchaser.¹²⁹ Whether the purchaser takes free of the charge will depend on the nature of the charge and the general rules of priority.
- 2.59 It is in the nature of a floating charge that the company retains, until crystallisation, the power to dispose of its assets in the ordinary course of business

normal common law rules apply and so a party to a later transaction will be bound by an earlier one if she had notice of the earlier transaction. Such a party will have constructive notice from the Companies Act 1985 if the earlier transaction is validly registered.

¹²⁶ A process often described as the 'tacking' of further advances.

¹²⁷ *Hopkinson v Rolt* (1861) 9 HL Cas 514.

¹²⁸ If the first mortgage is expressed to secure further advances, the mortgagee is not deemed to have notice of the second mortgage merely by virtue of its registration in the Land Registry or, it is thought (though there is no express statutory provision), registration in the Companies Registry. Where there is a registered charge over land for securing further advances, the Land Registration Act 1925, s 30 provides that the registrar is required, before making any entry which would prejudicially affect the priority of any further advance, to give notice of the intended entry to the proprietor of the charge, and that proprietor will not, in respect of any further advance, be affected by such an entry, unless the advance is made after the date when the notice ought to have been received in due course of post. Where the proprietor of a charge is under an obligation that has been noted on the register to make a further advance, a subsequent registered charge takes effect subject to any further advance made pursuant to the obligation.

¹²⁹ *Re Overseas Aviation Engineering (GB) Ltd* [1963] Ch 24, 38; *Stroud Architectural Systems Ltd v John Laing Construction Ltd* [1994] BCC 18, 24; W J Gough, *Company Charges* (2nd ed 1996) p 733; R Goode, *Commercial Law* (2nd ed 1995) pp 720-721. This rule would have been changed by the Companies Act 1989, s 95, had it been brought into effect. The Companies Act 1985, s 399 would have been amended to make a charge not registered within 21 days void against "any person who for value acquires an interest in or right over property subject to the charge" after the 21-day period.

free of the charge, and thus a purchaser will take free of the charge unless she has actual knowledge¹³⁰ that it has crystallised or that the disposition is not permitted because of some explicit restriction in the charge.

- 2.60 If the charge is a fixed charge the purchaser will take subject to it unless the doctrine of bona fide purchaser of a legal estate without notice applies. This may happen because it is possible that a purchaser (as opposed to a subsequent chargee) of the company's assets will not be put on notice of the charge merely because it has been registered. This is because a buyer of goods in the ordinary course of business cannot be expected to search against her seller in the Companies Register.¹³¹
- 2.61 It may be that in this context a distinction should be drawn between the purchaser of an item of the company's normal stock (which is in any event unlikely to be the subject of a fixed charge) and the purchaser of a capital asset which is sold by the business. It might seem reasonable to expect the purchaser to check for charges against capital assets.¹³² However, it seems to be assumed that, in the context of floating charges, sales of capital assets are in the ordinary course of business as much as sales of inventory; and in the context of the Sale of Goods Act 1979, section 14, the sale of a capital asset has been held to be in the course of business.¹³³ Thus it is not clear that this distinction between purchasers of capital assets and purchasers of inventory can be maintained.

PARTICULAR ISSUES ON WHAT IS REGISTRABLE

- 2.62 There are a number of areas of doubt surrounding the list of registrable charges in the Companies Act 1985, section 396.

Shares and 'registered securities'¹³⁴

- 2.63 Charges over shares¹³⁵ are not included within the list of registrable charges in section 396, but in practice a charge over shares will often be registered as a charge over book debts because of the continuing debate as to whether the right to receive dividends is a book debt. As later we will be considering the question whether charges over shares should be registered in any event, we note here some particular points about them. If the security is a floating charge then this is registrable under the Companies Act 1985 anyway.

¹³⁰ The doctrine of constructive notice will not apply to restrictions in the charge as these are not registrable: see above, para 2.42.

¹³¹ R Goode, *Commercial Law* (2nd ed 1995) p 719; cf W J Gough, *Company Charges* (2nd ed 1996) p 840, who agrees that that this result is desirable in the case of a buyer of stock-in-trade but who doubts whether the authorities produce this result.

¹³² See W J Gough, *Company Charges* (2nd ed 1996) p 840.

¹³³ *Stevenson v Rogers* [1999] QB 1028 (a sale by a fisherman of his old working boat was held to be made in course of business within the Sale of Goods Act 1979, s 14(2)).

¹³⁴ The term 'registered securities' also covers stock and bonds, as well as shares.

¹³⁵ We do not include bearer shares for the purposes of this section, as these are akin to possessory securities.

- 2.64 Legal title in shares is transferred by registration in the issuer's register of shareholders of the name of the transferee.¹³⁶ A legal mortgage takes effect when the shares are registered in the name of the creditor and a new share certificate is issued.
- 2.65 Parties may attempt to create a charge over certificated shares by depositing the share certificate and a blank stock transfer with the creditor. The security will be enforced by filling in the name of the transferee or selling on. This method may in fact be less than completely secure since it was established in *Longman v Bath Electric Tramways Ltd*¹³⁷ that the actual share certificate is neither a negotiable instrument¹³⁸ nor a document of title and the title evidenced by the share certificate will be liable to be defeated by a person with a superior title. Registered shares also constitute an exception to the general rule for priority of competing mortgagees of choses in action, that is priority is determined by whoever gave notice first to the 'debtor'. In the case of shares the House of Lords decided that priority is determined by the usual rule of first in time.¹³⁹
- 2.66 In modern practice the shares of many larger public companies may be traded without share certificates being re-issued to each new shareowner. The process used is sometimes referred to as 'immobilisation'. The company issues its shares to a depositary.¹⁴⁰ All the paper shares are held by the depositary and the depositary is registered as the owner on the issuer's register of shareholders. The depositary will then hold the shares on behalf of the Operator of a settlement system (who in turn holds it for the members of the settlement system) or directly for the members of the settlement system. The members who beneficially own the shares will be recorded in an account at the settlement system. This will also be the case if the member acts as an intermediary and sells on its interest in the shares. The ultimate investor will be registered in the books of the intermediary immediately above it in the chain. The depositary will only ever be the one with the legal interest in the shares.¹⁴¹
- 2.67 Typically an investor will have a securities account with a custodian; upon deposit of the securities the account is credited. The securities may be fungible or non-fungible. 'Fungible', in this context, means that the securities are held in an omnibus account for all investors holding accounts with the intermediary, without designation of the individual customer's entitlement. Where the account is non-fungible, separate accounts or sub-accounts are maintained in the name of each customer.

¹³⁶ *Macmillan Inc v Bishopsgate Investment Trust plc and others (No 3)* [1996] 1 WLR 387.

¹³⁷ [1905] 1 Ch 646.

¹³⁸ Bearer shares are negotiable instruments. Security over these are effected by a pledge, not a charge or mortgage.

¹³⁹ *Société Générale De Paris and Colladon v Walker* (1885) 11 App Cas 20.

¹⁴⁰ For a more in depth discussion on electronic settlement of securities, see J Benjamin, *Interests in Securities* (2000) ch 1.

¹⁴¹ The nature of the investor's interest in the securities is the subject of intense debate internationally. See R Goode, "Security Entitlements as Collateral and the Conflict of Laws" JIBFL special supplement, September 1998 p 22.

- 2.68 When shares are held in a depository, the investor can create a security interest in its shares in three ways. The first is by what is called (inaccurately) a 'pledge'. The investor has an account with the intermediary that will remain in the 'pledgor's' name but the intermediary agrees only to act on the instructions of the pledgee. We say 'inaccurately' called a pledge because this device does not operate in the same way as a normal pledge; it seems to create only a personal right against the 'pledgor'. If the investor were to go insolvent or bankrupt then because the pledgee does not have a proprietary interest in the shares it cannot retain them. Secondly, the investor can mortgage the shares. In this case its account with the intermediary is transferred into the name of the mortgagee. Lastly, the investor can mortgage the shares to the intermediary itself and this will be reflected in the accounts of the intermediary.
- 2.69 Shares can now be issued wholly electronically, with no paper certificate: this is known as 'dematerialisation'. These are currently settled through CREST (the 'Operator') and regulated by the Uncertificated Securities Regulations 2001. They do not involve the use of a depository so members of CREST are registered directly on the issuer's register of shareholders.
- 2.70 Title to shares is transferred through electronic instructions sent to CREST, which then reflects the transaction in member accounts and the Operator register of members.¹⁴² Once the Operator's register is updated, an automatic electronic instruction is sent to the participating issuer company who is then required by the Companies Act 1985 to update its register of members. As with certificated shares, legal title passes when the issuer's register is updated.¹⁴³
- 2.71 As with intermediaries, it is not possible to register security interests on the Operator's or issuer's register. There are two ways to create security interests with dematerialised shares. The first is by mortgage, when the shares will be transferred from the account of the mortgagor to that of the mortgagee. The second is by a similar mechanism to the 'pledge' mentioned above. With uncertificated shares it is obviously not possible to create an equitable mortgage by deposit of the share certificates along with a blank stock transfer form.¹⁴⁴ However the market's need for a functional equivalent is obtained by means of an escrow balance. The chargor places the secured shares in a sub-account in its name but passes control to the chargee by means of a power of attorney. Again CREST does not concern itself with this and does not register this arrangement on the Operator register. A concern for the chargee (in the event of insolvency) is that the placing of securities in the escrow balance does not transfer a proprietary interest and would therefore not be enforceable upon the insolvency of the chargor. Parties therefore ensure that a proprietary security interest is conferred contractually.¹⁴⁵

¹⁴² Uncertificated Securities Regulations 2001, SI 2001 No 3755 reg 27.

¹⁴³ The Uncertificated Securities Regulations 2001, regs 31(1)-(2) state that the transferor retains title until the issuer's register denotes the transferee as the holder. Once the transferee is registered upon the Operator's register of members, an equitable interest is created. These Regulations replaced the 1995 ones.

¹⁴⁴ Equally a pledge cannot be granted because there is no share certificate.

¹⁴⁵ J Benjamin, *The Law of Global Custody* (1996) p 187.

2.72 Financial markets now rely ever increasingly on collateral consisting of portfolios of securities held in book entry form in international clearing systems. In recent years this has led to a proliferation of proposals, Regulations and Directives at European Level.¹⁴⁶ There has also been discussion at international level, generated by the Hague Conference on Private International Law which has now produced a draft Hague Convention on the law applicable to securities held with an intermediary; we understand that this is likely to come before a Diplomatic Conference later in 2002. The specific issues of perfection have been focussed on by a proposed EU Collateral Directive,¹⁴⁷ the latest draft of which was circulated on 6 March 2002. We return to this Draft Directive later in this Consultation Paper.¹⁴⁸

Charges over credit balances

2.73 In financing transactions it is common for a bank lending money to a customer to require the customer to make a deposit with the bank itself, and the bank may then take a charge over the deposit. The question is then whether the bank is able to take an effective charge over a deposit made to itself, that is, a credit balance. The balance represents a debt owed by the bank to the customer and there has been uncertainty in English law whether a valid charge can be taken in such a case.

2.74 In *Re Charge Card Services Ltd*¹⁴⁹ Millett J, as he then was, said that it was conceptually impossible for a person to have a charge over a debt which she owes to another because the relation between a debtor and creditor is not a species of property at all, merely a personal right to be paid. There is no *res* between the parties, and therefore nothing to which a security interest can attach.¹⁵⁰ The decision generated a great deal of controversy, with radically differing views being voiced among academics and practitioners. Lord Hoffmann's statement in the House of Lords in *Re Bank of Credit and Commerce International SA (No 8)*¹⁵¹ that a 'charge back' (as they are commonly called) is like any other charge except that instead of the beneficiary of the charge having to claim payment from the debtor, the realisation would take the form of a book-entry, has not ended the debate.¹⁵²

¹⁴⁶ See, eg, Council Regulation 1346/2000/EC (OJ L160, 30.6.2000, p 1) on insolvency proceedings (which came into force 31 May 2002). The general aim of this regulation is to establish mutual recognition of proceedings and co-operation for cross border insolvency proceedings. It does not harmonise substantive law between the states. See also Council Directive 98/26/EC (OJ L166, 11.6.1998, p 45) of the European Parliament and of the Council on settlement finality in payment and securities settlement systems.

¹⁴⁷ See Council of European Union, Interinstitutional file 2001/0086(COD); 5530/3/02.

¹⁴⁸ See below, para 5.25-5.27.

¹⁴⁹ [1987] Ch 150.

¹⁵⁰ Millett J followed the reasoning set out in R Goode, *Legal Problems of Credit and Security* (2nd ed 1988) pp 110 and 125, where it was suggested that a bank as debtor could not become its own creditor and that it was conceptually impossible for the bank to be given a charge over its own obligation.

¹⁵¹ [1998] AC 214.

¹⁵² [1998] AC 214, 226-227. See R Goode, "Charge-backs and legal fictions" (1998) 114 LQR 178, where it is argued that at the conceptual level Lord Hoffmann's analysis does not withstand examination; it is entirely result driven.

- 2.75 If such a charge is possible it is unlikely to be registrable under the Companies Act 1985, a point made by Lord Hoffmann.¹⁵³ Charges over debts are normally registrable only if the debts are book debts or the charge is a floating charge.

Contractual liens over sub-freights

- 2.76 We discussed earlier the operation of the lien.¹⁵⁴ An issue arises in respect of a lien over sub-freights. A ship-owner may hire a ship out to a charterer under a time charter. The charterer may also hire out the ship to a subcharterer. A contractual lien over sub-freight is the right of a ship-owner to intercept freight¹⁵⁵ payable to the charterer under the subcharter, in order to secure payment due under the charter. This clause will be included in the main time charter. This right is created by contract; it does not exist in common law or equity nor by statute.
- 2.77 The contractual lien gives the ship-owner the right to stop the sub-freight from going to the charterer and to receive it. The ship-owner intercepts the sub-freight by giving notice to the sub-charterer. It does not give the ship-owner a right to follow the sub-freight once the charterer has received it.¹⁵⁶
- 2.78 It is difficult to classify the right of the ship-owner over the sub-freights.¹⁵⁷ Traditionally, such a 'lien' was not registered as a charge over book debts or as a floating charge because the inability to trace the proceeds suggested that the lien did not create any proprietary right. However in *Re Welsh Irish Ferries Ltd*¹⁵⁸ it was held that the lien on sub-freights operated to create an equitable charge on the company's book debts - and was therefore registrable - because the charterer has a chose in action against the subcharterer and the limited right to that chose in action is acquired by the ship-owner by some form of equitable assignment. This equitable assignment of the chose in action creates an equitable charge over it. *The Annangel Glory*¹⁵⁹ held that the lien created a floating charge because the charterers could deal with the sub-freights before the lien was exercised and thus was registrable. These cases are controversial, as a lien that has no tracing remedy does not seem theoretically similar to a charge. This argument was circumvented in *Re Welsh Irish Ferries Ltd* by stating that if a subcharterer paid a third party who had

¹⁵³ [1998] AC 214, 227. Lord Hoffmann expressed no view on the point on whether such charges were book debts, but referred to the suggestion in Lord Hutton's speech in *Northern Bank Ltd v Ross* [1990] BCC 883 that, in the case of deposits with banks, an obligation to register is unlikely to arise.

¹⁵⁴ See above, paras 2.8-2.10.

¹⁵⁵ Freight, in its ordinary mercantile usage, is the reward payable to the carrier for the carriage and arrival of cargo by ship.

¹⁵⁶ *Tagart, Beaton & Co v James Fisher & Sons* [1903] 1 KB 391, 395.

¹⁵⁷ For a fuller discussion see F Odith, "The juridical nature of a lien on sub-freights" [1989] 191 LMCLQ.

¹⁵⁸ *Re Welsh Irish Ferries Ltd (The Uglund Trailer)* [1986] Ch 471, 478-479.

¹⁵⁹ *Annangel Glory Compania Naviera SA v M Gobdetz Ltd (The Annangel Glory)* [1988] 1 Lloyd's Rep 45.

notice of the lien then the ship-owner would have a right to follow this money, thus there was a proprietary right.¹⁶⁰

2.79 It is arguable whether a contractual lien over sub-freights creates an equitable assignment:¹⁶¹ any equitable assignment by way of security would give the assignee a proprietary right and we have already noted that the ship-owner has no right to trace the proceeds of the book debts. The contractual lien may be more akin to a personal right to intercept the sub-freights and therefore not registrable. In the recent Privy Council case of *Agnew v Commissioner of Inland Revenue*, Lord Millett expressed the opinion that a lien over sub-freights was merely a personal right and that there were conceptual difficulties with classifying it as a charge as well as adverse commercial consequences.¹⁶²

¹⁶⁰ *Re Welsh Irish Ferries Ltd (The Uglund Trailer)* [1986] Ch 471, 478.

¹⁶¹ *Care Shipping Corp v Latin American Shipping Corp (The Cebu)* [1983] QB 1005.

¹⁶² *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 727.

PART III

THE NEED FOR REFORM OF THE COMPANY CHARGES REGISTRATION SCHEME

- 3.1 In this Part we consider whether the current scheme for registering company charges is in need of reform. We reach the provisional conclusion that there is a need for some form of registration but that the weaknesses in the way the current scheme operates are such that there is a good case for reform. In later Parts of this Consultation Paper we go on to consider how such reform could be implemented.¹

THE NEED FOR A SYSTEM OF REGISTRATION

- 3.2 In its consultation document on registration of company charges the Steering Group said that previous consultations had led it to the view that a system of registration of charges performs a useful commercial function. It is:

a means of providing information on the financial position of companies which the business community and its professional advisers find important and helpful.²

Therefore the Steering Group did not propose that the system should be abolished.³ Nonetheless it did ask consultees whether a registration system is still needed. There was virtually unanimous agreement on the part of consultees that there is such a need. In the light of this we do not intend to re-open this question. As one commentator put it recently:

it remains a simple fact that the system is here to stay.⁴

However, it is also clear that the current scheme is open to criticism. The question is the form that the scheme should take.

- 3.3 To evaluate the effectiveness of the current registration scheme we need to establish criteria against which it can be measured. We think that it is instructive to start from the beginning, as it were, and ask what potential users could expect of a modern scheme of registration.
- 3.4 We believe that a registration scheme should perform two basic functions: (1) to provide information to persons who are thinking of extending secured lending

¹ In Part IV we consider the introduction of a notice-filing system (after briefly considering reform by way of amendments to the current company charges registration scheme).

² Registration of Company Charges para 2.1.

³ Registration of Company Charges para 2.1. See also Final Report para 12.1, where the Steering Group stated that the law relating to the registration of company charges “is of real importance to the capital markets, as it guards against fraud and facilitates commercial borrowing.”

⁴ De Lacy, p 333.

(and occasionally unsecured lending, where the amount is large), credit rating agencies and potential investors about the extent to which assets that may appear to be owned by the company are in fact subject to securities in favour of other parties, in particular creditors; and (2) to determine the priority of securities.⁵

- 3.5 In performing the first function the system should enable interested parties to find out about securities over the company's assets, particularly ones that they are unlikely to be able to discover easily from other sources. In relation to priority the system should, in general, enable potential secured parties to be confident (1) that they can take a security without any risk that it will be subject to other existing interests of which they had no reasonable means of knowing; (2) that, having checked the register, they will be able by taking simple steps to ensure the priority of any security they subsequently take over one that is taken in the meantime by another party;⁶ and (3) that registration will ensure the priority of their security against any subsequent security interest (unless there are good reasons of policy for the later interest to have priority).
- 3.6 The system should also provide clear rules on the rights of purchasers who buy assets that are subject to security interests, both where the interest has been registered and where it should have been but has not been.
- 3.7 In practice these aims mean that users of the scheme should be able to rely on the information contained in the register (in other words, the information available should be reasonably complete and what is provided should be accurate). On the other hand, the system should be efficient, simple and cheap to operate. The requirements should not unnecessarily hinder a company in dealing with its assets, and should not impose registration requirements that will involve companies, creditors or the registry itself in unnecessary work. Thus the register should not duplicate information readily available elsewhere (for example, in another public register, unless, perhaps, entries in both registers can be made by a single operation). Preferably the operations should be computerised so that both registering and searching of the register can be done easily and with the minimum of human effort.
- 3.8 It is obvious that these different aims may conflict. For example, the aim of presenting as complete a picture of the company's affairs as possible may conflict with that of minimising the burden on the parties involved. A balance will have to be struck. However, it is worth asking how the current scheme for registration of company charges measures up to the criteria we have set out.

⁵ We noted in para 1.26 above that we use the term 'security' when discussing traditional securities and 'security interest' to include both traditional forms of security and functionally-equivalent transactions ('quasi-security interests'). In this Part we refer to securities, but the points we make apply equally to security interests, which we consider later in this Consultation Paper.

⁶ As one of our advisers put it, "creditors should be able to create and perfect security interests in any order".

INEFFECTIVENESS OF THE CURRENT REGISTRATION SCHEME

- 3.9 As we noted in Part II, registration was originally introduced to provide information to the public about whether a company had charged its assets, in order to prevent it giving an impression of ‘false wealth’ by appearing to own assets that in fact were charged in favour of others. We also noted that the introduction of invalidity of the charge as against an administrator, liquidator or other creditors as a sanction against failure to register, and acceptance of the rule that registration puts third parties on constructive notice of the charge, have resulted in registration developing a second function in respect of the priority.⁷
- 3.10 However, we have formed the view that, because the list of registrable charges is incomplete (in part because the list has been little changed since its introduction over a century ago), and because the priority aspect has developed only as an indirect effect of attempts to secure compliance, the current scheme does not seem to fulfil either its ‘public notice’ function or its ‘priority’ function efficiently. We explain our reasoning in the following paragraphs.

The public notice function

- 3.11 The extent of the public notice function that the scheme fulfils is actually very limited because the list of charges that must be registered on the Companies Register is out-of-date and incomplete, and the information required is incomplete or likely to be unreliable.

The list of registrable charges is seriously incomplete

- 3.12 The Companies Act 1985 sets out a fixed list of what charges need to be registered:⁸ if a charge is created which does not fall within this list, then delivery of the particulars for registration is not required.⁹ However, this list is outdated and omits a number of important charges that are commonly created over a company’s assets. With the exception of the addition of charges on aircraft and registered designs or design rights, the list of registrable charges is unchanged from the Companies Act 1948, which itself drew on the same lists which had been compiled by previous Companies Acts going back to 1900. De Lacy makes the point that although the whole philosophy of the Companies Act 1900 was “to insure the fullest information being given to all those who desire to take part in companies or invest their capital”,¹⁰ the list of charges “had effectively crystallised by 1928.”¹¹
- 3.13 There was wide agreement amongst respondents to the Steering Group’s consultation document that the current list of registrable charges does not accord

⁷ See above, para 2.21. The sanction of invalidity is in addition to the criminal sanctions set out in the scheme.

⁸ See above, para 2.26.

⁹ Although such a charge must appear in the company’s own register of charges, required to be kept under the Companies Act 1985, s 407: see above, para 2.30.

¹⁰ *Per* the President of the Board of Trade, Hansard (HC) 26 June 1900, vol 84, 1141, cited by de Lacy, p 336.

¹¹ De Lacy, p 337.

with current commercial practice.¹² Some respondents commented, for example, that charges are now given over expected future income from PFI and other major projects.¹³ These are not registrable unless the income is in the form of 'book debts'. Respondents noted that security was now sought over types of assets that had a large commercial value, but which did not exist, or were in their infancy, at the time the present provisions were drafted, such as computer software and film negative rights. Charges over contingent debts, including the proceeds of insurance policies, are not currently registrable; amongst respondents to the DTI's 1994 consultation document there was strong support for making these registrable.¹⁴ It has also been questioned whether the general exclusion of charges over shares from the list of registrable charges can still be justified.¹⁵ Conversely it has been pointed out that the list includes some charges that are now rarely if ever used, for example charges to secure issues of debentures.

- 3.14 In some cases it is hard to decide what falls within the type of charge listed. For example, a charge over 'book debts' is registrable,¹⁶ but the meaning of this phrase has generated much discussion in the courts and has provoked some controversy.¹⁷ For a non-lawyer the list can be particularly hard to interpret. Thus the list does not refer to charges over goods but to:

a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale.¹⁸

The law in relation to bills of sale - which has to be considered when deciding whether the charge would be registrable - is complex and out of touch with the realities of modern day commercial practice, and the benefits of continuing to link company charge registration in this way are questionable.

- 3.15 In addition there is the more fundamental criticism that the form of a transaction triumphs over its function. In other words, the law does not class as a security - let alone a 'charge' - a number of transactions that actually perform the function of securing payment of a debt or performance of an obligation. This criticism was made in both the Crowther and Diamond reports,¹⁹ and is in addition to other

¹² Final Report para 12.59.

¹³ Final Report para 12.59.

¹⁴ See Registration of Company Charges para 3.38, referring to the DTI's 1994 consultation document *Company Law Review: Proposals for Reform of Part XII of the Companies Act 1985*.

¹⁵ See Registration of Company Charges paras 3.43-3.44.

¹⁶ Companies Act 1985, s 396(1)(e).

¹⁷ See, eg, as to whether a ship-owner's lien on a sub-freight creates a registrable charge: see above, paras 2.76 ff and G McCormack, *Registration of Company Charges* (1994) pp 40-52. It is still difficult in some cases for professional advisors to give confident advice that certain assets will constitute book debts.

¹⁸ Companies Act 1985, s 396(1)(c).

¹⁹ See below, para 7.2.

criticisms made about the substantive law of security.²⁰ This point we take up in Part VII.

The registered particulars are not necessarily accurate

- 3.16 The company creating the charge (or in practice the creditor acting on the company's behalf) must submit certain particulars and the charge instrument. In principle the registrar will check the particulars submitted against the charge instrument and the Companies Act 1985 provides for the registrar to issue a certificate which is conclusive evidence that the requirements as to registration have been satisfied.²¹ The certificate will prevent a charge being invalidated for non-compliance with the section in the event that it has been registered, even if the particulars do not give an accurate reflection of the actual terms of the charge itself. It has been suggested to us that in practice the registrar's staff are not in a position to make a detailed comparison between the particulars and the charge instrument in every case.²² However, the effect of the certificate is that the registered charge is valid as to its original terms, not as to the terms actually appearing on the Companies Register. Consequently, the Companies Register may not be relied on to contain accurate information about the details of the charge and the conclusive certificate, whilst protecting the chargee, does not ensure the accuracy of the Companies Register.

The register does not reveal important information about charges that are registrable

- 3.17 A search of the Companies Register is unlikely to reveal the correct amount of the outstanding secured debt. Although the amount secured by the charge is supplied on the relevant form at the time of submitting the particulars, this can only reflect the amount at that time, and not the amount at the time of searching (the amount may have increased or reduced in the meantime). Indeed, in the case of an 'all-monies' charge, it is inherently impossible to determine the state of the current indebtedness from the Companies Register. Consequently, if someone wishes to know the current state of indebtedness between the chargor and chargee, he will not be able to ascertain it from the Companies Register alone, and will have to contact the chargor or the chargee.

²⁰ Eg, the Diamond report suggested that there were obstacles to security, in that whilst a security could be taken in almost anything, provided an appropriate method were used, it was not always clear what the most appropriate method should be. The law was said to be complex, particularly as to the divisions existing between common law and equity. See the Diamond report para 8.2.

²¹ Companies Act 1985, s 401(2).

²² The Steering Group pointed out that the current requirement to present the instrument of charge presupposes that it will be examined by the staff at Companies House, and that this is incompatible with modern electronic registration systems, including that operated at Companies House. They also note that it would be "imprudent" to rely on the register for a current view of the extent of the encumbrances: see Registration of Company Charges paras 3.18-3.19.

The company's own register

- 3.18 It ought to be possible to obtain accurate information about all the charges created by the company (and not just those that are registrable under the Companies Act 1985, section 395) from the company's own register of charges required to be kept at its registered office.²³ However, it was clear from the responses to the Steering Group's consultation document that compliance with this statutory requirement is poor. Moreover, respondents who answered the question whether such registers were widely used almost unanimously answered that they were not.²⁴ Even if the register is up-to-date, it will not necessarily provide full information even about the terms of the charge: whilst a company's own register is open to all, copies of the charge instrument may be inspected only by members of the company and existing creditors.²⁵
- 3.19 As some charges are not registrable except in the company's own register, and as that register does not seem to be used much (possibly as a result of its not being kept up-to-date), it seems to be a legitimate inference that creditors can get adequate information from elsewhere - presumably directly from the company itself and, if necessary, the chargee. We have also pointed out that, even if creditors do consult the company's own register of charges, they will still have to ask the company for additional information, or to examine a copy of the instrument of charge; and if they wish to discover the amount currently secured by the charge they will presumably approach the creditor concerned.
- 3.20 In the light of what we have said, interested parties will have to go to a source beyond the Companies Register in order to obtain complete and up-to-date information about the state of the charged asset. The Companies Register cannot therefore be seen as a complete and accurate source of information for interested parties. In terms of the details of charges it will make some of the information more easily available, but will tell them nothing that they cannot find out almost as easily from the company itself or the creditor, to whom they will need to talk in any event. To this extent the public notice function of the Companies Register is limited.

Notification of the existence of charges

- 3.21 What in practice the Companies Register does achieve is to put persons searching the register on notice (in an informal sense) that there is probably a registrable charge in existence about which they ought to seek more information from the chargor company or the secured chargee. It hardly seems efficient to require the company or its creditor to prepare particulars of the charge and then send these and the charge instrument itself to Companies House, but then not to make good use of it. This is particularly so given that preparing the particulars to be submitted can be burdensome for the party registering the charge, and that checking the particulars against the instrument of charge by the registrar - if it is done

²³ Companies Act 1985, s 407.

²⁴ See Registration of Company Charges para 3.72, and Final Report para 12.68.

²⁵ See the Companies Act 1985, s 408(2). The unimplemented Companies Act 1989, s 101 would have inserted a new Companies Act 1985, s 412(2)(a), which would have required a company to give a copy of its instruments to any person on payment of a fee.

effectively - is also burdensome (and possibly not useful, given that the subsequent certificate does not guarantee accuracy in the recorded particulars). In short, a lot of time and expense is required by the scheme in order to provide public notice of a very limited sort. We think that there is a good case for changing this whilst still retaining a public notice function.

3.22 The 'alerting' function is of course limited, in that a person searching can only become aware of the probable existence of a charge where it is one that falls within the list of registrable charges.²⁶ We have already suggested that the list of registrable charges needs to be updated. In some cases there may be practical reasons for excluding certain charges from the list of charges. For example, it is commonly said that it would not be practical to require registration of charges over shares that may be traded on a regular basis.²⁷ That may be right but equally it may depend on the registration requirements. It may be asked whether, if the process of registration were simplified, the range of registrable charges could be increased so as to warn third parties of those not currently registrable.²⁸

3.23 We began this Part by identifying what should be expected of a modern registration scheme, and we suggested that one aim would be to enable third parties to find out about securities over the company's assets, and in particular ones that they are unlikely to be able to discover easily from other sources. There needs to be some way in which a third party can discover whether an asset that appears to be the company's is in fact subject to another party's interest, together with an indication of where further information about that security can be obtained from. If the existence of a security on a company's asset is readily discoverable by other means there is no need to provide an additional warning by means of a public register.

3.24 For example, there has never been a general requirement to register pledges,²⁹ nor is this suggested. Because a valid pledge requires that the creditor takes possession of the goods or document pledged, the asset will not be in the debtor's possession and a third party interested in taking the goods as security will discover the pledge. We will consider below whether by analogous reasoning other charges should also be excluded. For the moment, two examples will suffice. First, in practice charges over immobilised or dematerialised investment securities take the form of registration of the security in the name of the creditor. The third party will discover this and registration may therefore be unnecessary. Secondly, if the charge is also registrable in a specialised asset register, such as those kept at the Land Registry, it can be argued that registration in the Companies Register also is not

²⁶ The limitation may not be as severe in reality as it sounds, since we are told that in practice there is a tendency to register any charge whether or not registration is required.

²⁷ See below, para 5.22 ff.

²⁸ Although we later suggest that charges over shares should not be registrable: see below, para 5.28.

²⁹ However, a pledge of goods which is effected by the debtor's written attornment to the creditor requires registration under the Companies Act 1985, s 396(1)(c) as an instrument which, if executed by an individual, would require registration as a bill of sale: see *Halsbury's Laws* vol 4(1) para 621.

strictly necessary; a third party who is contemplating taking a security over the land will inevitably check with the Land Registry and will discover the charge.

The priority function

- 3.25 The effect of the registration scheme on the question of priority - its second, indirect function - is also highly inefficient and open to criticism. Failure to register may have an effect on the priority of a charge as against another registered charge.³⁰ However, registration itself is not a priority point: by this we mean that a chargee cannot ensure priority over another chargee of the same asset simply by registering his charge first.
- 3.26 One particular result of the scheme not expressly determining priorities is the '21-day invisibility' problem that we have already described in Part II.³¹ It also seems to be the case that a charge that is duly registered within the 21-day period may nonetheless be 'overtaken' by a charge that was created after the first charge was created but before it was registered. If the first charge is equitable and the second interest legal, and if the second creditor had no notice of the earlier charge, he may be protected by the doctrine of the bona fide purchaser of a legal estate for value and without notice. The second creditor will not have constructive notice if, at the time the second charge was created, the first charge had not been registered.³²
- 3.27 An additional problem, in terms of the determination of priorities, is that the existence of a negative pledge clause in a floating charge is not something that must be registered (unlike in Scotland). The existence of such clauses will therefore not be apparent from a searching of the register. The clause will be ineffective to preserve the priority of a floating charge against a subsequent fixed charge unless it can be shown that the subsequent chargee had actual notice of the negative pledge clause.
- 3.28 The current registration scheme's relationship with the priority of a charge is therefore unsatisfactory: it has an impact on priority in some cases yet it does not set out a clear method of determining priorities. As we noted at the beginning of this Part, one of the aims of any new registration scheme, if it were being considered afresh, ought to be that it set out rules to determine the priority of

³⁰ See above, para 2.37. The Diamond report was critical of the way the law of priority operated against a background of the many different ways of achieving similar economic ends, leading to "fortuitous claims" in the event of an insolvency. Moreover, it was suggested that the uncertainty of the effect of some retention of title clauses in contracts of sale can make it difficult for a receiver or liquidator to discover what are in effect security interests: see the Diamond report para 8.2.10. There are theoretical problems, at least, in respect of priority between registrable but unregistered charges (see de Lacy, p 381ff), and there are doubts as to whether the holder of an unregistered charge who enforces it before insolvency has to account for the proceeds to a second charge holder who has registered: see Registration of Company Charges para 3.4.

³¹ See above, para 2.37. De Lacy points out that, although the issue has not featured in case law, there is considerable divergence of view of the priority as between two charges neither of which is registered in time: de Lacy, p 364.

³² See above, para 2.37. The scheme also means that if a court allows a charge to be registered late it must make the order without prejudice to subsequent charges taken prior to that registration, otherwise allowing the late registration would have the effect of giving priority to the first-created charge: see Registration of Company Charges para 3.5.

registrable interests. A registration scheme should ensure that those who do register are secure in their priority (for example, there should be no 'hidden' problems such as with the 21-day invisibility problem). In addition, the position of third party purchasers should be clear and they should not need to concern themselves with creditors who have not chosen to register what are registrable securities. As we have seen, the current registration scheme clearly fails to fulfil these aims: we think that this is a particularly significant weakness.

No 'advance' registration

- 3.29 Two major practical problems of the current system are caused by the fact that it is not possible to register a charge before it has been created. The first is that a potential lender seeking to take a security may check the register, discover the state of the company's charges at the date of search and decide that the company can offer adequate security for an advance. However, during the period it takes to negotiate and set up the security there is no way in which he can ensure that the company will not create further charges that will rank ahead of his.
- 3.30 The second is that each individual charge must be registered even when it is just one of a long series between the same parties. For example, the difficulty and expense this causes is the explanation usually given for suppliers not registering extended retention of title clauses even though these frequently create registrable charges.³³

Registrable charges and purchasers

- 3.31 We suggested in Part II that the effect of a security on purchasers was difficult to ascertain. It appears that a purchaser may be bound by a fixed charge even if the charge has not been registered, unless the doctrine of bona fide purchaser of a legal estate without notice applies. This seems to offer inadequate protection. Conversely, it is uncertain whether purchasers are bound by charges that have been registered, as it is unclear whether purchasers are expected to check the register and will thus be fixed with constructive notice of a charge that has been registered. This uncertainty also seems unsatisfactory.³⁴

ADDITIONAL CRITICISMS OF THE REGISTRATION SCHEME

- 3.32 We also need to deal with two additional criticisms that have been made in relation to the operation of the current scheme. These are in relation to overseas companies and to the relationship between the Companies Act 1985 and the European Convention on Human Rights. One of these criticisms we provisionally think to have merit, the other less so.

³³ The Steering Group noted the particular problems and high compliance costs caused by the registration scheme in respect of corporate underwriting members of the Lloyd's insurance market. This appears to raise a different issue and is considered below, in paras 5.78-5.86.

³⁴ De Lacy points out that the law is unsatisfactory but that the Steering Group did not address the issue: de Lacy, p 365.

Overseas companies

- 3.33 The Steering Group has noted that a company incorporated overseas may carry on business in Great Britain in one of three ways: on a 'services' basis, whereby dealings are conducted without establishing a presence of its own in Great Britain (either through cross-frontier communication or by using an agent based in Great Britain); by establishing a presence in Great Britain from which business is done (through a 'place of business' or a 'branch', each bearing a different meaning); or by establishing a subsidiary company. The first method is not regulated by company law; the second is governed by Part XXIII of the Companies Act 1985; and the third is treated in the same way as any other domestic company.³⁵
- 3.34 Under the current law a company incorporated overseas is required to register certain particulars with the registrar if it establishes a place of business in Great Britain.³⁶ However, it seems that there is little relationship between the requirements of Part XXIII and those of Part XII in relation to the registration requirements for company charges. In practice, the extension of the registration scheme for company charges to companies incorporated outside Great Britain but having an established place of business in England and Wales³⁷ has given rise to problems.
- 3.35 The question of whether an overseas company should be required to register charges with the registrar, when it had an established place of business in England and Wales but was not in fact registered there under what is now Part XXIII, was considered in the case of *NV Slavenburg's Bank v Intercontinental Natural Resources Ltd*.³⁸ The defendant, a company incorporated in Bermuda that dealt with oil and petroleum products, some of which it stored in England, had charged some of its assets in favour of the plaintiff, a Dutch bank, but the charges had not been registered under section 95 of the Companies Act 1948, then in force (now section 395 of the Companies Act 1985), nor had the defendant registered under what is now Part XXIII. The company was wound up by order of a court in Bermuda, and both the defendant and the liquidators claimed that the charges were invalid for non-registration.
- 3.36 Following a trial of preliminary issues, Lloyd J rejected the claim that the Companies Act 1948, section 106 (now the Companies Act 1985, section 409) applied only to a company that had been registered under the Companies Act 1948, Part X (now the Companies Act 1985, Part XXIII). By virtue of section 106, section 95 applied to the charges on the English property, and the charges were therefore void against the liquidators. Even though the practice of the registrar at that time required compliance with the registration requirements under

³⁵ See *Modern Company Law for a Competitive Economy: the Strategic Framework* para 5.6.23.

³⁶ See Companies Act 1985, s 691. There is a separate registration regime for "branch" registration under the Eleventh Company Law Directive 89/666/EEC: see *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* for a general overview. A company incorporated elsewhere than in Great Britain which establishes a place of business in Great Britain is defined in the Companies Act 1985 as an "overseas company": see s 744.

³⁷ Companies Act 1985, s 409.

³⁸ [1980] 1 WLR 1076.

Part X before the particulars of charges for registration would be accepted, the provisions of section 95 did not require registration of a charge to render it valid but merely that particulars of the charge be delivered to the registrar.³⁹

- 3.37 The *Slavenburg* decision has highlighted a number of difficulties. First, where such a company has not complied with the registration requirements under Part XXIII, Chapter I, it may not be easy for a creditor who has taken a charge over such a company's assets to determine whether it has a 'place of business', and hence whether particulars of the charge have to be sent for registration.⁴⁰ In addition, the use of the word 'established' may also mean that it is not easy to determine whether a place of business used by a company has a sufficient degree of permanence to regard it as coming within this term.⁴¹
- 3.38 Secondly, Lloyd J's decision that the unwillingness of the registrar to register the charge without prior registration by the foreign company did not prevent compliance with what is now section 395⁴² (as the charge was saved by delivery), and that consequently if the particulars had been delivered for registration the charge would be valid even though it did not appear on the register, has been criticised. McCormack argues that the *raison d'être* of a public registration scheme seems unclear when the law concedes that a charge can remain valid despite the fact that the details of it have been incorrectly recorded or not recorded at all. He also suggests it is harsh to expect a searcher to check the instrument of charge at the company's own registered office,⁴³ and that in any event this is difficult in the case of an overseas company.⁴⁴
- 3.39 A third problem concerns the location of a company's assets when the charge was created. The terms of section 409 of the Companies Act 1985 indicates that it applies to property located in England and Wales at the time the charge was created (or acquired, in the case of property that was subject to a pre-existing charge). However, that section makes no mention of property that is located overseas when the charge is created. In such a case, it seems that the charge would not be registrable. However, what if the charged asset is subsequently brought into England or Wales? If this happens more than 21 days after the creation of the

³⁹ Lloyd J applied *National Provincial and Union Bank of England v Charnley* [1924] 1 KB 431.

⁴⁰ As we have seen, the charge would be registrable, notwithstanding that the company has not registered under Part XXIII, Chapter I. Companies House keeps a so-called 'Slavenburg register' in respect of such unregistered companies that have an established place of business in England, Wales or Scotland.

⁴¹ In *Re Oriel Ltd* [1986] 1 WLR 180, 184 Oliver LJ said that the word "established", when being used as an adjective, connotes "not only the setting up of a place of business at a specific location, but a degree of permanence or recognisability as being a location of the company's business." Carrying on business was distinguishable from having an established place of business. See also *Cleveland Museum of Art v Capricorn Art International SA* [1990] BCLC 546. See generally, G McCormack, *Registration of Company Charges* (1994) pp 152-153.

⁴² Cf the registrar's practice now to have a 'Slavenburg' register.

⁴³ In having to attend the company's registered office to search its own register, the person searching will potentially lose anonymity.

⁴⁴ See G McCormack, *Registration of Company Charges* (1994) pp 154-155.

charge, it could not be delivered to the registrar for registration owing to the expiration of the statutory period allowed. It has been suggested that, under *Slavenburg*, the transfer of a charged asset into England during the subsistence of the charge will invalidate the charge even though it is not possible to register it.⁴⁵ In a related problem, as the Steering Group has pointed out, some kinds of property are not located in a single place, and that goods and (particularly) vehicles may be moved in and out of Great Britain.⁴⁶

- 3.40 The problems relating to the registration of company charges by foreign companies have been recognised for some time, and have been the subject of criticism by a number of commentators.⁴⁷ The Diamond report noted that reform was needed.⁴⁸ The Companies Act 1989 contained a number of new provisions designed to overcome some of the problems, although these reforms were recognised to be themselves problematical, and they were never brought into force. This area is clearly still in need of reform. The regime is acknowledged to be complicated, and proposals for its reform have been put forward by the Steering Group.⁴⁹

The European Convention on Human Rights

- 3.41 The Steering Group was concerned over the suggestion made by one respondent to its consultation document that the sanction of invalidity resulting from failure to comply with the requirements of the current scheme of registration could constitute a disproportionate 'deprivation' of a person's possessions in contravention of Article 1 of Protocol 1 of the European Convention on Human Rights ('ECHR').⁵⁰

⁴⁵ This seems to follow from Lloyd J's rejection of the submission that the previous version of s 409 only applied to charges on property which was in England at the time the charge was created or the property acquired. He held that in applying (what became) s 395 to overseas companies Parliament must have intended it to apply to floating charges as well as fixed charges and must therefore have intended it to apply to a charge on future property in England and not just property existing in England at the time the charge was created. Lloyd J also held that, once property fell within s 395 by virtue of s 409, it remained within that section even if the company ceased to have a place of business within England before the winding up commenced. See *NV Slavenburg's Bank v Intercontinental Natural Resources Ltd* [1980] 1 WLR 1076, 1089. The inability to comply with s 395 would also put the company in breach of its duty to register charges under s 399.

⁴⁶ Registration of Company Charges para 3.66.

⁴⁷ See, eg, G McCormack, *Registration of Company Charges* (1994) ch 8. The Law Society's response to the Steering Group's consultation document on *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* indicated that this area was in need of reform.

⁴⁸ Diamond report para 27.10.

⁴⁹ See the consultation document *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* and Final Report paras 11.21-11.33. See also below, paras 5.88 ff.

⁵⁰ See Final Report para 12.16. The Steering Group suggested that the concerns that had been raised could be met by the incorporation within any new system of a right to apply to the court for relief from the sanction of invalidity, although the court, in granting such relief, should not be able to change the relative priority of registered charges: see *ibid*, para 12.19.

- 3.42 The Steering Group referred by analogy to the recent case of *Wilson v First County Trust Ltd (No 2)*,⁵¹ where the Court of Appeal held that section 127(3) of the Consumer Credit Act 1974 was incompatible with the rights guaranteed by Article 6 and Article 1 of Protocol 1 of the ECHR.⁵² We think that there are clear differences between the provisions of the Consumer Credit Act 1974 and the Companies Act 1985: the effect of non-compliance under the Consumer Credit Act 1974 is to render the agreement unenforceable as between the parties, whilst non-compliance under the Companies Act 1985 only results in the charge being void against the liquidator, administrator or creditor, and not the parties themselves.⁵³ In addition, the Companies Act 1985, section 404 contains provision for a court to rectify the register. Despite this, the *Wilson* case may be a decision that is of relevance in considering the need for reform to the company charges registration system. Leave to appeal this decision to the House of Lords has been given,⁵⁴ and we understand, at the time of writing, that an appeal has been submitted.
- 3.43 It is our provisional view that the ‘sanction of invalidity’ under the Companies Act 1985 is not incompatible with the ECHR. This is because the provision merely invalidates the unregistered charge as against third parties in certain circumstances, not as between the parties themselves in all cases;⁵⁵ because the sanction is imposed for the important purpose of securing publicity of charges that may have a serious effect on third parties; and because the sanction is easy to avoid by registration, which is not unduly onerous, even under the current system, for the ends to be achieved. However we would welcome the views of consultees on this question.

CONCLUSION

- 3.44 Earlier in this Part we outlined what we thought should be expected of a modern scheme of registration, and we suggested that it should provide public notice (within the limited meaning we have discussed) and should determine priority. We also noted that it should not unnecessarily hinder the ability of a company to deal with its assets, and that it should achieve all these aims efficiently, simply and cheaply. As part of this, we explained that users should be able to rely on the information contained in the register; should not have to duplicate information; and should be allowed to perfect their interests in any order.
- 3.45 It seems clear that the aims relating to public notice and priority are not fulfilled by the current registration scheme in a satisfactory way. It requires the provision of

⁵¹ [2002] QB 74.

⁵² The Consumer Credit Act 1974, s 65(1) provides that an improperly executed regulated agreement is enforceable against the debtor only on a court order. However, s 127(3) provides that: “The court shall not make an enforcement order under section 65(1) if section 61(1)(a) (signing of agreements) was not complied with unless a document (whether or not in the prescribed form and complying with regulations under section 60(1)) itself containing all the prescribed terms of the agreement was signed by the debtor or hirer (whether or not in the prescribed manner).”

⁵³ However, cf the provisions of the Bills of Sale Acts 1878 and 1882.

⁵⁴ *Wilson v First County Trust Ltd (No 2)* [2001] 1 WLR 2238.

⁵⁵ As would be the case with a bill of sale: see below, paras 8.18-8.19 and 8.32-8.33.

a relatively large amount of information in respect of individual transactions from the party registering the charge, but in return gives only a limited amount of useful information to enquirers; the information given cannot necessarily be relied on as accurate; the information given is too restricted; and there is no clear relationship between the act of registration and priority. The scheme is inefficient in other ways also. Under the current registration scheme, each individual transaction (or series of debentures) needs to be registered, and the instrument of charge sent with the prescribed particulars. This prevents advance registration in anticipation of a charge that is being arranged and means that each charge, even in a long series between the same parties and for the same purpose, must be separately registered.

- 3.46 Additional cost burdens are imposed by the obligation for dual registration, in the case of some assets, at both Companies House and at specialist registries.⁵⁶ This dual registration burden may not be necessary, and later in this Consultation Paper we suggest that it might be easier to leave each specialist asset to the rules contained in the relevant registry (although possibly notification of the charge should be sent to the Companies Register purely for public notice purposes).⁵⁷
- 3.47 It is our provisional view that the current registration scheme fails to achieve what should be expected from a modern registration scheme: it is unnecessarily complicated, incomplete and restrictive. Whether or not the fears about a potential conflict between the Companies Act 1985 and the ECHR are justified, there are good grounds for saying that the current law is in need of reform, and that a new method of registering charges or other security should be introduced.
- 3.48 **We ask whether consultees agree with the criticisms we have made of the current registration scheme, and, where they do not so agree, we ask them to explain why.**

⁵⁶ See above, paras 2.49 ff.

⁵⁷ See below, paras 4.199 ff.

PART IV

NOTICE-FILING FOR COMPANY CHARGES

- 4.1 In Part III of this Consultation Paper we reached the provisional conclusion that the current scheme of registration of company charges under the Companies Act 1985 has serious weaknesses and is in need of reform. In this Part we consider how a basic notice-filing system for company charges might operate and explain our provisional agreement with the Steering Group's conclusion that a notice-filing scheme should be adopted. It would be the best way to meet the objectives we identified in Part III.¹

AN ALTERNATIVE APPROACH: AMENDING THE CURRENT REGISTRATION SCHEME

- 4.2 As we explained in Part I, the Steering Group's initial approach was not to adopt notice-filing but to amend the current scheme of registration. It put this forward as the favoured option in its consultation document. The Diamond report also made a number of proposals for improving the existing scheme, but in this case intended only as a temporary measure pending implementation of the wider proposed notice-filing system.² Some of the proposals found their way into the unimplemented provisions of the Companies Act 1989. Before we turn to notice-filing, we explain briefly why we have rejected the approach of amending the current scheme.
- 4.3 Taking its consultation document and Final Report together, the Steering Group proposed a large number of changes to the current registration scheme. These related to the particulars to be delivered to the registrar; defects in the registration of a registrable charge; the role of Companies House and the registrar's certificate; the procedure for registration; the period for registration and late registration; the effect of non-registration and the sanctions for failure to register; assignment of charges; priorities; provisional registration; the position of purchasers of charged property; the register of company charges, and the company's own register of charges.
- 4.4 A detailed discussion of how each change might operate and its advantages will be found in Appendix A. However, like the Steering Group in its Final Report, we provisionally reject this approach as a whole. On the one hand, the proposed changes are so many as to be almost a notice-filing system; on the other, the amendments proposed would still not achieve all that a notice-filing system could do. For example, we will see that a major advantage of a notice-filing system is that a single registration can cover a series of transactions, so avoiding the need for

¹ In this Part we do not discuss what should be a registrable security (either under an amended version of the current scheme or under notice-filing): this question is dealt with in Part V. We also deal in that Part with the possibility of exempting trusts created by corporate members of Lloyds from the application of the notice-filing system: see below, paras 5.78-5.86.

² See the Diamond report ch 20.

repeated filing as each transaction is made. The amendments proposed to the current scheme would still not enable that to be done.

THE POLICY AIMS OF ANY NEW SYSTEM

- 4.5 We suggested earlier that a registration scheme should perform the two basic functions of providing information about property which appears to be owned by the company, but which is subject to interests in favour of others, and determining the priority of registrable interests.
- 4.6 In what follows we explain the detail of how a notice-filing system might operate and suggest that such a system would fulfil the aims identified in Part III very much better than the current registration scheme does.³ We have drawn heavily on the work done by the Steering Group and by the Crowther and Diamond reports, as well as on the experience of overseas jurisdictions that are operating a notice-filing system.⁴

AN OUTLINE OF NOTICE-FILING

- 4.7 Typically, the notice-filing systems of other jurisdictions that we have considered operate in the following way. A 'financing statement' is registered at a central registry, usually electronically. The statement provides brief details of a transaction or series of transactions that secure payment or performance of an obligation. It may be filed before or after the transaction is entered into, and the security agreement itself is not sent to the registry. The legislation sets out a series of rules relating to the priority of filed interests, with priority generally being determined by the date of filing (although there are a number of important exceptions⁵).
- 4.8 The overseas systems deal with more than notice-filing for company charges, as they apply notice-filing to some quasi-securities and they apply regardless of the legal personality of the debtor. They also include a statement of the rules on the creation, attachment and perfection of securities and of the remedies on default (amounting, in effect, to a partial codification of the law of security). These points are not considered in this Part.⁶
- 4.9 These notice-filing systems rest on three principles:
- (1) filing is not necessarily in relation to a specific transaction, but is a notice that a person has taken or intends to take a non-possessory security over a designated asset or class of assets;

³ See above, paras 3.4-3.8.

⁴ We have also been assisted by the Australian Law Reform Commission's 1993 report, *Personal Property Securities*, ALRC 64.

⁵ See especially below, paras 4.155 ff. Some the exceptions of these would not apply were the scheme to be confined to company charges: see further below, paras 7.71 ff.

⁶ See above, para 2.5, and below, Parts VII, X, XI and Appendix B.

- (2) thus the secured party can file a notice to protect the security interest either before or after the security is created,⁷ with (once all the other elements of a perfected security agreement are in place) priority normally going back to the time of filing of the financing statement; and
- (3) as a consequence of this, and also to reduce the burden of filing and to allow for a purely automated system, transaction documents are not filed and particulars to be filed are kept to a minimum, it being left to a searcher to get the information she wants from the company or chargee.

PRINCIPAL CHANGES INVOLVED IN ADOPTING NOTICE-FILING

- 4.10 The move to a notice-filing system for company charges would bring about four main changes, and we outline these before we consider each in more detail.
- 4.11 The first change would be as to the information to be registered on what we shall call the Company Charges Register.⁸ Registration of detailed particulars of the charge would be replaced by the 'filing' of a financing statement that would contain only brief particulars.⁹ It would not be necessary to send either the original security agreement, or even a copy of it, as part of the process of filing.¹⁰ One advantage of cutting down the amount of information required to be on the Company Charges Register would be that it would assist the operation of a computer-based system, by making registration simpler and quicker. In effect filing could be done on-line by a party (normally the creditor) entering simple details into boxes onto a computer screen and clicking the appropriate buttons.¹¹ The details will then appear automatically on the register without the need for human input at Companies House; the party filing would take responsibility for the accuracy of the particulars in the financing statement and would bear the risk of any mistakes. Searching could also be carried out on-line.
- 4.12 Secondly, filing would not be dependent on a charge already having been created. The financing statement could be filed in advance and (subject to what we say about security that qualifies as a 'purchase-money interest'¹²) would operate to preserve the priority of any charge subsequently created that falls within the scope of the financing statement. This would enable a creditor contemplating taking a charge to ensure that no other charge, already created but not yet registered, will have priority: it would also allow a creditor who has filed to be confident that it will have priority over most other charges¹³ even if they are created, and even

⁷ Eg, by making the security agreement, giving the advance, and then registering the security interest, or by registering the intended security interest first, making the security agreement, and then giving the advance.

⁸ We refer to this rather than to the Companies Register for reasons explained below, para 4.35.

⁹ See further below, paras 4.19 ff.

¹⁰ This has implications for the certificate currently issued by the registrar, a situation we discuss later in this Part: see below, paras 4.37-4.38.

¹¹ This is the system that has recently been introduced in New Zealand.

¹² See below, paras 4.155 ff.

¹³ Subject again to the proviso about purchase-money interests.

registered, before its own is completed. Notice-filing also permits the filing of a single financing statement to cover a series of transactions, rather than requiring an individual filing for each transaction.¹⁴

- 4.13 Thirdly, subject to any special rules, it would produce a system of priorities based principally on the date of filing of the financing statement, rather than the date of the creation of the security interest. Questions concerning the legal or equitable nature of the interest would cease to matter for this purpose; and questions of notice would be of far less importance than they are under the current law.¹⁵
- 4.14 Fourthly, it would bring about a significant change in the interrelationship between the Companies Register and specialist registers, in particular that operated by the Land Registry. At present the validity of a charge as against a subsequent chargee of the same land depends on the first charge being registered at Companies House within the 21-day period. Under the notice-filing system that we propose, priority of charges over land would be determined solely by the rules applying to registered land. For the purpose of information to the public it could be required that the charges be registered on the Company Charges Register (possibly through the Land Registry forwarding on the information) but neither the validity nor the priority of the charges would depend on this.¹⁶ The system would also have this result in relation to the other specialist registries.

Possessory securities

- 4.15 We note at this point that, with one exception, we do not envisage that possessory securities such as the pledge would be brought within the scope of the notice-filing system that we are outlining.¹⁷ This was an exclusion the Steering Group also suggested in its Final Report.¹⁸ Where there is actual possession by the creditor, the existence of the pledge would be evident to third parties, and hence the 'false wealth' risk would not apply: perfection is achieved by such possession. Similarly, where the creditor has constructive possession of goods that are in the hands of a third party who has attorned to the creditor, the existence of the pledge would

¹⁴ See further below, paras 4.116-4.117.

¹⁵ See further below, paras 4.19 ff.

¹⁶ See further below, paras 4.199 ff.

¹⁷ Both the Crowther and Diamond reports suggested that such interests should come within the general codification of security law they proposed, but also that it should not be necessary to register such interests: see the Crowther report para 5.7.61 and the Diamond report paras 9.5.6-9.5.7 and 11.5.2-11.5.7. We return to the 'wider' scheme when we discuss the possible codification of security law: see below, Part XI.

¹⁸ The Steering Group suggested that there should be an exception from the requirement to register charges where the chargee has actual or constructive possession. This was contrasted with an approach, favoured by a few consultees, whereby a charge should be registrable unless the *chargor* did *not* have actual or constructive possession of the goods - the difference was said to be important when the charged asset was not in the possession of either chargor or chargee, the example being given of whisky in a bonded warehouse. The Steering Group's suggestion would seem to mean that a charge over such goods was registrable unless the creditor had constructive possession (ie, where the whisky was held to the order of the chargee); the minority view would result in the charge being registrable if the debtor had constructive possession, but not otherwise. See Final Report para 12.57.

soon be found out.¹⁹ However, the situation is different where the goods are in the hands of the debtor and the debtor attorns to the creditor. It would be difficult for a third party to find out that the debtor's apparent possession is subject to the creditor's security in the absence of any requirement to register.²⁰ Currently, such an attornment (if in writing) would require registration as a bill of sale or under the Companies Act 1985, s 396(1)(c).²¹ We think that such attornments should continue to be registrable under a notice-filing system.

4.16 Trust receipts (given when a pledgee allows the pledgor to have the goods or documents of title for a limited purpose, such as for sale as agent) are regarded as a method of securing the continuance of the pledge rather than as an independent security device, and are not registrable under the current company charges registration scheme.²² They do create a temporary form of non-possessory security. However, they do not seem to pose a great threat to third parties. By definition the debtor has authority to sell the goods or documents so that a purchaser will take free of the pledge and the situation is unlikely to last long enough to mislead other third parties into thinking the debtor owns the assets concerned outright. It would be possible to do as the SPPSA does and hold that the pledge will remain perfected only if the debtor has possession of the goods or documents for less than 15 days. Perhaps because of this the SPPSA applies not only when the goods are handed over for the purpose of selling them but also for such things as processing with a view to sale or trans-shipment. We would welcome consultees' views on whether there should be a similar provision in respect of a notice-filing system for companies.

4.17 **We provisionally propose leaving possessory securities out of the scope of the notice-filing system, save where the creditor's possession is constructive and results from the debtor attorning to the creditor. We invite views on whether a pledge of goods that subsequently are delivered to the debtor under a trust receipt should cease to be perfected if the debtor remains in possession of the goods for more than 15 days.**

Security arising by operation of law

4.18 We also note that in our provisional view notice-filing should not apply to any form of security that arises through the operation of law rather than by agreement of the parties.²³ Such interests are generally excluded (at least in part) from the scope of

¹⁹ The Steering Group noted that, so far as apparent possession was concerned, an asset may be out of possession but still included in the company's accounts by virtue of the Companies Act 1985, Schedule 4 paras 48(2) and 50(1): Final Report para 12.57.

²⁰ Although presumably some information will be revealed from the company's accounts.

²¹ See, eg, *Halsbury's Laws* vol 4(1) para 621.

²² R Goode, *Commercial Law* (2nd ed 1995) p 1029. Where the goods relate to imported goods, there is a separate provision exempting such documents from being a bill of sale: see the Bills of Sale Act 1890, s 1, and see below, para 8.13.

²³ As we have seen in Part II, only charges that are 'created' fall within the current registration scheme, and then only if they are on the list of registrable charges. Thus a debtor does not 'create' a charge where it arises from operation of law, such as in the case of most liens: see, eg, *London and Cheshire Insurance Co Ltd v Laplagrene Property Co Ltd* [1971] Ch 499, 514, and above, para 2.22 n 53. We would include the concept of the 'Quistclose' trust as such an

the overseas systems.²⁴ **We propose that notice-filing should not apply to security created by operation of the law.**

THE FINANCING STATEMENT

The particulars that should be required

- 4.19 Under the Companies Act 1985, the particulars that currently have to be supplied to the registrar are set out in secondary legislation.²⁵ The present forms used by Companies House²⁶ for registering a mortgage or charge²⁷ require the name and number of the company; the date of the creation of the charge; a description of the instrument (if any) creating or evidencing the charge; the amount secured by the charge; the names and addresses of the persons entitled to the charge; short particulars of all the property charged; details of the presenter; particulars as to commission allowance or discount, and a signature of the company or the chargee.²⁸ In contrast to the sometimes lengthy details that are often supplied in practice under the current scheme, a financing statement may be rather less detailed.
- 4.20 The Crowther, Halliday and Diamond reports all briefly considered financing statements, and made a number of common suggestions about the contents, which we note below.²⁹ Whilst the approach taken by the overseas systems obviously varies, there are many similarities as to the information required to be contained in the financing statement.³⁰ Sometimes the requirements are set out in the primary

interest: even if such trusts amount to charges, they are not registrable as they are created by operation of law. See further below, para 7.53.

²⁴ The SPPSA, s 4(a) states that, unless expressly provided for, the Act does not apply to “a lien, charge or other interest given by statute or rule of law”; the NZPPSA, s 23(b) provides that the Act does not apply to a “lien (except as provided in Part 8 [which deals with priority points]), charge, or other interest in personal property created by any other Act or by operation of any rule of law.” The Crowther report had envisaged that the scope of its new system for security and filing should extend to non-consensual security interests arising by way of lien: see the Crowther report paras 5.3.1 and 5.7.75, and Appendix III, para 4. However, the Diamond report considered that the new law on security interests it proposed should only apply to security interests created by agreement: see the Diamond report para 9.3.1.

²⁵ See the Companies (Forms) Regulations 1985, SI 1985 No 854, which provides for the use of a series of forms.

²⁶ Form No 395 is used for the particulars of a mortgage or charge. There are other relevant forms, eg, for registration of a charge over property acquired or a series of debentures.

²⁷ References on the form to a charge also include mortgage.

²⁸ Not all the particulars that have to be supplied are necessarily ‘particulars of the charge’ for the purposes of the Companies Act 1985, s 395: see *Grove v Advantage (T10) Ltd* [2000] 1 BCLC 661, where the company’s number was held to be a particular of the ‘mortgagor’, rather than of the ‘charge’ which had to be registered.

²⁹ The Diamond report did not go into much detail, but instead suggested that the form of the financing statement would be laid down by regulations: see the Diamond report para 10.5.5.

³⁰ Some of the requirements vary, depending on whether the parties are businesses or individuals: this reflects the fact that the overseas systems all generally apply to all debtors, regardless of legal personality.

legislation, but it is more usual to have detailed secondary legislation setting out the full requirements.³¹

4.21 We think that, in general,³² all that is needed on the financing statement is the following information:

- (1) the names, Companies House registration numbers and addresses of the parties;
- (2) a general description of the type of property subject to the security (including, where appropriate, an indication that its proceeds are included);
- (3) (where filing is by a party other than the chargor) a statement that the chargor has consented to the filing being made;
- (4) an indication of the period of validity of the security agreement;
- (5) whether the charge is fixed or floating (or both);
- (6) where applicable, any unique serial number identifying the secured asset; and
- (7) confirmation that the chargor is either the beneficial owner of the property charged or that it holds it in trust.

We consider (1) and (2) at this point; items (3), (4), (5), (6) and (7) we will discuss later as they become relevant.³³

4.22 We provisionally think that the name of the debtor should be given, as should its Companies House registration number. There should be some method of obtaining the address of the debtor to allow further enquiries to be made by a person who discovers from the register that a charge exists or may do so. Although we understand that the registered address can be obtained from Companies House via the registration number, it may be simpler to require the registered address or an address for communication also.

4.23 The question of whether the creditor's identity should be given is more controversial. The question has been raised as to whether any aspect of the chargee's identity should be revealed on the financing statement. This is because of concerns that such disclosure might hinder the availability of credit where banks and other potential lenders were made the subject of campaigns of intimidation or attack by pressure groups or individuals on the basis that they were extending financial assistance to companies that were deemed by some to be carrying on

³¹ See, eg, the Personal Property Security Regulation for Alberta (AR 95/2001) and the Personal Property Security Regulations for Saskatchewan. Some of the minimum requirements are sometimes included in the enabling statute: see, eg, the PPSA for Manitoba, s 48(1) and the NZPPSA, s 142.

³² More particular requirements are discussed in the relevant contexts, see paras 4.81-4.86, 4.103-4.108 and 4.186-4.187.

³³ See below, paras 4.81-4.86, 4.103-108, 4.139, 4.186-4.187 and 5.56-5.72.

controversial forms of business.³⁴ The provision of information about the identity and address of the chargee would serve a useful purpose in the context of a public notice of security (for instance, it would provide a point of contact other than the company for other potential secured parties), but we would welcome the views of consultees on whether the problem of possible ‘improper’ use of such information is sufficiently serious to justify not disclosing the chargee’s identity. (We note that the overseas systems all seem to require this information to be included.)

4.24 There should also be an indication of what the secured property comprises. Typically, the overseas notice-filing systems require either a description or a classification of the secured property. The Saskatchewan requirements, for example, provide for describing the collateral by item or kind, or as “goods”, “chattel paper”, “security”, “document of title”, “instrument”, “money” or “intangible”. Alternatively, a statement can be given that the security interest has been taken in all the debtor’s present and after-acquired personal property (allowing for exceptions of certain things).³⁵ The New Zealand scheme is a wholly electronic one and requires identification of the collateral type being registered from an on-screen choice of 13 types, such as various sorts of goods (such as livestock, crops or “other”); documents of title; chattel papers; investment securities; negotiable instruments; money; intangibles; “all present and after acquired personal property” and “all present and after acquired personal property except ...”.³⁶

4.25 We provisionally think that a brief description of the property or type of property charged should be included, but given that the purpose of the notice-filing system is to provide only a warning of the possible existence of a charge, the description does not need to be detailed. We would envisage the kinds of description required in Saskatchewan or New Zealand being appropriate: if the system were to operate electronically (as we hope that it would), a list of options could be presented on-screen to the user in a manner similar to that provided under the New Zealand legislation. We also provisionally think that a party should be able to indicate

³⁴ See generally the Steering Group’s discussion in relation to company directors’ residential addresses in its Final Report paras 11.44-11.48.

³⁵ Personal Property Security Regulations for Saskatchewan, s 14. The UCC Revised Article 9 requires a description of the collateral covered by the financing statement: see Section 9-504 and Section 9-108. Similarly, the other Canadian systems require a description or classification of the secured property, although the details may often be brief: eg, the Ontario system requires an indication that the classification of collateral is “consumer goods, inventory, equipment, accounts or that the classification is other than consumer goods, inventory, equipment or accounts or any combination thereof”: Revised Regulations of Ontario 1990, reg 912, s 3(1)(f). Sometimes an indication has to be given that a particular asset is included in the collateral, eg, a motor vehicle: see the Revised Regulations of Ontario 1990, reg 912, s 3(1)(g). See also the Personal Property Security Regulation for British Columbia (BC Reg 279/90), s 13. The Australian Law Reform Commission recommended that a short description of the property be given: see ALRC 64, *Personal Property Security* paras 13.10. The Crowther report suggested that there should be a statement of the security given or intended to be given (indicating the types or describing the items): Crowther report para 5.7.53. A similar suggestion was made in the Halliday report para 51. The Diamond report did not go into details on this point. The Steering Group proposed that the property or class of property charged should be identified: Final Report para 12.28.

³⁶ For further details of this system, see the registry website at <http://www.ppsr.govt.nz/search/cad/dbssiten.main>.

whether it intends the security interest to extend to the proceeds of the secured asset: this is a point we discuss later in this Part.³⁷ (We also discuss the other suggested requirements later in this Part when they arise in context.³⁸)

- 4.26 Although the Steering Group had recommended that the financing statement indicate whether the charge is in respect of a monetary obligation, and, if so, the amount secured,³⁹ we do not think that this is necessary. It is not required in the overseas systems, and would be of limited use, given that it might well be out of date by the time of searching.⁴⁰ The notice-filing system simply warns that a security interest may exist on the specified property, it then being up to the searching party to contact the company for details of the obligation secured and the exact indebtedness. Nor do we think it necessary for the financing statement to state the date of the security agreement.⁴¹
- 4.27 We have considered other proposals for additional pieces of information that have been suggested (by the Steering Group in particular) for inclusion on the financing statement, but which we do not think are necessary. Our reasons for not accepting most of them will be explained later in this Part.
- 4.28 We cannot explore every possible requirement of a financing statement in a Consultation Paper of this nature. **We therefore would be grateful for the views of consultees (particularly from those who have experience of using notice-filing systems in other jurisdictions) on any matters which they think should be included in the required particulars in addition to those we have discussed.**
- 4.29 **We provisionally propose that under a notice-filing system for company charges a financing statement should contain at least:**
- (1) the names of the debtor and secured party (although we ask consultees for their views on whether the creditor should be identified at all);**
 - (2) the Companies House registration number of the debtor and, where appropriate, the secured party;**

³⁷ See below, para 4.171.

³⁸ See below, paras 4.81-4.86, 4.103-4.108, 4.186-4.187 and 5.56-5.72.

³⁹ Final Report para 12.28. The Halliday report had suggested that the amount secured should be a voluntary, rather than mandatory, particular: see the Halliday report para 51.

⁴⁰ We agree with the Australian Law Reform Commission's conclusion that little purpose would be served by requiring the inclusion of the amount of money to be repaid (as it would vary from time to time and have to be checked with the lender), and its consequent recommendation that it should not be required: see ALRC 64, *Personal Property Security* para 13.4.

⁴¹ This had been recommended in the Halliday and Diamond reports, and by the Australian Law Reform Commission: see the Halliday report para 51; the Diamond report para 11.2.12; and ALRC 64, *Personal Property Security* para 13.10. However, it may be that a financing statement is filed which relates to a security agreement yet to be entered into, and consequently a date cannot be entered on the financing statement. In the light of this,

- (3) a brief description of the secured property, including, where appropriate, an indication that the proceeds of the secured property are included (we ask consultees for their views regarding the level of detail to be given in order to identify the secured property).**

(In addition, we will suggest later that the financing statement should indicate where the party registering the charge is not the debtor, confirmation that the debtor has consented to the filing; a statement of the period of validity of the security agreement;⁴² whether the charge is fixed or floating (or both); where applicable, any unique serial number identifying the secured asset;⁴³ and whether the chargor company is acting as a trustee.⁴⁴ There might have to be additional requirements of an administrative nature.⁴⁵)

The form of the financing statement

- 4.30 The form of the financing statement will depend in part on the nature of the register itself. A notice-filing system that did not involve sending the charge instrument would enable a wholly electronic system of filing to be introduced.⁴⁶ Electronic filing is permitted in some of the systems operating in America and Canada. The New Zealand system provides for a wholly electronic filing system: if financing statements are submitted in a form that does not enable the data to be entered directly by electronic means, they will not be registered.⁴⁷
- 4.31 If the register were to be operated on a wholly electronic basis then it is likely that the financing statement would comprise a standard on-screen form to complete. A financing statement that was completed electronically on-screen would have the additional advantage (apart from ease of use) of there being no transcription involved on the part of registry staff, reducing the possibility of error at this stage. If the system were to permit either electronic or postal filing (similar to the scheme currently operated by Companies House in respect of some matters) then compliance with a prescribed form should be sufficient. In any event, these matters would be dealt with by detailed regulations.
- 4.32 The Steering Group discussed in a different consultation document the question of electronic filing at Companies House, and proposed a general power enabling

requiring a date could confuse, particularly where a charge came into agreement after the filing of the financing statement.

⁴² See below, para 4.81-4.86.

⁴³ See below, para 4.186-4.187.

⁴⁴ See below, para 5.72.

⁴⁵ See, eg, the Personal Property Security Regulation for Alberta (AR 95/2001) and the Personal Property Security Regulations for Saskatchewan.

⁴⁶ The Diamond report suggested that the register that it was proposing should be kept on computer to facilitate searching, and favourable comment was made about two of the Canadian registries in operation at the time: Diamond report para 11.6.1.

⁴⁷ See the NZPPSA, ss 139(2)(a) and 143(a). The Personal Property Securities Register came into effect on 1 May 2002: for further information see the web site of the registry at <http://www.ppsr.govt.nz/search/cad/dbssiten.main>.

the registrar to prescribe the form and manner of delivery of information.⁴⁸ The Steering Group expressed surprise that a majority of consultees were against the mandatory electronic filing of some or all information at Companies House, and suggested that the lack of such a power could eventually become a structural deficiency in company law, so far as the provision of public information is concerned. In spite of the responses, the Steering Group suggested that the case for requiring certain kinds of information to be filed electronically is likely to become overwhelming, although it did not envisage a requirement of this kind being imposed until most companies were already voluntarily making electronic filing, and expected extensive consultation to take place before such a power were used.⁴⁹

4.33 The mandatory filing of electronic information other than that concerning the registration of charges is outside the scope of our Consultation Paper, but we are of the clear provisional view that for a notice-filing system to operate efficiently the ability to file and search electronically is important. Not to have electronic filing and searching would, in our view, negate many of the advantages of modern notice-filing systems over the current registration scheme, in terms of accessibility, simplicity and flexibility.⁵⁰ However, we would welcome consultees' views on whether they think information - in respect of notice-filing, as opposed to other forms of information required under legislation - should be supplied in an electronic format. In responding to this point we ask consultees to note that there would be no need to supply the charging instrument itself (unlike under the present scheme).

4.34 **We provisionally recommend that any register under a notice-filing system should be operated on an electronic basis. We would welcome the views of consultees as to the practical and economic impact that operating an electronic system would have.**

Responsibility for the register

4.35 A notice-filing system in respect of securities granted by companies differs from the wider register of security interests in personal property suggested in the Crowther and Diamond reports.⁵¹ It would seem sensible for any new system that applied only to company charges to be administered by the Companies Registrar.⁵² We are aware that the Steering Group recommended that the Company Charges

⁴⁸ *Modern Company Law for a Competitive Economy: Completing the Structure* URN 06/1335 para 6.63.

⁴⁹ *Modern Company Law for a Competitive Economy: Completing the Structure* para 6.64.

⁵⁰ We would envisage any notice-filing system to be voluntary, not mandatory.

⁵¹ Crowther report para 7.4.8; Diamond report paras 1.11 and 11.6.1.

⁵² The Crowther report suggested that the register should be administered by the Commissioner, who has responsibility for registration under the Bills of Sale Acts 1878 and 1882: see the Crowther report para 7.4.10. The Diamond report suggested that there should be two registers (one for England and Wales and the other for Scotland), and that the registrars of companies would be the best people to run them (although it was also proposed to retain the Companies Act 1985 registration system for security interests in land): see the Diamond report paras 11.6.2-11.6.5 and 12.2.6.

Register (or Mortgage Register) should be abolished.⁵³ However, the Steering Group does not appear to have considered the implications of extending any notice-filing system to non-corporate debtors. It will be seen later that we provisionally propose that the notice-filing scheme should be extended to cover security interests created by non-corporate debtors. It would obviously be inappropriate for such interests to be registrable at Companies House, and it seems unnecessary for there to be two separate registers of security interests.⁵⁴ We therefore suggest that while the scheme is limited to company charges, financing statements be registered, not in the general Companies Register, but in the separate register of charges that the registrar is required to keep by section 401 of Companies Act 1985.⁵⁵ It is this register we refer to when we speak of the 'Company Charges Register'. If and when the scheme were extended to security interests created by non-corporate debtors, the Company Charges Register could form the basis of the new, wider register. It would presumably be administered by another body and be re-named, perhaps as the Register of Security Interests.

- 4.36 There is some concern that not all information about companies would be on the Companies Register. However, we are not sure that this would be a particular problem given that searching any new Register of Security Interests would be a speedy task (and creditors are currently used to searching more than one register⁵⁶). In any event, by the time such a new Register of Security Interests were operational, technology would presumably be sufficiently advanced to allow an electronic link between that register and the Companies Register (and any other specialist register), so that a single filing could be made to produce entries in both registers if that were desired. However, the actual creation and operation of such a Register of Security Interests is something that will obviously require detailed technical work.

The registrar's certificate

- 4.37 Under the current company charges registration scheme, certain prescribed particulars, together with the charging instrument (if there is one), are sent to the registrar. A certificate is then issued by the registrar, which is conclusive that the requirements as to registration have been satisfied.⁵⁷ The checking of the particulars may involve the examination of a lengthy and complicated document, carrying with it the possibility of discovering errors which may result in the particulars form having to be sent back by the registrar, corrected and then returned, all within the original 21-day period. The Steering Group, when considering possible changes to the existing law (as its then-recommended alternative to notice-filing), stated that:

⁵³ Final Report para 12.69.

⁵⁴ As we will see later, an advantage in having a single register would be that for certain types of collateral, searches could be made by asset. Security interests over the asset would be revealed whether the chargor was a company or not.

⁵⁵ Which the Steering Group proposed should be abolished: Final Report para 12.69.

⁵⁶ Such as the 'specialist' registers, which we discuss below, in para 4.199 ff.

⁵⁷ See above, para 2.25.

The problem of the conclusive certificate has been the most difficult obstacle to changes in the company charge registration system.⁵⁸

- 4.38 The result of having a conclusive certificate is twofold. First, it provides a measure of protection to the chargee. In the event of errors in the particulars, an administrator, liquidator or other creditor will not be able to assert that those errors mean that the registered charge is invalid as against it.⁵⁹ Indeed if a certificate has been given, even if there are errors in the registration process or the detail recorded in the Companies Register, the secured charge is valid as to its terms. Secondly, in relation to its interaction with the Land Registry, the certificate proves that a charge over land is validly registered under the Companies Act 1985, and will not therefore be invalid for want of registration as against subsequent charges over the same land. (Where the charge is over registered land, the Land Registrar will note on the Land Register that the charge is subject to the provisions of the Companies Act 1985, section 395.⁶⁰) The second point is considered later.⁶¹ In this section we consider the question of errors in registration and the registrar's certificate.

The effect of errors in registration

- 4.39 In a notice-filing system, as the Steering Group noted, only the particulars of the charge would be required to effect its registration.⁶² the security agreement itself would not be filed or even sent to the registrar.⁶³ Indeed, if the system is to permit filing in advance of any security agreement being created, there might be no security agreement against which the accuracy of the financing statement could (even theoretically) be confirmed.⁶⁴ There would be no equivalent registrar's certificate.⁶⁵ All that would be required to protect the security is that the required

⁵⁸ Registration of Company Charges para 3.12.

⁵⁹ Registration of Company Charges para 3.13.

⁶⁰ The unimplemented Companies Act 1989, ss 94 and 95 introduced new Companies Act 1985, ss 397 and 399(1), whereby the registrar's certificate was to be conclusive only that the specified particulars were delivered no later than the stated date, and that failure to deliver within the required time would result in invalidity against the liquidator, administrator or any person who for value acquired an interest in or right over property subject to the charge. The registrar's certificate would therefore have become conclusive only as to date of filing, whilst the sanction of invalidity for any breach of the registration requirements would have been retained. The Steering Group put this forward as an important reason for the non-implementation of Part IV of the Companies Act 1989: see Registration of Company Charges para 3.14.

⁶¹ See below, paras 4.199 ff.

⁶² Final Report para 12.20.

⁶³ Although this is not always the case: under the system operating under the PPSA for Manitoba, in the case of corporate securities, the trust deed containing the security interest, or a copy of the bonds, debentures or debenture stock containing the security interest must accompany the financing statement: see s 48(3). The Australian Law Reform Commission also recommended that in the case of securities over company property the documents constituting the transaction would have to be lodged: see ALRC 64, *Personal Property Security* paras 13.13 and 13.23.

⁶⁴ See further below, paras 4.110 ff.

⁶⁵ Although there could be some form of verification statement that the financing statement had been filed. The Steering Group thought that entry on the Companies House register could be conclusive as to the date, and did not think that the issuing of a separate certificate

particulars be filed. The burden of correctly setting out the information shifts from the registrar to the party filing the financing statement. What happens if there are errors in the financing statement?

- 4.40 The starting point of all the systems based on UCC Article 9 is that errors or omissions do not invalidate the filing unless they make the financing statement “seriously misleading”.⁶⁶ The rule for seriously misleading errors seems to be aimed at cases in which it is not reasonably possible to discern from the financing statement who is the debtor or which specific asset is covered (for instance, where the error in the debtor’s name or the description of the asset means that it is not reasonably apparent who or what is meant). In such cases the financing statement will not be validly registered, or will not be valid as against that particular asset.
- 4.41 The test of whether an error is seriously misleading is generally said to depend on whether a reasonable search using the appropriate search terms (for example, the name or number of the debtor) would have revealed the financing statement.⁶⁷ Thus with computerised records what is seriously misleading will depend on the search facilities provided. If, for example, it is easy to search using multiple fields (if there are separate fields for different words from the company’s name and for the company’s registration number), it will be rare that the financing statement will not be discovered, even if the company has changed its name since the financing statement was filed. This approach does mean that as search engines become more sophisticated, fewer errors will be seriously misleading, but that seems an advantage rather than a disadvantage of this approach.

would be necessary: see Final Report para 12.20. We provisionally agree with this view, although there would clearly need to be rules to determine times of filing within the same day, eg, the SPPSA, s 43(2), which provides that registration of a financing statement is effective from the time assigned to it at the registry and, where two or more such statements are assigned the same time, the order of registration is determined by reference to the registration numbers assigned to them at the registry.

⁶⁶ See UCC Revised Article 9, Section 9-506(a); the SPPSA, s 43(6); and the NZPPSA, s 149. The PPSA for Manitoba, s 48(5) provides that “An error of a clerical nature or in an immaterial or non-essential part of a financing statement ... that does not mislead” does not invalidate the registration. See also *ibid*, s 4(2).

⁶⁷ In *Coates v General Motors Acceptance Corporation of Canada Ltd* (case no 21546, 3/12/99), Grist J, sitting in the Supreme Court of British Columbia, provided a summary of applicable principles. He was referring to the registration of serial numbered goods (on which, see below, paras 4.186-4.187) but the principles are of more general application. “1. The test of whether a registration is seriously misleading is an objective one, independent of whether anyone was or was not misled by the search, or whether a search was in fact conducted. 2. Total accuracy in registration by name or registration by serial number is not necessary. 3. A seriously misleading description of either the name or the serial number in the registration will defeat the registration. 4. A seriously misleading registration is one that, (a) would prevent a reasonable search from disclosing the registration or, (b) would cause a reasonable person to conclude that the search was not revealing the same chattel (in the case of a serial number search) or the same debtor (in the case of a name search). The obligation is on the searcher to review the similar registrations to make this determination. 5. Whether a registry filing and search program is reasonable in the sense that its design will reveal simple discrepancies without arbitrary distinction, will not be assessed in determining if a reasonable search would disclose a registration. The only question to be answered is whether a registry search will reveal the incorrect registration.” *Ibid*, para 17. See also *Gold Key Pontiac Buick (1984) Ltd v 464750 BC Ltd (Trustee of)* [2000] BCCA 435.

- 4.42 In the case of minor errors, other creditors are not protected by the invalidity of the incorrectly filed charge. For instance, although this is not the case in every system, in most systems it might not matter that the name of the debtor is given incorrectly or that the asset is wrongly described, provided that the error is not seriously misleading.
- 4.43 Nor will a misdescription of the assets covered invalidate the filing as a whole. What protects the other creditors is that, on the one hand, the chargee cannot claim greater rights than it in fact has under the security agreement and, on the other, if the secured collateral does not fall within the description in the financing statement, it will not be covered (although the correctly described collateral will still be validly covered⁶⁸). Thus if the financing statement lists only one particular class of assets as being subject to the security agreement, whereas the agreement in fact covers a second class also, the chargee cannot claim priority over the second class of assets as against a subsequent chargee who, in reliance on the financing statement, has taken security over the second class of assets. The UCC provides that if a financing statement is incorrect, the secured interest is subordinated in priority to a conflicting perfected security interest to the extent that the latter holder gave value in reasonable reliance on the incorrect information. A purchaser of the secured asset takes free to the extent that it gave value in reasonable reliance on the incorrect information (and received delivery, in the case of certain secured assets).⁶⁹
- 4.44 The UCC provisions just cited may be termed an ‘estoppel’ approach. Such an approach makes it clear that the secured party cannot claim a greater security interest than it has indicated in the financing statement. We wonder whether in addition there should be a provision allowing for damages to be awarded against someone who provides false information to the detriment of another.⁷⁰ Loss and damage to the debtor could be caused, for example, through the filing of an inaccurate financing statement. This might deter other lenders before the debtor finds out and has the offending statement corrected. However, this might be best left to the current law relating to misstatements. We would welcome the views of consultees.
- 4.45 The Steering Group also recommended a criminal sanction to help prevent the provision of false particulars or other information.⁷¹ If this were to apply in the case of deliberate (or possibly reckless) provision of false information, this too would seem to be a useful additional deterrent.
- 4.46 **We would welcome consultees’ views on our provisional proposals to allow for estoppel in relation to seriously misleading (whether intentionally or not) and/or spuriously filed financing statements. We also ask whether**

⁶⁸ Eg, the SPPSA, s 43(9) provides that “Failure to provide a description in a financing statement in relation to any item or kind of collateral does not affect the validity of the registration with respect to other collateral described in the financing statement.” See also the NZPPSA, s 152.

⁶⁹ See UCC Revised Article 9, Section 9-338.

⁷⁰ See Final Report para 12.32. See also the Diamond report para 22.3.3.

⁷¹ See Registration of Company Charges para 3.27.

consultees think that there should be a provision to allow the awarding of damages where loss has been caused by the provision of false information.

4.47 **We would also welcome consultees' views on whether there should be criminal sanctions relating to the provision of false particulars or other information.**

4.48 We therefore provisionally propose following the overseas approach that serious errors or omissions in the financing statement should invalidate the filing. Whether an error or omission was seriously misleading would have to be determined by the courts, although it is possible that guidance could be given in the system itself by deeming that certain errors either were or were not seriously misleading.⁷² Minor errors would not invalidate a filing but the secured party would not be able to claim a greater right than was claimed in the financing statement or was in fact given by the security agreement, whichever is the lesser.

4.49 Several of the overseas systems have a provision that an error may be seriously misleading even though no one actually was misled.⁷³ An advantage of such a provision is that it acts as a discipline to encourage the party filing the financing statement to ensure that the particulars were accurate. The alternative would be to have a provision that an error would not seriously mislead someone searching the register where it was actually known by that person to be an error, or that a seriously misleading error would actually have to prejudice the person claiming to be misled. **We welcome the views of consultees on whether a person must actually have been misled in order for an error to be seriously misleading, and whether that person should actually have been prejudiced by such an error.**

⁷² The overseas systems do not go this far, although they do provide some guidance. See, eg, Section 9-506(b) of UCC Revised Article 9, which provides that a financing statement that fails sufficiently to provide the name of the debtor (in accordance with Section 9-503(a)) is seriously misleading (but see also Section 9-506(c) and Section 9-507); there may still be dispute over what constitutes "sufficiently". The PPSA for Manitoba, s 48(6) provides that an error in the spelling of any part of the name of a debtor invalidates the registration unless a judge or court is of the opinion that it did not actually mislead anyone whose interests are affected by the registration. The NZPPSA, s 150 provides that "a registration is invalid if there is a seriously misleading defect, irregularity, omission, or error in (a) the name of any of the debtors required by section 142 to be included in the financing statement other than a debtor who does not own or have rights in the collateral; or (b) the serial number of the collateral if the collateral is consumer goods, or equipment, of a kind that is required by the regulations to be described by serial number in a financing statement." However, although the title to this section is "When financing statement seriously misleading" (sic), the wording of the section does not really assist on this matter: it does not provide that an error in the name of the debtor, for example, *is* seriously misleading, but rather than an error in the name will result in invalidity *if* it is seriously misleading; there is no actual help to the court in determining what "seriously misleading" means. A similar sort of provision exists in the SPPSA, s 43(7).

⁷³ See, eg, the SPPSA, s 43(8), and the NZPPSA, s 151. However, cf the PPSA for Manitoba, s 48(6): an error in the spelling of any part of the name of a debtor invalidates the registration unless a judge or court is of the opinion that it did not actually mislead anyone whose interests are affected by the registration. See also Section 9-506(b) of UCC Revised Article 9.

- 4.50 The effect of having such provisions, in the absence of any form of conclusive certificate, would be that the liquidator, administrator or other creditors could challenge the validity of the financing statement on the grounds that it contained a seriously misleading error. In other words, when a party is contemplating lending money to a company, it would have no ‘guarantee’ that its security would be virtually unimpeachable on an insolvency (unlike under the current scheme). Would this risk deter lenders? As an overstatement of the chargee’s rights would not normally be seriously misleading, given that the chargee could not claim any greater right than is in fact given under the security agreement, we think that the sanction would apply only in extreme cases. **We provisionally consider that the absence of a conclusive certificate is unlikely to deter lenders.**

Should any new notice-filing system be compulsory?

- 4.51 There are two aspects to the question of whether any new system should be compulsory. First, should compliance be compelled through the threat of criminal sanctions? Secondly, should there be civil ‘sanctions’ for not complying with the system? In summary, we provisionally think failure to participate in the system should not be a criminal offence, but that non-compliance should give rise to consequences relating to the validity of the charge as against third parties.

Criminal sanctions

- 4.52 Under the current law, there is a duty on a company to register the charges it creates, default being punishable with a fine.⁷⁴ Both the Crowther and Diamond reports suggested that their proposed notice-filing systems should be voluntary.⁷⁵ The Steering Group indicated in its Final Report that it thought that it would be unnecessary to have a criminal sanction for failure to register a charge, as did a majority of those who responded to the earlier consultation document.⁷⁶
- 4.53 These proposals might seem contrary to the aim of ensuring that the register gives the public warning of the existence of security interests over the company’s property. However, if as we propose below the sanction of invalidity is retained, the secured party who does not file will not, in the event of insolvency, be able to enforce the security against other creditors, whether secured or unsecured. Thus it is not clear that third parties will be prejudiced, and therefore a criminal sanction seems not to be justifiable. Therefore we provisionally agree with the suggestions noted above. Providing that there are commercial consequences for not filing along the lines of those we suggest in the paragraphs below, it seems to us to be unnecessary generally to impose criminal sanctions for failing to file a financing statement.⁷⁷

⁷⁴ Companies Act 1985, s 399.

⁷⁵ The Crowther report noted that it should be for the secured party to take the commercial decision whether to risk subordination of her interest to a subsequent purchaser: see the Crowther report para 5.7.48. See also the Diamond report paras 9.8.1 and 11.3.9.

⁷⁶ Final Report para 12.48.

⁷⁷ Although we think there should be a criminal sanction for the deliberate or reckless filing of false information: see above, para 4.47.

- 4.54 **We ask consultees whether they agree with our provisional view that there should not be a criminal sanction for failing to file a financing statement (in other words, that participation in the system should be voluntary).**

Filing and the sanction of invalidity.

- 4.55 The Steering Group noted in its Final Report that under its proposals for a notice-filing system the effect of failure to file a financing statement would be that, on the debtor's insolvency, the charge would be invalid against the liquidator and unsecured creditors.⁷⁸ In addition, even before insolvency, a creditor who does not file risks loss of priority as against subsequent holders of security who file first. We think that the rules should make it clear that failure to file would also lead to a loss of validity of the security as against an administrator. As at present, we think that the charge should still be enforceable against the company by the chargee.
- 4.56 Under the overseas notice-filing systems, failure to perfect the security interest⁷⁹ renders it invalid, as against unsecured creditors, in the event of the debtor's insolvency; and makes it vulnerable to loss of priority as against other secured creditors. The SPPSA, for example, contains an express provision that a security interest in collateral is not effective against a trustee in bankruptcy⁸⁰ or a liquidator, if the security interest is unperfected on the day that the bankruptcy or winding up order is made.⁸¹ As against other secured creditors, the effect of failure to perfect a security interest is a priority point.⁸²
- 4.57 The question of filing would therefore become a commercial decision rather than one of statutory compulsion, but this would not prejudice other secured creditors. It would mean that the Company Charges Register was not necessarily a complete record of the securities created by the company. However, it is not a complete record under the present law, as many charges (let alone quasi-securities) are not registrable. We expect secured creditors would seldom choose not to register.
- 4.58 **We are provisionally of the view that the effect of a failure to file should be invalidity against an administrator and liquidator, and a loss of priority against a subsequent secured creditor who files first. We would welcome consultees' views.**

Supply of information to other parties

- 4.59 If the filing of a financing statement does not provide a great amount of detail about the security interest (being rather a way of notification of the existence of such an interest), and if the filing of a financing statement is in any event voluntary, should any new system provide for the disclosure of additional

⁷⁸ Final Report para 12.44.

⁷⁹ Possessory security interests are perfected by possession. In the UCC security interests over investment securities are perfected by 'control'. On this, see further below, paras 5.29-5.34.

⁸⁰ This reflects the fact that the overseas systems apply to all forms of debtor, and not just companies.

⁸¹ SPPSA, s 20(2).

⁸² See below, para 4.120.

information about the matters referred to in the financing statement or about charges over company property? In considering this issue, it is necessary to separate the giving of information to other parties with interests in the assets concerned (typically other secured creditors) from the giving of information to members of the public who have no current interest in the company's assets (such as potential creditors or investors).

Other parties with interests in the property affected

- 4.60 The Diamond report referred to the Canadian Uniform Personal Property Security Act and noted that, as the financing statement only provided minimal information and did not show whether a security agreement had actually been entered into, an important part of that registration system was that those with a legal or equitable interest in the collateral should be able to demand from the secured creditor information as to the amount due and the property subject to the security interest.⁸³ Implicitly approving the Canadian provisions, the Diamond report also suggested that the system it was proposing should expressly state that the secured party should be estopped from denying the accuracy of its statements when responding to a request for information.⁸⁴
- 4.61 The systems in Saskatchewan and New Zealand are similar in this respect. A debtor, creditor⁸⁵ or person with an interest in the personal property of the debtor (or an authorised representative) may make a demand for certain information.⁸⁶ The information that can be requested is generally one or more of the following: a copy of the security agreement that provides for the security interest; a written statement of the amount and terms of payment of the indebtedness; a written approval or correction of an itemised list of personal property attached to the demand, indicating which items are collateral; a written approval or correction of the amount and terms of payment of the indebtedness; and sufficient information as to the location of the security agreement (or a copy of it) to enable a person entitled to receive a copy of the security agreement to inspect it.⁸⁷ The secured party has 10 working days to comply,⁸⁸ and a court order may be obtained to

⁸³ It was noted that the court has the power to enforce that obligation, and that failure to comply, or the provision of incorrect information, renders the secured party liable for any foreseeable loss incurred as a result. See the Diamond report paras 18.6.1-18.6.2.

⁸⁴ Diamond report para 18.6.3.

⁸⁵ In New Zealand, the statute refers only to "judgment creditor": see the NZPPSA, s 177.

⁸⁶ See the NZPPSA, s 177, and the SPPSA, s 18(1) (under which a sheriff is also listed as a person who may make a demand). A person with an interest in personal property of the debtor is only entitled to make a demand with respect to a security agreement that provides for a security interest in the property in which she has an interest: see the SPPSA, s 18(3).

⁸⁷ See the SPPSA, s 18(2). See also the NZPPSA, s 177. The Australian Law Reform Commission recommended that lenders who chose to register their securities should be required to provide copies of the security instruments if a reasonable request were made: ALRC 64, *Personal Property Security* para 13.23. This was subject to the question of privacy, and in the case of a debtor who was an individual, the debtor's consent would be required before the information was to become available: *ibid*, para 13.24.

⁸⁸ NZPPSA, s 178; SPPSA, s 18(6).

compel performance.⁸⁹ Failure without reasonable excuse to comply with the demand, or the provision of incomplete or incorrect information, entitles the person demanding the information to apply to the court to compel compliance.⁹⁰ The court may, amongst other things, declare that in the event of non-compliance with the court order to respond to the demand, the security interest is unperfected or extinguished and that any related registration is discharged.⁹¹ Where the person to whom the demand was made no longer has an interest in the obligation or property of the debtor that is subject to the demand, she must disclose the name and address of the immediate successor and the current successor, if known.⁹²

4.62 It is our provisional view that similar provisions to those in Canada and New Zealand would be needed. However, we are not sure that the secured creditor should be required to produce a copy of the security agreement itself, rather than merely relevant details. The current company charges registration scheme does not permit the instrument of charge to be viewed by persons searching the register, and, whilst a company has an obligation to keep copies of instruments of charges it creates,⁹³ the right to inspect such copies is limited only to existing creditors or members of the company.⁹⁴ We are concerned that a secured creditor might be obliged to produce a security agreement that contains commercially sensitive matter of no relevance to the party seeking the copy of the agreement (although under the current law presumably someone could find this information out from the company by purchasing shares and thus becoming a member of the company).⁹⁵ We ask for views.

4.63 **We are provisionally of the view that the debtor company, and anyone else with an existing interest in the company's property, should be entitled to obtain further information about the security agreement. We have no view as to whether this should include a copy of the agreement itself, or just a more detailed summary of the information it contains, and we would welcome the views of consultees on the question.**

4.64 The Diamond report recommended that there should be provision for an estoppel to operate as to the details contained in the financing statement. In Saskatchewan, though not New Zealand, there is express provision that the secured party who

⁸⁹ See the SPPSA, s 18(8). Under the New Zealand system, the request must be complied with unless exempted by a court order following an application by the secured party: see the NZPPSA, ss 178-179.

⁹⁰ SPPSA, s 18(8); NZPPSA, s 181. If the court is satisfied that it would be unreasonable to comply with the request, it may exempt the secured party from complying with a request in whole or in part, or may extend the time for compliance: see the NZPPSA, s 179.

⁹¹ SPPSA, s 18(12); NZPPSA, s 182.

⁹² NZPPSA, s 183; SPPSA, s 18(9).

⁹³ Companies Act 1985, s 406. We have also already noted that PPSA for Manitoba, s 48(3) requires that in the case of corporate securities, the trust deed or a copy of the bond, debenture or debenture stock that contains the security interest must also be filed.

⁹⁴ Companies Act 1985, s 408(1).

⁹⁵ The unimplemented Companies Act 1989, s 101 created a new Companies Act 1985, s 412, which would have made it compulsory to allow any person to inspect a copy of any charge (and, on payment of a fee, any entry in the company's own register).

replies to a demand is estopped for the purposes of the SPPSA from denying the accuracy of the information or that the copy of the security agreement provided is a true one.⁹⁶ Whilst it may already be the case that estoppel might operate in respect of information given by the creditor as a result of a request for information, we think that a new notice-filing system could usefully make express provision for this.⁹⁷

- 4.65 **We welcome consultees' views on whether an error made in the details by a person who is responding to a request for information should give rise to an estoppel.**

Notice to the wider public

- 4.66 We noted above that one of the aims of a notice-filing system is to provide a degree of public notice of the possible existence of certain encumbrances to those with no existing interests (such as potential creditors and possibly investors).⁹⁸ Would this aim be significantly hampered if there were no means for someone who has no existing interest to discover more details about the security interest than is contained in the financing statement? The financing statement alone may not be sufficient for a commercial decision on whether to invest to be made but it will alert any potential investor to the existence of certain encumbrances on the company's assets. Does the reduction of the quantity of information that will be on the Company Charges Register mean that we need a provision to allow potential investors, and not just parties with existing interests, to obtain information?
- 4.67 Before deciding this issue, however, we need to consider the question of the company's own register of charges, since this provides an alternative source of information.

THE COMPANY'S OWN REGISTER OF CHARGES AND COPIES OF INSTRUMENTS

- 4.68 Under the current law a company is required to keep its own register of all charges over its property, whether or not such charges are registrable at Companies House.⁹⁹ A clear majority of those who responded to the Steering Group's consultation question were in favour of retaining the requirement for companies to maintain registers of their own charges. Nonetheless, in its Final Report, the Steering Group recommended the abolition of the requirement. It noted the statutory right for members and creditors to inspect a company's instruments of

⁹⁶ See the SPPSA, s 18(14); see also ss 18(15) and (16) for provisions dealing with estoppel in relation to successors in interest.

⁹⁷ Where supplementary information has been filed correcting the error, we provisionally think that estoppel would still operate in respect of reliance on the previously inaccurate information prior to the change being made.

⁹⁸ See above, paras 3.4-3.5.

⁹⁹ See above, para 2.30.

charges,¹⁰⁰ but also that abolition would be apparently to the detriment of potential creditors. However, it went on to say that:

in practical terms, a potential creditor can be expected to note the existence of the charges from the information at Companies House and, if it is then refused access to copies of the instruments creating prior charges, it would be able to withhold its proposed loan.¹⁰¹

In the light of this, no further safeguard was felt necessary.¹⁰²

- 4.69 We provisionally think that the argument in favour of abolishing the requirement to keep the company's own register depends very much on what charges or security interests come within the system of filing a financing statement. Under the current registration scheme, the company's own register should record all charges created by the company, and not just those that are registrable at Companies House: it therefore potentially provides a wider source of information about the encumbrances on a company's assets than the Company Charges Register. If there were still to be charges that even under a notice-filing system a company could create that would not appear on the Company Charges Register, and which were not readily discoverable by other means, we would be reluctant to recommend abolition of the company's own register, for to do so would prevent those potential investors who were not members or creditors from having access to a source of information about the company's encumbrances: a potential investor would not know whether to ask to see instruments of charge of which she was not aware. Abolition of the register would remove this source of information.
- 4.70 However, later in this Consultation Paper we provisionally propose widening the list of charges and other security interests that should be registered, so that very few would be omitted save those that a third party is readily able to find out about.¹⁰³ If that were done, the case for retaining the company's own register would be weaker.
- 4.71 **We welcome consultees' views on whether the requirement to register all charges on the company's own register should be abolished.**

THE AVAILABILITY OF INFORMATION TO THE WIDER PUBLIC

- 4.72 As we have noted, under the current scheme, a potential investor can have sight of the Companies Register (which does not contain a copy of the charging instrument) and also the company's own register. However, beyond this, requests to the company would have to be made, failing which, the decision not to invest could be taken. We do not think the situation would be that different under a notice-filing system. The overseas systems we have considered do not provide for additional information to be supplied to the wider public: the list of those who can

¹⁰⁰ Although the right to inspect the instruments (as opposed to the register) does not extend to those who are not members or creditors of the company (contrary to the suggestion in Registration of Company Charges para 3.70).

¹⁰¹ Final Report para 12.68.

¹⁰² Except for a point affecting Scots companies: Final Report para 12.68.

¹⁰³ See below, Parts V and VII.

make a request of the secured party is limited.¹⁰⁴ Other parties may approach the debtor for information and, if the information is not forthcoming, may decide not to deal with or invest in the debtor. Provisionally we agree with this approach, and do not think that there should be provision for a potential investor to demand additional information about the security interest detailed in the financing statement. Our concerns about the availability of commercially sensitive (but irrelevant) information being made available on request are heightened when the requesting party does not have an existing relationship with the company, but is instead a general member of the public.

- 4.73 **We provisionally propose that there should not be a general requirement to provide further information or a copy of the security agreement to a member of the public upon request, but we would welcome consultees' views.**

Other aspects of filing a financing statement

Time allowed for filing

- 4.74 Under the current company charges registration scheme a charge has to be delivered to, or received by, the registrar within 21 days after the date of the charge's creation.¹⁰⁵ Late registration requires the court's permission. Under a notice-filing system, the situation is different. Filing is voluntary and may be done at any time,¹⁰⁶ except that a charge for which no financing statement has been filed will be invalid against other creditors if the debtor goes into administration or insolvency. Thus administration or insolvency acts as a 'cut-off'.
- 4.75 The Crowther report suggested that setting a time limit caused inconvenience and expense and did not appear to serve any useful purpose. It was thought that subsequent encumbrances were adequately protected by the rule giving them priority over a previous unregistered interest.¹⁰⁷ We agree with this. **We provisionally propose that a creditor should not be required to file within a certain time after creation of the security interest.**
- 4.76 There is a question, however, whether the creditor should be free to file at any time before insolvency, or should be prevented from 'last-minute' filing. In other words, should the filing be invalidated if it was not done promptly after the creation of the charge and took place within a certain period before the insolvency?

¹⁰⁴ See above, paras 4.61-4.62.

¹⁰⁵ Companies Act 1985, s 395: see above, para 2.27. There is, however, provision to extend the time for registration or to rectify errors and omissions in the register: see s 404.

¹⁰⁶ The UCC Revised Article 9 has no time limit for filing the initial financing statement (nor did the previous version). However, there are time limits for filing continuation statements before the expiry of the period of validity of the original financing statement: see Section 9-515(d). On the question of the period of validity of an original financing statement, see below, para 4.81-4.86. Similarly, neither the Saskatchewan nor the New Zealand system has a time limit. An earlier version of the PPSA for Ontario imposed a 30 day deadline for filing financing statements after the execution of the security agreement (see the Diamond report para 7.1.4); however, the current 1990 version no longer has such a requirement.

¹⁰⁷ Crowther report para 5.7.54.

- 4.77 The Crowther report proposed that a security interest filed more than 21 days after its execution should be void against the trustee in bankruptcy or liquidator in the event of the debtor becoming bankrupt or going into winding up within three months of the filing, so as to prevent a secured party gaining an unfair advantage over other creditors by deferring filing until the eve of bankruptcy or winding up.¹⁰⁸ Similarly, the Diamond report recommended that although there should be no mandatory requirement to file within 21 days (or at all), a financing statement should not operate to protect a security interest created more than 21 days before the filing if insolvency occurred within 12 months of the date of filing.¹⁰⁹ Twelve months was chosen, rather than the three recommended in the Crowther report, as it was thought that fewer professional advisers would take the risk of deferring filing for the longer period than for the shorter one.¹¹⁰
- 4.78 In its Final Report the Steering Group rejected the idea that a charge should be invalidated if not registered a certain time before the chargor's insolvency.¹¹¹ Insolvency was considered to be a:

defined point of which the world at large, and in particular the Registrar, has notice so that they can determine whether or not the charge may still be registered.¹¹²

As far as secured creditors in general are concerned we see no reason to disagree with this conclusion.¹¹³

- 4.79 We are hesitant, however, where the secured party is connected to the company, in particular a director.¹¹⁴ A director is in a particularly good position to know when a company is approaching insolvency, and might be tempted to take a floating charge to secure money owed to her but (to disguise the company's position) not file until the last minute. This would not prejudice secured creditors who, assuming they have filed, will have priority, but it might well prejudice unsecured creditors who have lent on the assumption that there is no floating charge over the company's assets.¹¹⁵ The Insolvency Act 1986, section 245, provides for the

¹⁰⁸ Crowther report para 5.7.55. The Halliday report para 55 recommended that filing should take place within 21 days of execution.

¹⁰⁹ Diamond report para 11.3.9.

¹¹⁰ Diamond report para 11.3.8.

¹¹¹ Provisions of the Companies Act 1989, if implemented, would have provided that late-registered charges would have been invalidated where insolvency proceedings began within one of several periods varying from six months to two years after the particulars were delivered (depending on the nature of the charge): the Companies Act 1989, s 95 introduced a new Companies Act 1985, s 400. The Steering Group described this unimplemented change as "an unnecessary and undesirable complication in insolvency law." See Registration of Company Charges para 3.9.

¹¹² Final Report para 12.46.

¹¹³ We have sympathy with the Steering Group's suggestion in its consultation document that it would be inequitable to penalise a creditor if the company were solvent at the time the charge was created, and for some time afterwards: see Registration of Company Charges para 3.9.

¹¹⁴ We are most grateful to Dr Sarah Worthington for bringing this point to our attention.

¹¹⁵ See, eg, *Re Fablehill Ltd* [1991] BCLC 830.

avoidance of floating charges created in favour of a connected person within two years of insolvency unless certain conditions are fulfilled (for example, that the charge was for new value received by the company); but this provision relates to the date of creation not the date of filing. In the past, late filing has required the consent of the court, which in the circumstances we envisage would certainly be withheld, but the court's consent will not be needed under notice-filing. We think that there may be a case for preventing last-minute filing by connected persons.

- 4.80 **We provisionally propose that there be no time limit for filing a financing statement, although we invite consultees' views on whether 'last-minute filing' by creditors or connected persons should be permitted, and if so what cut-off period is appropriate.**

Duration of filing

- 4.81 Subject to what is discussed later in this Part concerning the filing of provisional financing statements,¹¹⁶ once a financing statement has been filed, should it remain validly on the register indefinitely, or should it be subject to removal or renewal? Different approaches have been taken to this question by the overseas systems, and by the Crowther, Halliday and Diamond reports.
- 4.82 There is no common approach taken by all the overseas systems. The UCC Revised Article 9 provides generally for a period of validity of five years after date of filing, renewable by the filing of a continuation statement within six months before the expiration of the five-year period. On the expiration of the period of effectiveness, a security interest becomes unperfected.¹¹⁷ The Saskatchewan system provides that registration is effective for the period indicated on the financing statement and may be renewed by filing a 'financing change statement'¹¹⁸ before the registration expires.¹¹⁹ The New Zealand system provides that a registration is effective until whichever is the earlier of either the expiration of the term specified in the financing statement or the expiration of five years after registration, and can be renewed for the shorter of either the period specified in a financing change statement or five years.¹²⁰
- 4.83 The Crowther report had proposed that, as under the version of the UCC Article 9 then in force, filing should be effective for five years and should be renewable for successive five-year periods. Non-renewal would result in the statement being removed on expiration of the five-year period and destroyed. However, in respect of certain types of corporate security, such as debentures and debenture stock, it

¹¹⁶ See below, paras 4.110 ff.

¹¹⁷ UCC Revised Article 9, Section 9-515. There are longer periods for certain transactions: see Section 9-515 (b), (f) and (g).

¹¹⁸ See below, para 4.90.

¹¹⁹ SPPSA, s 44. The PPSA for Manitoba takes a slightly different approach, providing that in the case of corporate securities, there are no time limits set out, although in other cases the time limit is generally three years (but not in the case of instruments, securities, letters of credit, advices of credit or negotiable documents of title): see s 53.

¹²⁰ NZPPSA, ss 153-154.

was recommended that these should be valid indefinitely until vacated.¹²¹ The Halliday report agreed with these proposals, but suggested that there should be provision to renew a statement within six months after its expiration.¹²² The Diamond report, however, suggested following the method adopted by Saskatchewan: that of permitting the parties to specify in the financing statement the period of time for which it is to be effective.¹²³

- 4.84 We agree with the Diamond report that having a five-year period, such as that of UCC Article 9, may put some secured creditors at serious risk of loss due to inadvertently failing to renew the notice.¹²⁴ It seems better to permit the parties to specify in the financing statement the time for which the filing is to be valid.
- 4.85 In an electronic system, the financing statement could contain a box to be completed or ticked to indicate the period of validity, and software could provide for the automatic removal of the financing statement where the period of validity had expired (thus ensuring the removal of outdated information). There would presumably have to be provision for allowing an indication that there was no expiry date where there was no express period of validity agreed between the parties.
- 4.86 **We provisionally propose that a registration be effective for the period indicated on the financing statement.**

The recording of changes to the information filed

- 4.87 After a financing statement has been filed, changes may occur that render the filed information inaccurate: the type or nature of the secured asset may change, the indebtedness under the security agreement may have become wholly or partially discharged, or the debtor or creditor may transfer its interest to another party. Whilst the register may be rendered out of date by such changes, the effect of any resulting inaccuracies - if the register remains uncorrected - will vary. Many would be unlikely to cause any significant prejudice to a potential creditor who is searching the register, but others might do so. If changes have occurred or the indebtedness has been discharged, should the debtor or creditor be required to amend the filed information, or can this be done on a wholly voluntary basis? Under the current law, there is no obligation to register an alteration of an existing charge,¹²⁵ although there is provision for the voluntary delivery to the registrar of memoranda of satisfaction or release.¹²⁶

¹²¹ Crowther report paras 5.7.56 and 5.7.45.

¹²² Halliday report para 56.

¹²³ Diamond report para 11.8.6.

¹²⁴ Diamond report para 11.8.6.

¹²⁵ See Registration of Company Charges para 3.49. However, there is such an obligation in Scotland: Companies Act 1985, s 466.

¹²⁶ Companies Act 1985, s 403. Note that if failure to register a change makes the financing statement seriously misleading then the filing may become invalid: see above, paras 4.39 ff.

4.88 We approach this question by recalling that a notice-filing system is intended to provide only a limited amount of information to a person searching.¹²⁷ We discussed earlier in this Part the minimum information that we thought ought to be included on a financing statement.¹²⁸ The reason for recording changes would be to ensure that the register can still fulfil its ‘warning’ and priority functions.¹²⁹ What changes are likely to be important to a person searching the register? On the basis that the list of particulars is as we have provisionally proposed,¹³⁰ we think that a person searching would want to know if there were important changes to the property covered by the charge (including whether there was indeed a security interest still in existence) or to the parties involved, such as where the charge had been assigned. Minor changes are probably of less importance to the inquirer, given that in any event she will need to seek further information from either the debtor or the secured party.

CHANGES TO THE SECURITY AND TERMINATION OF LIABILITY

4.89 Changes that bring more property within the scope of the charge will not be enforceable by the secured party, in the event of insolvency, unless they are reflected in the financing statement. Nor will they get priority if the property is charged to a subsequent secured creditor. As the Steering Group noted, any addition to the property charged would result in a new charge being created, as would a change to the nature of the charge.¹³¹ It is rather the debtor who may be prejudiced if the range of property covered decreases or the security is terminated altogether but the financing statement remains unaltered. The Steering Group noted that in practice it is common for charges to be satisfied but memoranda not to be filed.¹³²

4.90 How should changes to the security or the termination of liability be dealt with?¹³³ The overseas systems have approached the question of recording changes to the

¹²⁷ The purpose is to provide a warning, rather than a detailed breakdown, of possible encumbrances on a debtor’s assets.

¹²⁸ See above, paras 4.19 ff.

¹²⁹ See above, para 3.4.

¹³⁰ See above, para 4.29.

¹³¹ Eg, a change from a fixed to a floating charge: Final Report para 12.39.

¹³² Registration of Company Charges para 3.52. The Steering Group suggested that the delivery of memoranda of satisfaction (in whole or part) should remain voluntary, on the basis that the only party to suffer was the company itself, as a satisfied charge that was still on the register gave an impression that its assets were more encumbered than they were. In addition, the Steering Group argued that it would be difficult to see how effective sanctions for non-compliance could be imposed, given that the registrar would have no means of knowing that a charge had been satisfied. Whilst the majority of those who responded to the Steering Group’s consultation document supported such filing as being voluntary, there were some who thought it should be compulsory, expressing concern that otherwise the register would give an inaccurate impression to anyone searching it. The Steering Group also proposed that the chargee’s signature should be required on a memorandum of satisfaction, and that the chargor should have the right to apply to the court for an order if the chargee refused to sign (and in such circumstances to be indemnified in costs): Final Report paras 12.41-12.42.

¹³³ The Steering Group suggested that the filing of some changes - assignments, changes to negative pledges and the late introduction of a negative pledge - should be voluntary, but it did not consider that any other change needed to be notified: Final Report para 12.40.

filed particulars (including where there is no outstanding secured obligation) by the use of ‘financing change statements’.¹³⁴ The Saskatchewan and New Zealand systems provide that, where there have been changes,¹³⁵ the debtor,¹³⁶ or any person with an interest in property that falls within the description of the collateral on the financing statement, may give a written demand to the secured party to amend or discharge the registration.¹³⁷ The secured party is given 15 days after the demand in which to comply, failing which¹³⁸ the person giving the demand may register the financing change statement herself.¹³⁹ In the case of certain security interests, different procedures apply.¹⁴⁰

4.91 In addition to the debtor being able to demand a financing change statement be filed, the Saskatchewan and New Zealand systems provide that an amendment to, or discharge of, a registration may be effected by the secured party registering a

¹³⁴ See, eg, the NZPPSA, s 135, which defines a financing change statement as the data required or authorised by the Act and regulations to be entered in the register to renew, discharge, or otherwise amend a financing statement.

¹³⁵ This includes where all of the obligations pursuant to the security agreement have been performed; where the secured party has agreed to release part or all of the collateral described in the financing statement; and where the description of the collateral contained in the financing statement either includes an item or kind of property that is not secured collateral, or does not distinguish between original collateral and proceeds: SPPSA, s 50(3); NZPPSA, s 162.

¹³⁶ Which the Saskatchewan legislation defines, for these purposes, as including “any person named in a registered financing statement as a debtor”. See the SPPSA, s 50(1)(a).

¹³⁷ In order to reflect the terms of the agreement or the collateral description, so as to exclude items or kinds of property that are not secured collateral or to identify items and kinds of property as original collateral or proceeds: SPPSA, s 50(4); NZPPSA, s 163. Similar suggestions for the demanding and lodging of notices of full or partial discharge were made by the Australian Law Reform Commission: see ALRC 64, *Personal Property Security* para 13.18. The Crowther report (based on UCC Article 9 then in force) suggested that the debtor should be able to obtain a termination statement from the secured party, the presentation of which should result in the removal of the financing statement from the file. It was also recommended that where the security is released by the secured party (in whole or in part), the debtor should be entitled to a statement of release, and to have this noted on the file: Crowther report para 5.7.57-5.58. The Diamond report also recommended that there should be similar requirements to those of UCC Article 9: Diamond report paras 18.5.1-18.5.3.

¹³⁸ Or where the secured party does not give to the registrar a court order confirming that the registration need not be amended or discharged (the secured party being permitted to seek such an order under the SPPSA, s 50(7) and the NZPPSA, s 167).

¹³⁹ In Saskatchewan this is done on providing the registrar with proof that the demand has been given to the secured party: SPPSA, s 50(5). In New Zealand the registrar is required to ensure that the secured party is given a notice (as soon as reasonably practicable after the financing change statement is entered in the register) stating that the financing change statement will be registered unless a court order maintaining the registration is served on the registrar within 15 working days of the notice being given to the secured party: NZPPSA, ss 165 and 166. In the case of termination statements, UCC Revised Article 9, Section 9-513 provides that (in cases not involving consumer goods) within 20 days after receiving an authenticated demand from a debtor, the secured party has to cause the party named as the secured party on the original financing statement (the “secured party of record”) either to send the debtor a termination statement for the financing statement or file the termination statement, provided certain conditions are met.

¹⁴⁰ See, eg, the SPPSA, ss 50(8)-(9) and the NZPPSA, ss 164 and 168.

financing change statement at any time during the period of effectiveness of the registration.¹⁴¹

- 4.92 The provisions operating in Saskatchewan and New Zealand are sensible, both for removing filings where there is no outstanding secured obligation and for the recording of other changes. They allow for a chargor to remove inaccurate assertions of indebtedness in a way that reduces the possibility of fraudulent cancellation, whilst providing the chargee with notice of the proposed amendments together with an incentive for it to comply with the procedure through the sanction of obtaining a court order (presumably a costs penalty could result, to give this provision 'bite').¹⁴² **We provisionally propose provisions allowing the debtor to demand that a change in an inaccurate financing statement be made, or an outdated financing statement be removed, by the secured party within a certain period, failing which the debtor may make the change.**

TRANSFERS OF INTEREST

- 4.93 It is possible that the parties to a security agreement may wish to dispose of their interest to another party whilst maintaining the security: the creditor may wish to sell or transfer its secured interest to another, or the debtor may wish to sell or transfer the asset subject to the charge.¹⁴³ In each case the creditor will be concerned also that the charge should not lose its priority. In the case of a security that has been registered under a notice-filing system, a change of either creditor or debtor will mean that the original financing statement is no longer accurate. In this section we consider whether the original filing should have to be amended in the light of such changes. The overseas systems have specific rules relating to the transfer of interests by both the debtor and the secured creditor, although in both cases the onus is on the secured party to take some action to ensure continuity of priority.

Transfers by the secured party

- 4.94 The SPPSA provides that where a secured party transfers its security interest in whole or part, a financing change statement may be registered disclosing the transfer,¹⁴⁴ and in the case of partial transfers describing the collateral in which the interest is transferred. After registration of such a financing change statement, the transferee becomes the secured party for the purposes of registration (and, by extension, the priority) provisions of the legislation.¹⁴⁵

¹⁴¹ See the SPPSA, ss 44(3)-(4), and see the NZPPSA, s 160, which also allows for a statement of discharge to be entered.

¹⁴² There would, in addition, be sanctions for the filing of false information: see above, para 4.45.

¹⁴³ Here we deal only with the disposition of property expressly subject to the charge; the sale of charged property to a purchaser who does not agree to take subject to the charge is considered later in this Part: see below, paras 4.173 ff.

¹⁴⁴ As with a financing statement, a financing change statement disclosing a transfer of a security interest may be registered before or after the transfer takes place: SPPSA, s 45(4).

¹⁴⁵ See the SPPSA, s 45.

- 4.95 In the absence of such a financing change statement the register would be inaccurate, as it would record the wrong name as creditor. This would mean that persons searching the register would not be able to contact the creditor for details of the secured interest (assuming they chose not to contact the company itself¹⁴⁶). Whilst this may not be an overly significant factor (in most cases, information will probably be sought from the company rather than the creditor, and subsequent potential creditors are more likely to be concerned about the nature of the security interest rather than the identity of the holder), it is possible that such an inaccuracy might result in the financing statement being ‘seriously misleading’, or result in an estoppel operating to prevent the unnamed creditor from asserting it was a secured party. Such a result would go towards ensuring the accuracy of the register, and filing such a financing change statement should not be a particularly onerous task for the new creditor to perform. Our provisional view, on balance, is therefore that there should be a similar provision, to enable the ‘new’ creditor to file a financing change statement to amend an existing one.¹⁴⁷ However, filing would not be necessary to preserve either the validity or the priority of the charge.¹⁴⁸
- 4.96 **We ask whether consultees agree with us that there should be provision for the original financing statement to be amended following the transfer of a creditor’s interest over a registrable security interest.**

Transfers by the debtor

- 4.97 Here we are dealing with the transfer by the debtor of its interest so that there is a new debtor in relation to the secured property. This situation is recognised under the current law: the Companies Act 1985 requires that, where a company has acquired property that is already subject to a charge that would require registration had it been created by the company after it acquired the property, it must be registered.¹⁴⁹
- 4.98 Under the SPPSA, where a security interest is perfected by registration, and the debtor transfers all or part of its interest in the collateral, that security interest may be subordinated to other interests perfected or registered following the transfer if the secured party does not take steps to perfect its interest against the transferee. The problem is that when the collateral charged by a company (D1) to a creditor (C1) is transferred to a second company (D2), a subsequent creditor (C2) thinking of lending to D2 may assume that the collateral is unencumbered. There is no problem if a fresh financing statement is filed by C1 against D2 before C2 files.

¹⁴⁶ Such a person might choose initially not to contact the company itself either for reasons of anonymity or possibly as a more independent source of information.

¹⁴⁷ There should always be an existing financing statement where the debtor is a company; if the debtor is not a company, our proposed rules will not apply (at least until any scheme is extended to include unincorporated debtors). For these purposes the legal personality of the creditor is irrelevant.

¹⁴⁸ See below, paras 4.118 ff. The Steering Group recommended that there should be provision for voluntary filing where there was assignment to a new chargee: it was not in favour of having either a criminal sanction or a sanction of invalidity in respect of a failure to file: Final Report para 12.38. The SPPSA, s 23(2) provides that a transferee of a security interest has the same priority with respect to perfection of the security interest as the transferor had at the time of the transfer.

¹⁴⁹ Companies Act 1985, s 400.

However, it would be unreasonable to require C1 to file immediately. C1 is therefore given 15 days' grace. The rules vary according to whether the creditor (C1) has or has not agreed to the transfer. In essence, if C1 has consented, to preserve its priority it must file against D2 within 15 days of the transfer.¹⁵⁰ If C1 did not consent, it has 15 days from when it has sufficient knowledge of what has taken place to file against D2.¹⁵¹ (It may be that the property has been transferred more than once; then the 15 days run from when C1 had knowledge of the most recent transferee who still has the collateral and of anything else C1 needs to know to file; C1 need not bother with intermediate transferees.¹⁵²)

- 4.99 The name of the debtor being wrongly recorded on the register as a result of a transfer would be a more serious inaccuracy than the name of the creditor: it would mean that there was a risk that the existence of security interests would not be revealed on a search of a company name. We therefore think that there should be a similar provision, so that where a company acquires property that is subject to a registrable security interest from the existing debtor (so that it has, in effect, become the new debtor),¹⁵³ a financing statement would have to be filed (where there was no existing filing¹⁵⁴) or an existing one amended in order to preserve priority within the rules of any new system.
- 4.100 The risk of subordination in priority to subsequent security interests would, we provisionally think, provide a powerful incentive to ensure financing change statements were filed in such circumstances. **We would welcome the views of consultees as to whether they think that, on a transfer by the debtor of its interest, the creditor should be given a short period from the transfer (or, if it had not consented to the transfer, from when it knows the facts) in which to file against the transferee.**
- 4.101 Whether the change relates to the nature of the charge or to the parties (through transfer), there is no compulsion on any party to record changes (subject to the procedure for demanding that the creditor file a financing change statement). We do not think that this will mean that changes are not recorded. Generally, it is in the debtor's own interest to ensure that the record of its indebtedness is accurate.

¹⁵⁰ SPPSA, s 51(1). Although the debtor is the one undertaking the transfer, the relative priority of the security interest is more likely to be of concern to the secured party to the debtor.

¹⁵¹ Where the secured party knows the information required to register a financing change statement disclosing the transferee as the new debtor (where the debtor has transferred all or part of its interest), or where the secured party knows the new name of the debtor (where there is a change in the debtor's name), similar rules apply although the 15 days are taken from the date of knowledge: SPPSA, s 51(2).

¹⁵² In such a case, where there are one or more subsequent transfers of the collateral without the consent of the secured party before the secured party acquires knowledge of the name of the most recent transferee, the secured party is deemed to have complied with the requirements of the SPPSA if it registers a financing change statement not later than 15 days after acquiring knowledge of the name of the most recent transferee who has possession of the collateral and the information that is required to register a financing change statement (the secured party need not therefore register a financing change statement with respect to an intermediate transferee): see *ibid*, s 51(4).

¹⁵³ As to the possible range of registrable security interests, see below, Parts V and VII.

¹⁵⁴ Eg, where the purchase was from an unincorporated body that was not subject to the requirement to file a financing statement, being outside the notice-filing system.

In addition, we have considered whether there should be provision for invalidating the financing statement as against third parties where it contains seriously misleading errors.¹⁵⁵ Even if a new notice-filing system were not to have the specific rules relating to subordination that we have considered in the above section, the possibility that a failure to record changes might result in the originally filed financing statement becoming seriously misleading would act as an additional encouragement to the creditor to ensure that significant changes would be recorded.

- 4.102 We consider the use of financing change statements further when we discuss the filing of provisional financing statements in advance of the creation of the charge.¹⁵⁶

Should the financing statement be signed?

- 4.103 As a financing statement may be filed in advance of any security agreement being made, there is always some risk that a party might file a statement which was purely speculative and which might hinder the debtor in raising other finance. It is therefore important to have some means of ensuring that the debtor has consented to the filing. Should this be achieved by requiring that the financing statement be signed by either the chargor or the chargee, or both?

- 4.104 The Crowther report suggested that the financing statement should be signed by the secured party and, where filing takes place before the creation of the security agreement, by the debtor.¹⁵⁷ At the time of the Crowther and Diamond reports, and of the Steering Group's consultation, UCC Article 9 required that the financing statement be signed by the debtor.¹⁵⁸ Although some of the Canadian systems require a signature,¹⁵⁹ UCC Revised Article 9 no longer requires one.¹⁶⁰ Were it desirable to keep the requirement of signature as part of a computerised filing system, some definition of what would amount to 'signature' would have to be developed, but we regard this as a secondary issue.¹⁶¹ The question of whether

¹⁵⁵ See above, paras 4.40 ff.

¹⁵⁶ See below, paras 4.111-4.113.

¹⁵⁷ Crowther report para 5.7.53.

¹⁵⁸ See Section 9-402(1) of UCC Article 9 as in force at the date of those publications. This was presumably for the purpose of preventing fraudulent attempts to remove the registration.

¹⁵⁹ See, eg, the PPSA for Manitoba, s 48(1) (but not where it relates to a corporate security and it is accompanied by the trust deed, bond, debenture or debenture stock containing the security interest: *ibid*, s 48(2)). See also the Personal Property Security Regulations for Saskatchewan, s 7, and the Personal Property Security Regulation for Alberta (AR 95/2001), s 9(1) (although an electronic statement filed is deemed to be signed by the secured party: see *ibid*, s 93), and the Personal Property Security Regulation for British Columbia (BC Reg 279/90), s 15.

¹⁶⁰ See Section 9-502 and Section 9-516 of UCC Revised Article 9. See J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) pp 782-783: "The drafters of Revised Article 9 apparently concluded that the debtor's signature was an unnecessary technicality". We also understand that there may have been concerns over the validity of electronic signatures in an electronic filing system which the removal of the requirement to sign the financing statement overcame.

¹⁶¹ It would be possible, for instance, to require that filing be accompanied by a digital signature of the company or its responsible officer. See the Electronic Communications Act 2000 and (2001) *Electronic Commerce: Formal Requirements in Commercial Transactions - Advice from the*

or not the financing statement should be signed should be determined on the merits and not on a supposed technological question.

- 4.105 The Steering Group in its Final Report opposed a requirement for both the chargor and the chargee to sign the financing statement.¹⁶² Instead, it proposed that if the particulars were filed by someone other than the chargor and the charge has not yet been created, then that party should be required to verify that the chargor has consented to the filing. This would be supported by the proposal for the deliberate filing of inaccurate particulars being an offence.¹⁶³
- 4.106 In our provisional view, there is no need for the financing statement to be signed by either chargor or chargee.¹⁶⁴ We agree that where the financing statement is filed by someone other than the chargor, the person filing should be required to confirm that the filing is being made with the consent of the chargor (for example, by the chargee confirming on the financing statement that the chargor has consented). There should also be a mechanism to ensure that the chargor is aware of the filing after it has been made (for example, by the debtor company being sent either a copy of the filed financing statement or at least notification that such a statement had been filed¹⁶⁵). We agree with the Steering Group that there should be a sanction on a party who deliberately provides false or inaccurate information.¹⁶⁶
- 4.107 We asked earlier in this Part whether there should be a provision for damages to permit the corporate debtor to claim compensation from the person filing false information for damage suffered as a result. Such a provision might be sensible in this context, but we would welcome the views of consultees.¹⁶⁷
- 4.108 **We ask whether consultees agree with our provisional proposal that the signature of both the chargor and chargee on the financing statement should not be required but that:**

Law Commission. Requiring a signature on paper would mean that the system could not be wholly electronic (as we think it should be).

¹⁶² See Final Report para 12.23. It seems from the context that the Steering Group was concerned that to require the chargor's signature might delay filing.

¹⁶³ See Final Report para 12.23. See also above, para 4.45.

¹⁶⁴ The Australian Law Reform Commission also recommended that a signature should not be required: see ALRC 64, *Personal Property Security* para 13.6.

¹⁶⁵ The NZPPSA, s 148 provides that, not later than 15 days after receipt of the verification statement (which under s 145 must be given to the person who registered the financing statement as soon as reasonably practicable after such registration), the secured party must give the debtor a copy of it, unless it has given written waiver. See also the SPPSA, s 43(12), which provides for the secured party to send the debtor a copy of either the financing statement or the verification statement within 30 days of the filing or receipt of the verification statement. Failure to comply with this provision results in the debtor being deemed to have suffered damages of not less than the prescribed amount: see *ibid*, s 65(6).

¹⁶⁶ The Australian Law Reform Commission also recommended that it should be an offence knowingly or recklessly to lodge a false statement, and that the debtor should be entitled to compensation from the person filing for damage suffered as a result of lodging a false statement: see ALRC 64, *Personal Property Security* para 13.8. However, the overseas systems do not generally make express provision for such sanctions, although we presume attempts at fraud would be covered by the general law.

¹⁶⁷ See above, para 4.44.

- (1) **the person filing should be required to confirm that the filing is being made with the consent of the chargor;**
- (2) **there should be a mechanism to ensure that the chargor is aware of the filing after it has been made; and**
- (3) **there should be a criminal sanction on a party who deliberately (or possibly recklessly) provides false or inaccurate information.**

We also ask consultees whether damages should be available for a party that has suffered as a result of this (and, if so, whether this should depend on proof of negligence).

FLEXIBILITY OF NOTICE-FILING

4.109 Under the current registration scheme, registration cannot take place until a charge has been created, and relates to each individual charge transaction. A very important feature of a notice-filing system - and one of its significant potential advantages - is its flexibility as regards future transactions and multiple transactions.

Provisional notice-filing

4.110 The notice-filing systems in operation in overseas jurisdictions generally permit the filing of a financing statement either before or after a security agreement is made.¹⁶⁸ The advantage of filing such 'provisional' financing statements is that, if the security interest is created subsequently, priority is generally backdated to the date of filing. Thus a potential creditor can conduct negotiations with the company in the knowledge that by filing such a provisional financing statement it can preserve its priority against other security interests that might be granted during the conduct of negotiations.¹⁶⁹ Both the Crowther and Diamond reports recommended that filing should be possible even though not linked to an existing security agreement.¹⁷⁰ The Steering Group's Final Report also proposed that particulars could be filed in advance.¹⁷¹ **We provisionally propose that it should be**

¹⁶⁸ See the UCC Revised Article 9, Section 9-502(d); the SPPSA, s 43(4); and the NZPPSA, s 157. At the time of the Diamond report, the PPSA for Ontario did not permit registration in advance of the execution of the security agreement at all (see the Diamond report para 7.1.4), and this is still the case for consumer goods: see s 45(2). However, in the case of collateral other than consumer goods, filing is permitted either before or after the security agreement is signed by the debtor: see s 45(3).

¹⁶⁹ "It is implicit in the statutory requirements of a financial statement that the notice intended should be broad - that it should be a warning, nothing more. The notion of a warning with its underlying purpose of functionality, practicality and versatility is completely compatible with and actually promotes the notion of one financing statement giving notice of either an acquired or a pending security interest as well as of a security interest that was not specifically contemplated at the time of the notice and (it would appear to necessarily follow) of more than one such security interest." *Per Bayda CJS in Agricultural Credit Corporation of Saskatchewan v Royal Bank of Canada SKCA CA94082.*

¹⁷⁰ Crowther report para 5.7.53; Diamond report para 11.2.12. However, the Halliday report was not in favour of such a step: see para 54. It was thought that such a concession might open the way to unjustified or speculative filing (but see the comments on this aspect in the Diamond report para 11.2.11).

¹⁷¹ Final Report paras 12.22-12.23.

possible to file a financing statement before or after a security agreement is made.

- 4.111 As the Steering Group pointed out, where a charge has not in fact been created, it is not in the interest of a chargor company to allow a notice of that non-existent charge to remain filed, as it may affect the company's credit rating and its ability to raise finance.¹⁷² It would therefore be sensible to have some provision for removing such provisional financing statements from the register. The chargor cannot be permitted simply to file a cancellation statement without more because of the risk of a chargor fraudulently cancelling the financing statement for a valid charge. The putative chargee, on the other hand, would have no incentive to incur the time, cost and inconvenience of filing a notice of cancellation in respect of what were ultimately unsuccessful negotiations.
- 4.112 The Steering Group thought that such a problem could be solved either by requiring the filing of a confirmation notice in the event that a charge had been created, or by requiring a cancellation notice in the event that it had not.¹⁷³ The Steering Group preferred the latter approach, on the ground that it was less likely to have to be used than a confirmatory approach. This problem has been addressed in the overseas systems we have considered through the use of financing change statements. As we noted earlier, the Saskatchewan and New Zealand systems allow a debtor, or any person with an interest in property, to give a written demand to the secured party in certain circumstances, one of which is where a financing statement has been registered and no security agreement exists between the secured party and the debtor.¹⁷⁴ Failure to comply can result in the person giving the demand registering the financing change statement itself.¹⁷⁵ We think that a similar provision to that operating in Saskatchewan and New Zealand should be adopted.¹⁷⁶
- 4.113 **We provisionally propose that, where no security agreement exists, the debtor, or any person with an interest in the charged property, should be able to give a written demand to the secured creditor to change a filed financing statement, failing which the person making the demand can make the change itself.**
- 4.114 An additional point arises. The Steering Group suggested that the particulars of the financing statement should include an indication whether a charge has already been created. Such an indication may initially seem attractive, assuming such disclosure would prevent a false impression being given to those assessing the credit worthiness of a company. A company trying to raise finance may conduct negotiations with several potential lenders, each of which might seek to file a financing statement in an attempt to secure priority for any charge created by agreement with the company. Without an indication that a charge does or does not

¹⁷² Final Report para 12.33.

¹⁷³ Final Report para 12.34.

¹⁷⁴ SPPSA, s 50(3)(d); NZPPSA, s 162(d).

¹⁷⁵ See above, para 4.90.

¹⁷⁶ See below, paras 4.152-4.154 on the question of priority of future advances.

exist, the register could give the impression that the company was more indebted than it actually was. If this were the end of the matter we would be provisionally in favour of having such a requirement.

- 4.115 However, we do not think that indicating whether a charge has actually been created at the time of filing would in reality be of much use. Even if such an indication were made there would not be a way of telling the true position from a search of the register. Only half the picture would be revealed: an indication that a charge had actually been created would reveal this fact to a searcher, it is true, but equally an indication on the financing statement that no such charge had been created would not mean that, at the time of searching, there was no charge in existence. A charge might be created between the date of filing and the date of searching but it would not appear on the register as having come into existence. We are provisionally of the view that there should be no requirement to indicate whether or not at the date of filing a charge has in fact been created. As we have noted, the register cannot hope to give a complete picture of the encumbrances that are on a company's assets: all such a system will do is to provide a warning that such encumbrances might exist, and that therefore the person searching should make further enquiries of the company.¹⁷⁷ **We therefore provisionally propose not to require an indication of whether the charge has actually been created at the time of filing, but we would welcome the views of consultees on this point.**

Multiple transactions

- 4.116 A system that permits the filing of a financing statement in advance of the creation of a security interest enables a single filing to be made in respect of a number of secured transactions between the same parties.¹⁷⁸ This could greatly ease the administrative burden of dealing with such a succession of security interests, all of which, under the current scheme, would need to be individually registered. The New Zealand and Saskatchewan systems generally permit the financing statement to relate to one or more agreements, in addition to providing for such statements to be filed whether or not the security agreement has been executed.¹⁷⁹ The Diamond report suggested that this flexibility would allow for the turnover of shares in a portfolio,¹⁸⁰ a point which generated some discussion in the Steering Group's consultation document and to which we return later.¹⁸¹

¹⁷⁷ Whilst it would be possible additionally to require that where a financing statement had been filed in advance of the creation of a charge, subsequent confirmation should be made where the charge was in fact created at a later date, this would seem to negate the whole point of allowing notice-filing in advance of creation, and render the system more akin to a transaction registration scheme, with details of each individual transaction having to be supplied.

¹⁷⁸ See the Diamond report para 11.2.13.

¹⁷⁹ NZPPSA, s 147; SPPSA, s 43(5).

¹⁸⁰ Diamond report para 11.2.13.

¹⁸¹ See below, paras 5.18 ff. However, we suggest that a charge over shares should not generally be registrable.

- 4.117 **We ask consultees whether they agree that an important advantage of notice-filing would be that it would permit a single filing to cover a series of security transactions between the same parties.**¹⁸²

PRIORITIES

- 4.118 In this section we consider how any new system of notice-filing should deal with the question of priorities between competing secured interests. We noted earlier in this Consultation Paper¹⁸³ that one aim of any new system of notice-filing should be to set out a clear and secure system of priorities as between registrable charges.¹⁸⁴ The overseas notice-filing systems include specific rules setting out the priority position for a number of situations.
- 4.119 The UCC approach is that for registrable security interests that have already been created, filing both perfects the security and, in general,¹⁸⁵ ensures its priority over security interests that are only perfected later. (We also saw earlier that filing may take place in advance, in which case the security has priority as from the date of filing.¹⁸⁶) Neither the distinction between legal and equitable interests nor notice (whether actual or constructive) has any role to play.¹⁸⁷ This approach has been followed in the Saskatchewan and New Zealand systems and was advocated in the Diamond report.¹⁸⁸ In this section we begin by briefly considering any specific consequences of not filing a financing statement. We go on to consider the impact of notice-filing on priority disputes as between registrable company charges (considering both fixed and floating interests), and as between registrable and unregistrable interests. We also consider the position of innocent purchasers of assets that have been charged.

Consequences of non-registration under a notice-filing system

- 4.120 As we noted earlier, failure to perfect the security interest renders it invalid, as against unsecured creditors, in the event of the debtor's insolvency; and makes it vulnerable to loss of priority as against other secured creditors.¹⁸⁹ The SPPSA expressly provides that a security interest in collateral is not effective against a trustee in bankruptcy or a liquidator, if the security interest is unperfected on the

¹⁸² If a functional approach were to be taken as to what should be registrable under a notice-filing system (see below, Part VII), this flexibility would also permit a 'Romalpa seller' contemplating the supply of goods over a period of time to file a single financing statement in respect of an unlimited and unspecified number of future advances. See M Bridge, "Form, Substance and Innovation in Personal Property Security Law" [1992] JBL 1, 15.

¹⁸³ See above, para 3.5.

¹⁸⁴ And, depending on the scope of the system, quasi-security interests: see below, Part VII.

¹⁸⁵ The UCC requires filing for security interests but then for purposes of priority distinguishes between purchase-money and non-purchase-money security interests. See below, paras 4.155 ff.

¹⁸⁶ See above, para 4.110.

¹⁸⁷ The overseas systems make it clear that registration of a financing statement does not amount to constructive notice or knowledge of its existence or contents: see, eg, the SPPSA, s 47.

¹⁸⁸ Diamond report para 11.9.5.

¹⁸⁹ See above, para 4.56.

day that the bankruptcy or winding up order is made.¹⁹⁰ As against other secured creditors, the effect of failure to perfect a security interest is not that it is invalid as against them¹⁹¹ but that, unless the matter is dealt with by one of the specific rules, a perfected security interest will take priority over an unperfected one.¹⁹² As between two competing unperfected interests, priority is determined by date of attachment.¹⁹³

Priority as between registrable interests under a notice-filing system

- 4.121 A noticeable difference between the priority rules of these systems and current English law is that these systems do not distinguish between fixed and floating charges for the purpose of the application of their rules on priority. In the following sections we consider how such a system would affect holders of fixed security interests, and then go on to examine the more difficult issue of the effect of a notice-filing system on the floating charge.

Priority as between fixed registered interests

- 4.122 Where priority disputes arise between security interests for which a financing statement has been filed, the determination of priorities in the overseas notice-filing systems is generally based on the date of filing of a financing statement, rather than the date of the creation of the security interest.¹⁹⁴ This 'residual'¹⁹⁵ rule will in certain cases be overridden by specific provisions.¹⁹⁶ Save in relation to the purchase-money interest (an important exception which we deal with later in this Part), these specific provisions are not, we think, relevant to the limited notice-filing scheme for only company charges that we are considering in this Part.
- 4.123 Thus as between creditors each claiming a registrable fixed charge on the same property, priority of the competing claims would generally depend on the date of filing. Prior knowledge of the existence of a security interest would be irrelevant, and determining priority would therefore generally be a matter of comparing the dates of filing of the respective financing statements.

¹⁹⁰ SPPSA, s 20(2).

¹⁹¹ Compare the current English law: see above, para 2.28.

¹⁹² See UCC Revised Article 9, Section 9-322(a)(2); the SPPSA, s 35(1)(b), and the NZPPSA, s 66(a).

¹⁹³ See the SPPSA, s 35(1)(c) and the NZPPSA, s 66(c) and UCC Revised Article 9, Section 9-322(a)(3).

¹⁹⁴ See UCC Revised Article 9, Section 9-322(a)(1); the SPPSA, s 35(1)(a), and the NZPPSA, s 66(b)(i). These sections also allow for perfection by possession to be determinative of priority. The time of registration of the security interest is also taken to be the time of registration in respect of proceeds: see the SPPSA, s 35(3), and the NZPPSA, s 68. On the question of 'proceeds', see below, para 4.163 ff.

¹⁹⁵ See the SPPSA, s 35(1): "Where this Act provides no other method ...", and the NZPPSA, s 66: "If this Act provides no other way ...".

¹⁹⁶ All the overseas systems have specific rules dealing with particular situations: in Saskatchewan, for example, there are specific priority rules for liens, fixtures, crops, accessions, processed or commingled goods, and purchase-money security interests.

4.124 Determining priority by date of registration would be a significant difference to the current scheme under the Companies Act 1985.¹⁹⁷ Another fundamental difference between the existing registration scheme and the notice-filing system would be that a financing statement may be filed and priority secured before the charge is created.¹⁹⁸ We have already explained why we think this would be advantageous.

Priority as between fixed and floating registered interests.

4.125 Adoption of the priority rules under the overseas notice-filing systems would have - at least in theory - a significant impact on a floating charge. As we shall shortly see, it will involve a move away from the importance of crystallisation in the determination of priority.

THE CONCEPT OF A 'FLOATING' INTEREST UNDER THE UCC

4.126 The UCC Revised Article 9 does not recognise a floating charge but does incorporate a floating lien concept, that is, a fixed charge with provision for subordination. Thus Section 9-204 permits a security interest to operate over after-acquired property (except for consumer goods). Section 9-205 validates a provision giving the debtor liberty to use, commingle or dispose of all or part of the collateral. These provisions can be said to have conceptual parallels to the floating charge.¹⁹⁹

4.127 We consider that there is a clear need for a form of security interest that, like the floating charge, permits the company to dispose of its assets in the ordinary course of business without obtaining the consent of the creditor for each disposal.²⁰⁰ The Crowther report suggested that this be achieved by adopting the American concept of a fixed charge over shifting security. This would suggest that there would be no need to preserve the floating charge as a security device, but the Crowther report thought that it should remain, given that this form of security is so widely used.²⁰¹ The Diamond report also suggested that "the floating charge or something like it is here to stay."²⁰² Its existence is connected to the question of preferential debtors (which we discuss below). The question then is how to accommodate the concept of a floating charge within a new notice-filing system.²⁰³

¹⁹⁷ Although we have already noted that priority by date of registration already operates under the provisions of some of the specialist registers: see above, paras 2.49 ff, and see further below, paras 4.199 ff.

¹⁹⁸ See above, paras 4.110 ff.

¹⁹⁹ It has been noted that, in America, the development of equitable floating charges was arrested by judicial hostility: I Davies, "Floating charges and reform of personal property legislation" [1988] *Company Lawyer* 47, 48. As Gilmore points out, if floating charges had become common in America some of the pressure for change which brought about Article 9 would have been absent: G Gilmore, *Security Interests in Personal Property* (1965) pp 359-361.

²⁰⁰ As is the case with a floating charge: see above, paras 2.16-2.17.

²⁰¹ Crowther report para 5.7.77.

²⁰² Diamond report para 16.7.

²⁰³ The Halliday report seemed to suggest that the floating charge should exist outside any new comprehensive scheme covering personal property and security: see para 60(3), and see the comments on this in the Diamond report para 16.8.

THE POSITION OF THE FLOATING CHARGE UNDER A NOTICE-FILING SYSTEM

- 4.128 In terms of priority, the essential difference in principle between the floating charge and the fixed security interest on shifting assets operating under the UCC is that under the UCC the time when the charge crystallises does not determine the priority position of the secured party. Indeed the UCC does not recognise the concept of crystallisation (although presumably under the fixed charge over shifting assets there must come a time when the debtor is no longer free to dispose of the property subject to the security interest²⁰⁴). Under UCC Article 9, priority is determined from the date of filing of the financing statement.²⁰⁵ This obviously gives the floating lien a stronger position than a bare floating charge as it operates in England and Wales, which until the point of crystallisation will always rank behind a later created fixed charge.
- 4.129 However, in current practice, floating charges often appear with negative pledge clauses,²⁰⁶ which, if effective as against subsequent secured parties, give priority to the floating charge even before it crystallises. It is true that there is doubt about the effectiveness of negative pledges, in that noting them on the current particulars filed with the registrar may not give constructive notice of them, but a subsequent chargee who in fact discovers the existence of the clause will take subject to it. In Scotland negative pledge clauses must be mentioned in the particulars registered,²⁰⁷ which position the Diamond report recommended should be introduced for England and Wales.²⁰⁸
- 4.130 This means that, in practice, there would be little difference between a floating charge with a negative pledge clause and the fixed charge over shifting assets

²⁰⁴ It is the ability of the chargor company to carry on its business in the ordinary way regarding the particular class of assets that is subject to the floating charge that is regarded as the 'hallmark' of the floating charge: see *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 718. See also *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2001] 3 WLR 1347, 1359. This concept does not seem to be specifically addressed in the overseas legislation. There may also be an issue as to whether an execution creditor may seize goods that are covered by a floating lien. Currently an execution creditor may take goods that are subject to an uncrystallised floating charge, as the secured creditor is not regarded as having rights over any specific item: see R Goode, *Commercial Law* (2nd ed 1995) p 742. In the UCC Revised Article 9 the implication is that the 'judgment lien' takes priority: see J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) p 841. The same result has been reached under the Ontario PPSA: see G McCormack, "Personal Property Security Reform in England and Canada" [2002] JBL 113, 121. However these results seem to follow from a definition of attachment that covers all goods currently owned by the debtor, rather than from the adoption of notice-filing in itself. See further below, Appendix B paras B.9-B.11.

²⁰⁵ The Australian Law Reform Commission also recommended that a registered floating charge should take priority from the date of registration: see ALRC 64, *Personal Property Security* para 8.37.

²⁰⁶ So-called 'lightweight floating charges' that are solely for the purpose of giving the floating charge-holder the right to appoint an administrative receiver and thus to block an administration order (see, eg, *Re Croftbell Ltd* [1990] BCLC 844) may not contain a negative pledge clause, but we understand that in cases in which the charge-holder is looking to the charge to provide security in any real sense, a negative pledge clause is almost invariable.

²⁰⁷ Companies Act 1985, s 417(3)(e).

²⁰⁸ Diamond report para 16.10 The unimplemented Companies Act 1989, s 103 would have substituted a new Companies Act 1985, s 415(2)(a), allowing a negative pledge to be one of the prescribed particulars.

recognised under the UCC. We would expect companies to continue to use the floating charge. The rule of priority of such a charge under a notice-filing system would in theory be different, in that it would date from the date of filing, but in practice the effect would be the same as if the charge, with its negative pledge clause, were registered under the current system.

- 4.131 The Insolvency Act 1986, section 175 provides that in a winding up preferential debts are to be paid in priority to all other debts, and that they rank equally amongst themselves after the expenses of the winding up (or abate in equal proportions), and that they have priority over the claims of floating charge-holders (and that they shall therefore be paid out of any property comprised in or subject to that charge). The categories of preferential debt are set out in the Insolvency Act 1986, Schedule 6, and fall into six categories: debts due to the Inland Revenue; debts due to Customs and Excise; Social Security contributions; contributions to occupational pension schemes; remuneration of employees; and levies on coal and steel production. The Enterprise Bill proposes to abolish the Crown's preferential status in relation to debts due to the Inland Revenue or Customs and Excise, and in relation to social security contributions.²⁰⁹ However, preferential status will be retained for contributions to occupational pension schemes; remuneration of employees for the relevant period; and levies on coal and steel production.
- 4.132 The Enterprise Bill also proposes to insert a new Insolvency Act 1986, section 176A, providing for a percentage share of the company's assets to go to unsecured creditors, although the percentage will be set by Statutory Instrument, and the Explanatory Notes indicate this is to be the subject to consultation.²¹⁰
- 4.133 Since a charge that permits the debtor to dispose of the assets in the ordinary course of business free of the charge may still be described accurately as a floating charge, it would still be subject to the provisions of the Insolvency Act 1986 requiring that preferential creditors be paid before the floating charge-holder, but if preferential debts are to be retained it would be sensible to provide this expressly in order to avoid any doubt. The same applies to the provisions for the avoidance of certain floating charges contained in the Insolvency Act 1986, section 245.
- 4.134 We consider, however, that one change to the existing notion of a floating charge would have to be made. As we saw in Part II, the reason that a subsequent fixed charge can gain priority over an earlier floating charge is that the creation of subsequent fixed charges having priority is, in the absence of a negative pledge clause, treated as being in the ordinary course of the company's business.²¹¹ If this were to remain the rule, floating charges would continue to lose any priority they

²⁰⁹ Clause 242.

²¹⁰ Clause 243. The explanatory notes indicate that where a company has gone into liquidation, administration, provisional liquidation or receivership, the office-holder will, after taking account of preferential debts, fixed charges and realisation costs, make part of the company's property available to unsecured creditors, although it will not be necessary to distribute funds to unsecured creditors if they are less than the prescribed minimum, and the office-holder thinks that the cost of making a distribution would be disproportionate to the benefits.

²¹¹ See above, para 2.40.

might have through prior filing to subsequent fixed charges. That would defeat the aim of devising a simpler system of priority determined principally by the date of filing.

- 4.135 There are two ways in which this could be prevented. The first is to require that the financing statement reveal whether or not the agreement contains a negative pledge clause and to provide that all subsequent creditors are deemed to have constructive notice of any clause mentioned. No doubt floating charge-holders would very quickly include negative pledge clauses in all floating charges²¹² and file accordingly. We wonder whether the Steering Group had such a solution in mind when it made a recommendation that it should be possible to make a voluntary indication of whether the floating charge was subject to a negative pledge.²¹³
- 4.136 However, to rely on this mechanism is to re-import the doctrine of notice just at the moment that we are trying to move away from that doctrine to a simpler system. It is our provisional but strongly held view that it would be better to provide simply that a floating charge does not give the company authority to create subsequent security interests having priority to the floating charge.²¹⁴ This appears to be the effect of the provisions of the UCC quoted earlier.²¹⁵ no mention is made of power to create further security interests.²¹⁶ If the parties desire to alter the order of priority it can be achieved by a subordination agreement between the floating charge-holder and the second creditor.
- 4.137 Our proposal to limit the company's authority to create charges that might rank ahead of the floating charge should apply not only to fixed charges but also to pledges. This too is consistent with the priority rules of the notice-filing systems used elsewhere. As between a security perfected by filing and one perfected by possession, priority will go to the one that is first to file or to perfect by other means.²¹⁷
- 4.138 It should be noted that even with our provisional proposal to limit the company's authority to create fixed charges that would automatically get priority over the earlier floating charge, the special priority position given to the purchase-money interest (which we discuss below) would mean that such purchase-money interests granted by the company would have priority over an earlier filed floating charge (as

²¹² As administrative receivers are likely to be abolished under the forthcoming Enterprise Bill, 'lightweight' floating charges created solely to give the right to appoint a receiver and thus to block an administration order are also likely to disappear.

²¹³ Final Report para 12.26.

²¹⁴ And perhaps that a provision to this effect will be invalid.

²¹⁵ See above, para 4.128.

²¹⁶ As the Official Comment to Section 9-204 makes clear, the purpose of this Article was to prevent arrangements which give the debtor unfettered control over the collateral from being held void.

²¹⁷ UCC Revised Article 9, Section 9-322(a). This is a change from the 1962 version that was criticised by the Crowther report at Appendix III para 17, and achieves the result that the Crowther report recommended.

well as earlier fixed non-purchase-money interests). To this extent, the basic ‘first to file’ priority rule would be abated.²¹⁸

FLOATING CHARGES AND THE FINANCING STATEMENT

- 4.139 Earlier in this Part we discussed what details should be included on the financing statement.²¹⁹ The Steering Group suggested that the nature of the charge - whether it was fixed or floating - should be included on the financing statement. When it consulted on this proposal, some respondents expressed the view that this might be a difficult particular to require (particularly if there were to be some form of sanction in the case of error²²⁰), given the difficulties that have been experienced in practice in identifying a fixed charge from a floating charge.²²¹
- 4.140 Whilst we agree that it would be harsh if the charge were rendered invalid because of a difficulty in identifying accurately its nature led to the financing statement being incorrect, we do not see that this would occur under a notice-filing system. As we have already noted, we only envisage the sanction of invalidity operating in respect of errors that are “seriously misleading”.²²² It is hard to see that an error in the description of the nature of the charge would be seriously misleading. If it were stated to be fixed when it was in fact floating, a later creditor would not be prejudiced, since it could not be enforced as a fixed charge. Conversely, if what was stated to be a floating charge were in fact a fixed charge, it could only be enforced as a floating charge; the chargee would be estopped from claiming beyond what was registered.²²³
- 4.141 It is true that if our proposals above are accepted, priority of both sorts of charge would normally date from the time of filing (rather than, in the case of a floating charge, from crystallisation) and the difference between the two sorts of charges will be reduced for the purposes of determining priority as against subsequent security holders. However the information will be of use to a potential buyer if, as we propose later, a purchaser of the property subject to a filed security interest should bound by it.²²⁴ If the charge is stated to be a floating charge the purchaser can be confident that, provided the sale is in the ordinary course of business, she will take free of it.
- 4.142 **Do consultees agree with our provisional views that a floating charge should no longer give a company authority to create subsequent fixed charges that automatically get priority over an earlier floating charge; and**

²¹⁸ See below, paras 4.155 ff.

²¹⁹ See above, para 4.19 ff.

²²⁰ On this point, see above, paras 4.51 ff.

²²¹ Eg, the question of whether a charge was fixed or floating was again considered in the recent Privy Council decision in *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710. See also *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 3 WLR 1347.

²²² See above, paras 4.39 ff.

²²³ See above, para 4.44.

²²⁴ See below, paras 4.173 ff.

that the financing statement should indicate whether the charge is fixed or floating (or both)?

4.143 The Steering Group also proposed that the financing statement should indicate whether there was an automatic crystallisation clause.²²⁵ As our provisional view is that if priority is determined by date of filing, rather than date of crystallisation, there seems little need to make this a mandatory requirement for the purposes of priority. However, a problem may remain in relation to potential purchasers of assets who wish to know whether the company still has authority to sell the asset in the ordinary course of its business.²²⁶ If there is an automatic crystallisation clause and the crystallising event occurs, the company's authority ceases. If buyers have no means of knowing that the company's authority to sell has been withdrawn, they will take free of the charge in any event; but there will often be scope for arguments that the buyer will prefer to avoid. It might therefore be better to require filing of automatic crystallisation and to provide that until notice is filed purchasers will continue to take free of the charge. In other words, we do not think that it is necessary to register the existence of an automatic crystallisation clause, but we do think that it should be necessary to register the fact in the event that such a charge has crystallised if the charge-holder wishes to rely on it.

4.144 **We ask consultees whether they agree with our provisional recommendation:**

- (1) not to require inclusion of the nature of the charge and/or whether there is an automatic crystallisation clause in the financing statement, and**
- (2) to register the fact that a floating charge has crystallised pursuant to an automatic crystallisation clause.**

Priority as between pledges and interests protected by filing

4.145 A possessory security - in effect, the pledge - is perfected by the pledgee taking possession, and the pledgee will have priority over any subsequently filed charge. We have already noted that under the priority rules of the notice-filing systems we have examined, it appears that a pledge would not have priority over a floating charge that was registered before the pledge was perfected by the pledgee taking possession. The same is true of a fixed charge created and filed first. It also applies if a financing statement has been filed in advance of the creation of a charge of either type and before the pledge is perfected, even if the registered charge is not

²²⁵ See Final Report paras 12.25 and 12.28 (it was proposed to retain the mandatory requirement for Scotland). The Australian Law Reform Commission recommended that automatic crystallisation should only take place where a notice that the charge has become fixed by virtue of the crystallising event has been lodged with the companies' office; a receiver of property or the chargee (or its agent) has entered into possession of the property under the terms of the charge or another charge, or a liquidator or administrator of the company has been appointed: see ALRC 64, *Personal Property Security* paras 10.13-10.14. Cf the unimplemented Companies Act 1989, s 100, which would have introduced a new Companies Act 1985, s 410, which, amongst other things, would have enabled the Secretary of State to require notice to be given of the events which would cause crystallisation.

²²⁶ See below, paras 4.173 ff.

created until after the pledge. The charge will have priority as from the date of filing, and hence over the pledge, even if it only came into existence after the pledge was made: this is a consequence of permitting filing in advance of creation.

Priority between registered and unregistrable charges

- 4.146 The Steering Group's consultation document noted that the priority rules of a notice-filing system for company charges would not cover all priority questions.²²⁷ It would not deal with priority between unregistrable charges or between registrable and unregistrable charges. (It will be recalled that under the present scheme, not all non-possessory security interests created by companies are registrable.²²⁸) The Steering Group's view was that these would be determined by the general law.²²⁹ While this approach might be necessary were there to remain substantial numbers of unregistrable charges, we would regard it as a very unsatisfactory compromise given that it would mean that these priority issues would continue to depend on the questions of actual or constructive notice that the notice-filing system is designed to eliminate. We think that there is a much better approach.
- 4.147 In Part V of this Consultation Paper we suggest that all charges should be registrable, unless there is a good reason for them not to be (such as the existence of the security interest being obvious). We will suggest that charges over certain types of property - in particular, over shares and other investment securities - should not have to be registered provided that the shares are 'controlled' by the secured party (or in the case of certificated shares, if the certificates are in the secured party's possession). This is because the charge will then be apparent to third parties. In other words, a charge over shares that are within the control of the secured party will be treated as 'perfected' without the need for registration, just as a pledge is perfected by the creditor taking possession of the goods. Priority as against subsequent security interests will depend on the date of perfection.²³⁰
- 4.148 **We ask consultees whether they agree that, if our provisional proposal that charges over assets such as shares and other investment securities that are 'controlled' by the secured party (or in the case of certificated shares, if the certificates are in the secured party's possession) should be treated as perfected without the need for registration, priority between registrable and unregistrable charges should depend on the date of perfection.**
- 4.149 There may also be questions of priority between registrable but unregistered interests. In the overseas systems, priorities in such cases are sometimes dealt with by order of attachment.²³¹ This seems simpler than to leave it to be determined by

²²⁷ Registration of Company Charges para 2.10.

²²⁸ We consider what changes should be made to the list of registrable interests below, in Part V.

²²⁹ Registration of Company Charges para 2.10.

²³⁰ See below, paras 5.18 ff. In Part V we also ask whether it should be possible to protect a charge over shares and other investment securities by filing a financing statement. If this were made possible, then a rule would be required to deal with questions of priority as between the holder of a secured interest protected by filing and one protected by control.

²³¹ Attachment being dealt with within the system: see, eg, the SPPSA, s 35(1)(c).

the general law (thus depending on the date of creation, notice and such like).²³² **We provisionally propose that priority as between competing charges, each of which is registrable but neither of which has been registered, should be determined by the date of attachment.**

Contractual variation of priority - subordination

- 4.150 We do not propose to erode the principle of freedom to contract as between competing creditors. The overseas systems contain provisions allowing the parties to vary the statutory priority by agreement.²³³ In New Zealand the Law Commission recommended that subordination agreements should be effective as between the parties if a financing statement is registered recording the agreed order of priorities and, if relevant, the duration of the agreement.²³⁴ Any agreement should not adversely affect the rights and priority of third parties and the debtor should have to be informed of the variation.²³⁵ We are not convinced of the need to require the registration of subordination agreements. They operate to regulate priorities only as between the contracting parties and do not affect the position of other secured creditors. However, the SPPSA permits a financing change statement to be filed in the event that the secured party subordinates its interest, and we ask whether consultees think that this needs to be done.²³⁶ **We provisionally propose not to make the registration of a subordination agreement necessary for the agreement to be effective, and ask whether registration of a subordination agreement should be made possible.**

The effect of changes

- 4.151 Earlier in this Part we considered the question of changes to the security agreement as they affected the financing statement.²³⁷ Where changes have occurred that need to be recorded, we provisionally think that this should not affect the priority position of the security interest, subject to the comments about subordination that we made earlier.²³⁸ So where there has been a change of creditor recorded, for example, priority in the security interest should be preserved. This is the approach generally taken by the overseas systems.²³⁹ **Where the security agreement has been changed but the changes not yet recorded in the**

²³² See above, paras 2.36 ff. The date of attachment test would overcome the question of notice. Such priority would, however, be displaced if the second party then filed first (although this could not occur in the event of administration or insolvency).

²³³ See, eg, the SPPSA, s 40(1) and the NZPPSA, s 70(1).

²³⁴ NZLC R8, *A Personal Property Securities Act for New Zealand* d 39.

²³⁵ Cf, eg, ALRC 64, *Personal Property Security* para 7.13.

²³⁶ Where a security interest has been subordinated by the secured party to another's interest, a financing change statement may be registered to disclose the subordination at any time during the period that the registration of the subordinated interest is effective: see the SPPSA, s 45(6).

²³⁷ See above, paras 4.87 ff.

²³⁸ See above, para 4.100.

²³⁹ See the SPPSA, s 23(2) and the NZPPSA, s 69 and UCC Revised Article 9, Section 9-325. See also ALRC 64, *Personal Property Security* para 13.16.

financing statement we provisionally think that the priority position of the security interest should not be altered.

Tacking of further advances

- 4.152 The Saskatchewan system provides that the priority that a security interest has applies to all advances, including future advances.²⁴⁰ The UCC and the New Zealand system permit this only where the security agreement provides for future advances at the time when it is made.²⁴¹ This is different to the present rules of tacking,²⁴² under which a prior chargee who has notice of the subsequent charge will retain priority for further advances only if she was under an obligation to make them. The UCC and New Zealand schemes would permit this when the original agreement allowed for further advances without imposing any obligation on the lender.²⁴³ This approach is consistent with the policy of permitting filing in advance to protect a security interest that may or may not be taken.²⁴⁴
- 4.153 It seems to us that the approach taken by the UCC and the NZPPSA may pose a danger, in that it may permit the first lender to monopolise the provision of further credit to the debtor. Suppose that the debtor were to find another creditor prepared to advance further funds on better terms than the first lender, and at the time the assets charged to the first lender would be adequate to cover both the sums so far advanced by the first lender and those that the second lender plans to advance. The difficulty is that if the first lender can later advance yet further funds on the strength of its prior security interest, the second lender will risk being 'squeezed out'. Therefore it may refuse to lend in the first place and the debtor will be able to borrow only from the first lender.
- 4.154 However, under a scheme that permitted tacking of further advances it would always be possible for a second potential creditor to reach a subordination agreement with the first creditor. It will often be in the first creditor's interest for a further advance to be made by another creditor. Meanwhile, to refuse the tacking of further advances unless there were an obligation to make the further advance would be inconsistent with the policy of allowing advance filing for a series of transactions. Further advances of credit - whether of money or of goods on credit - would become impossible without obtaining the consent of subsequent creditors of whom the first creditor had notice.²⁴⁵ That would be extremely cumbersome and might well prejudice the debtor company more than the reverse rule. We think it

²⁴⁰ See the SPPSA, s 35(5).

²⁴¹ See the NZPPSA, ss 71-72 and UCC Revised Article 9, Section 9-323.

²⁴² See above, paras 2.56-2.57.

²⁴³ The Australian Law Reform Commission proposed that a security holder who, whether or not under a contractual obligation to do so, makes a further advance contemplated by the security transaction, with or without notice of a registered security filed later in time or a later but unregistered security, should have the same priority for the further advance as for the principal amount secured: see ALRC 64, *Personal Property Security* para 8.10.

²⁴⁴ Indeed if 'tacking' were not permitted in such a case, lenders would presumably file a financing statement covering a series of separate possible future loans.

²⁴⁵ It might be thought that under such a scheme the first creditor would even have to file a fresh financing statement.

better to follow the approach of the overseas systems. **We provisionally propose to allow the tacking of further advances where these are contemplated by the security agreement and are covered by the financing statement.**

Purchase-money interests

- 4.155 It is common for a company to create a registrable charge that purports to cover not only its existing property but also its future property. The company may then purchase additional property with a loan provided by another creditor and secured by a charge or other security interest over that property. Such interests are sometimes known as purchase-money interests.²⁴⁶ As the Crowther report pointed out, it would seem unfair to allow the security for this additional loan to be subordinate in priority to the earlier charge:

In this case, it is [the later creditor's] money that has led to the increase in the dealer's inventory, and it would be quite wrong that this increase should become a windfall added to the security of the original party ... simply because he had filed a prior financing statement.²⁴⁷

- 4.156 This problem occurs under existing law. It does not happen when the first charge is a floating charge (unless there is a negative pledge clause), as provided the second charge is fixed it will take priority. However, it may happen with a fixed first charge that applies to after-acquired property. If the debtor then acquires further property with finance provided by another creditor and secures the loan by charging the property to the second creditor, which creditor has priority? At one time it seemed that the first creditor might have priority: this was because the debtor was considered to own the property free of the second charge for a moment of time (the '*scintilla temporis*') before the second charge was granted, and in that moment the first charge attached.²⁴⁸ However, this approach was rejected by the House of Lords in *Abbey National Building Society v Cann*,²⁴⁹ where the approach

²⁴⁶ See the Crowther report para 5.2.12 and the Diamond report para 11.5.9. Some of the overseas statutes give a wide definition, eg, s 16 of the NZPPSA: "Purchase money security interest' (a) Means (i) A security interest taken in collateral by a seller to the extent that it secures the obligation to pay all or part of the collateral's purchase price; or (ii) A security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights; or (iii) The interest of a lessor of goods under a lease for a term of more than 1 year; or (iv) The interest of a consignor who delivers goods to a consignee under a commercial consignment; but (b) does not include a transaction of sale and lease back to the seller".

²⁴⁷ Crowther report para 5.7.73. The recommendation was therefore that there should be a distinction between a purchase-money security interest and a non-purchase-money security interest (that is, an interest taken in property already owned by the debtor). The Diamond report recommended that purchase-money security interests should be subject to the requirement to file a financing statement under the notice-filing system it proposed and agreed that purchase-money interests should receive some form of favourable treatment: Diamond report paras 11.5.19-11.5.20.

²⁴⁸ See *Church of England Building Society v Piskor* [1954] 1 Ch 553.

²⁴⁹ [1991] 1 AC 56.

taken was that the purchase of the new asset and the grant of the second charge are in essence a single transaction.²⁵⁰

- 4.157 This issue might re-emerge under a notice-filing system. We have noted that a floating charge (or a form of floating lien) under such a system would have priority from the date of filing. It would be unfortunate if this were to lead to the result that a second purchase-money interest chargee would lose its priority to the floating charge-holder, as subsequent potential lenders may be unwilling to advance secured lending if that security is likely to be subject to the priority of the earlier floating charge. This would risk stifling the flow of credit available to a company. The principle in *Abbey National Building Society v Cann* might be used to protect the second charge-holder when the acquisition and the second charge were a single transaction, but that might involve technical arguments, and in any event there may still be cases in which it is more convenient for the debtor to acquire the property and then charge it to the second creditor at a slightly later date.
- 4.158 The overseas systems deal with this issue by providing that the purchase-money interest will have priority, displacing the 'first to file' approach. In keeping with the broader scope of these systems, a functional approach is taken to the question of what is a purchase-money interest (and so the phrase purchase-money security interest is used²⁵¹); in such a context, 'quasi-securities' such as hire-purchase agreements fall within that definition, and it is to security interests such as these that the concept of the purchase-money security is perhaps most clearly applicable. We shall return to the concept of purchase-money interests and quasi-securities in Part VII, but the concept of the purchase-money interest is still relevant to a notice-filing system that applies only to traditional security, particularly in its relationship with the floating charge.
- 4.159 It might be asked why a purchase-money interest should be protected, whereas someone who had simply lent money that has been used to reduce a company's indebtedness should not be protected. It seems to us that there is a difference. Someone who simply advances further funds to a company, whilst providing new value in exchange for any security she takes, is not contributing to the property available to secured creditors: she is not making their position any better. In contrast, where the fresh finance was to enable the debtor to acquire further property, if the property subject to the purchase-money interest in favour of the second (or later) creditor was available to the earlier creditors, they would be better off as a result of that later creditor, who would probably lose out.²⁵²

²⁵⁰ Although the extent of this decision is questioned by Goode: see R Goode, *Commercial Law* (2nd ed 1995) pp 724-725.

²⁵¹ We have already noted that in this Consultation Paper we use the phrase 'security' to refer to traditional forms of security, and 'security interest' to encompass all transactions that have a security function, whether or not the law currently classes them as traditional security: see above, para 1.26.

²⁵² There might be an argument that if the loan were used to pay arrears of employees' salary that would otherwise constitute a preferential debt, then the floating charge-holder would benefit. We think that such a situation would perhaps be better dealt with by the creditor who is seeking to pay off the preferential debts to seek a subordination deal with the floating charge-holder, rather than create some specific provision giving purchase-money interest status to such debts in respect of floating charge-holders but not others.

- 4.160 **We provisionally propose that a purchase-money interest should have priority over an already registered non-purchase-money security.**
- 4.161 There is a danger involved in moving to a system that sets out the priority given to purchase-money interests. An existing secured creditor that sees the debtor acquire further assets may assume that they belong to the debtor and perhaps that they will be subject to its security, whereas in fact they are purchase-money interests and will have priority. There are two possible methods of warning the earlier creditor: the second creditor could file a financing statement or alternatively it could give notice to the first creditor. The UCC, SPPSA and NZPPSA require notice to be given in the case of inventory, and filing for other assets (in other words, it is harder to preserve priority in inventory²⁵³ and intangibles).²⁵⁴ The Crowther report favoured requiring that notice be given to the earlier creditors in all cases.²⁵⁵ The Diamond report proposed that filing should be the required method in all cases.²⁵⁶
- 4.162 We also consider that the holder of the purchase-money interest should have to make the existence of the interest clear to other security holders if the purchase-money interest is to retain its priority. At the very least it should have to perfect its interest (normally by filing) within a short period (15 days, for example²⁵⁷) after the debtor has obtained possession.²⁵⁸ As to whether notice should be required in some cases (for example, with inventory) we have no firm views. **We invite views as to whether in the case of inventory the holder of the purchase-money interest should have to give notice to other secured parties who have filed in order to preserve the priority of the purchase-money interest.**²⁵⁹

²⁵³ As well as in the case, under the UCC, of chattel paper; an instrument constituting proceeds of an instrument or chattel paper; and identifiable cash proceeds of the inventory: Section 9-324(b).

²⁵⁴ See UCC Revised Article 9, Section 9-324(a) and (b). The requirement to serve a notice is apparently to ensure that previous creditors who have agreed to make future advances are protected from the fraud of debtors: see J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) p 850. See also the SPPSA, ss 34(2)(b) 34(3) and the NZPPSA, ss 73-74. In the case of intangibles, the purchase-money security interest will obtain priority if it is perfected within 15 days of attachment (or 10 days in New Zealand): SPPSA, s 34(2)(b); NZPPSA, s 75. In addition, both the Saskatchewan and New Zealand systems also provide that a perfected purchase-money security interest in goods that continues in the product or mass has priority over a non-purchase-money security interest that either continues in the product or mass, or is given in the product or mass itself by the same debtor: SPPSA, s 39(6); NZPPSA, s 86. The Saskatchewan system requires notice to be given in some cases.

²⁵⁵ Crowther report para 5.7.74.

²⁵⁶ Diamond report paras 11.7.6-11.7.7.

²⁵⁷ See, eg, the SPPSA, s 34(2) (15 days) and the NZPPSA, s 73 (10 days).

²⁵⁸ In the case of shares or other investment securities, the debtor will not normally obtain possession as the shares will be in the control of the creditor; so a purchase-money interest for shares will not have to be filed (and probably will not be registrable, see below, paras 5.18 ff).

²⁵⁹ There may be additional priority rules applicable in the case of quasi-securities, which we return to in Part VII.

The right to proceeds

- 4.163 If the secured asset is disposed of by the debtor in some way, two questions arise. The first is whether the asset should continue to be subject to the security in the hands of the recipient. This depends firstly on whether the disposition was authorised (for example, if the charge was a floating charge and the disposition was in the debtor's ordinary course of business²⁶⁰). If it was authorised, the purchaser will take free of the charge. If the disposition was not authorised (for example, the asset was subject to a fixed charge and the creditor had not consented to the disposition), the relevant rules are those on the rights of purchasers (as explained in the next section, a purchaser may sometimes take free of the security interest even though the disposition was not authorised by the creditor) and on tracing.²⁶¹
- 4.164 In this section we are concerned with the second question, which is whether the money or property that the debtor received in return for the secured asset should become subject to the creditor's security. This is often referred to as the question of 'proceeds'.
- 4.165 The overseas systems contain specific provisions dealing with the question of proceeds. 'Proceeds' are defined by the SPPSA and the NZPPSA as being identifiable or traceable personal property, fixtures or crops derived directly or indirectly from any dealing with collateral or the proceeds of collateral, and in which the debtor acquires an interest. It also includes a right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to the collateral or its proceeds, and also a payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or a security.²⁶²
- 4.166 The security will attach to the proceeds if that was originally provided for in the security agreement and stated in the financing statement. Thus if the security is over all the company's assets, or covers property of the same kind as the proceeds, it will automatically catch the proceeds. Similarly if the financing statement specifically states that any proceeds of disposition of the collateral shall be subject to the security. In these cases perfection is treated as 'continuous',²⁶³ that is, priority will date with reference to the perfection of the original collateral.²⁶⁴
- 4.167 If the security agreement or the financing statement does not expressly cover proceeds, the SPPSA and NZPPSA both provide that the security will attach to the proceeds but apply rules that vary according to the nature of the proceeds. If

²⁶⁰ See above, para 2.40.

²⁶¹ As to which see below, para 11.32.

²⁶² SPPSA, s 2(1)(hh); NZPPSA, s 16(1). The definition excludes the offspring of animals used as collateral simply because they are offspring. UCC Revised Article 9, Section 9-102(a)(64) defines proceeds as including "whatever is acquired upon the sale, lease, license, exchange or other disposition of collateral".

²⁶³ SPPSA, s 28(2).

²⁶⁴ If the secured party enforces the security interest against both the collateral and the proceeds, the amount secured by a security interest in collateral and the proceeds is limited to the value of the collateral at the date of the dealing that gave rise to the proceeds: SPPSA, s 28(1); NZPPSA, s 45.

the proceeds consist of money, cheques or deposit accounts, the security interest is also regarded as continuously perfected in the proceeds and the creditor need take no further steps.²⁶⁵ If the proceeds are of other kinds the security interest will apply to them but the creditor must take steps to prevent it becoming 'unperfected'.

- 4.168 The reason for this is that, as the Diamond report noted, where proceeds are of property of a different type to that of the original secured asset, and this type of property is not covered by the financing statement, third parties might be misled. One of the purposes of the financing statement - that of putting third parties on notice that the goods described were, or might become, subject to a security interest - might thereby be compromised.²⁶⁶
- 4.169 The SPPSA provides that in the case of proceeds that are not covered by the original financing statement and are not money (and the like), the security interest in the proceeds is a continuously perfected security interest, but becomes unperfected after 15 days unless the security interest in the proceeds is otherwise perfected under the Act.²⁶⁷ The NZPPSA contains provisions to similar effect (although the period given is 10 working days).²⁶⁸
- 4.170 The UCC Revised Article 9 approach is similar to that of the SPPSA and the NZPPSA, providing for automatic perfection for 20 days, after which the security interest becomes unperfected unless the proceeds are identifiable cash proceeds or the security interest in the proceeds has been perfected by another method.²⁶⁹ The Diamond report recommended following the Canadian approach.²⁷⁰
- 4.171 It is our provisional view that the question of proceeds should be dealt with in a similar way to that taken by the overseas systems. Where the proceeds are money and the like, or where the proceeds comprise property that is covered by the original financing statement, we think that the security interest in the secured asset should extend to the proceeds automatically, with priority being backdated to the date of filing in respect of the original asset. We also provisionally think that a creditor should be able to secure continuous perfection where there has been an indication in the original financing statement that it covers not only the original asset but also its proceeds (hence our suggestion at the beginning of this Part that there be a requirement to indicate on the financing statement whether proceeds

²⁶⁵ NZPPSA, s 46, which also allows for continuous perfection where the financing statement covered the original collateral and the proceeds consist of a payment made in total or partial discharge or redemption of an intangible, a negotiable instrument, an investment security, or chattel paper; or a right to an insurance payment or any other payment as indemnity or compensation for loss or damage to the collateral or proceeds.

²⁶⁶ Diamond report para 15.1.6.

²⁶⁷ SPPSA, s 28(3).

²⁶⁸ NZPPSA, s 47, and see also s 42.

²⁶⁹ UCC Revised Article 9, Section 9-315(c) and (d).

²⁷⁰ Diamond report para 15.1.11. The Australian Law Reform Commission recommended that there should be a statutory rule to displace the common law and equitable rules. The security interest in the original property should continue into identifiable proceeds, unless the security agreement provides otherwise, and that an interest in identifiable proceeds should have the same priority as the original security interest without any further steps having to be taken: ALRC 64, *Personal Property Security* para 8.41- 8.42.

are covered²⁷¹). Such a description of the proceeds should be sufficiently detailed so that an original financing statement could have been entered in relation to it. Where there was no such indication, the creditor should be permitted to file a financing statement within a short time identifying the proceeds as the secured asset (or take other steps to perfect the security), or should otherwise lose the benefit of being able to 'backdate' the priority of the proceeds.

4.172 **We ask whether consultees agree with our provisional views that:**

- (1) where an asset subject to a security is dealt with or otherwise gives rise to proceeds, the security should extend to the proceeds;**
- (2) the proceeds should be treated as continuously perfected (and therefore having the priority of the original financing statement) where there was a financing statement covering the original secured asset and either**
 - (a) the proceeds are money or similar property (and we ask consultees whether they have views as to the extent of this provision); or**
 - (b) the proceeds would either come within the description of the property originally subject to the security, or the financing statement covers proceeds of the original property;**

and

- (3) where the proceeds are not continuously perfected, they should be temporarily perfected for a short period, allowing a new financing statement to be filed in respect of the proceeds, in which case, priority will be that of the original financing statement.**

Purchasers of charged property

4.173 In Part II we saw that registration under the Companies Act 1985 affects the validity of a charge only as against the administrator, liquidator or creditors. As concerns purchasers of property that has been charged, there are two points. First, a purchaser of the goods will take subject to the charge even if it has not been registered, unless the doctrine of good faith purchase for value and without notice applies to protect her.²⁷² Secondly, and conversely, if the charge is registered it is unclear to what extent this affects a purchaser in the ordinary course of business. Registration may give purchasers constructive notice but it is arguable that purchasers of stock-in-trade cannot reasonably be expected to search the Companies Register and therefore should not be treated as having constructive notice of registered charges.²⁷³

²⁷¹ See above, para 4.29.

²⁷² Estoppel might also act as a protection.

²⁷³ See above, para 2.60.

Purchasers and unregistered charges

- 4.174 On the question of purchasers of property subject to an unregistered charge, the UCC provides that a buyer takes free of a security interest provided that she gives value and, at the time of delivery, the security interest had not been perfected (for this purpose, let us assume this means one for which no financing statement has been filed) and the buyer did not know of it.²⁷⁴ A similar rule, but not referring to delivery, applies to buyers of accounts and intangibles.²⁷⁵
- 4.175 The Saskatchewan system has a similar provision, subordinating an unperfected security interest in a number of assets²⁷⁶ to the interest of someone who, pursuant to a transaction that is not a security agreement, acquires an interest for value and without knowledge.²⁷⁷ Where the purchase relates to an instrument, a security, or a negotiable document of title, the purchaser or holder who acquired it in the ordinary course of the transferor's business is held to have knowledge only if she knew of the existence of a prior security interest and knew that the transaction was in breach of it.²⁷⁸
- 4.176 In some systems the buyer's knowledge is irrelevant. The New Zealand system provides that a buyer or lessee of collateral who acquires it for value takes free of an unperfected security interest in it, unless the unperfected security interest was created or provided for by a transaction to which the buyer or lessee is a party.²⁷⁹ The Diamond report recommended a similar rule. In the part of the Diamond report that dealt with changes to the existing system, the recommendation was made that an unregistered (but registrable) charge should be void as against a purchaser who did not have actual knowledge of it.²⁸⁰ This proposal found its way into the unimplemented part of the Companies Act 1989, which would have made an unregistered charge void against a purchaser, but apparently irrespective of her knowledge.²⁸¹
- 4.177 It seems right that a purchaser should not be affected by a charge which should have been registered in the Company Charges Register (but, we will assume for the moment, not a specialised register) but which has not been: we think that it would be wrong to allow a chargor to have priority when a purchaser has no means of discovering the charge. As to the case in which the buyer does actually know of the charge, we see no reason to depart from the policy adopted by Parliament in enacting the Companies Act 1989. **We provisionally recommend that such an unregistered charge should be ineffective against any person who for value**

²⁷⁴ Section 9-317(b).

²⁷⁵ Section 9-317(d).

²⁷⁶ Goods, chattel paper, a security, a document of title, an instrument, an intangible or money.

²⁷⁷ SPPSA, s 20(3).

²⁷⁸ SPPSA, s 20(4).

²⁷⁹ NZPPSA, s 52.

²⁸⁰ Diamond report para 24.3.5.

²⁸¹ The Companies Act 1989, s 95 would have amended the Companies Act 1985, s 399 to make a charge not registered within 21 days void against "any person who for value acquires an interest in or right over property subject to the charge" (whether acquired before or after the 21-day period).

acquires an interest in or right over property subject to the charge and we consider that questions of actual knowledge should be as irrelevant for this purpose as they are for purposes of priority.

Purchasers and registered charges

- 4.178 On the question of purchasers of property subject to a charge that has been registered, UCC Revised Article 9 provides that a buyer “in the ordinary course of business” of goods subject to a security interest created by her seller takes free of it, even if the security interest has been perfected²⁸² and the buyer knows of it.²⁸³ However, the buyer will take subject to the security interest if she also knows that the disposition is in breach of the security agreement, as “buyer in ordinary course of business” is defined as a buyer “in good faith and without knowledge that the sale to him is in violation” of the security interest.²⁸⁴ The same definition also limits the protection given by Section 9-307 to purchases “from a person in the business of selling goods of that kind”. As Official Comment 2 points out, this limits the article primarily to sales of inventory. Thus those buying stock-in-trade will be protected unless they know that the sale is in breach of security agreement; other buyers will be protected only if the security agreement had not been perfected and they did not know of it.
- 4.179 The Crowther report stated merely that one who buys goods (other than motor vehicles, for which special rules were envisaged²⁸⁵) from a person selling in the ordinary course of business should not be obliged to search the register and should take free of the security interest unless she knows that the disposition is in breach of the security agreement.²⁸⁶
- 4.180 In the part dealing with notice-filing, the Diamond report proposed a more-wide-ranging reform of the rules of dispositions by non-owners²⁸⁷ but also, as a set of ‘minimum proposals’, suggested rules similar to those of UCC Article 9 then in

²⁸² Section 3-320, which replaces Section 3-307, provides an exception when the secured party had perfected her interest by taking possession. This seems correct in principle.

²⁸³ UCC Revised Article 9, Section 9-320, which replaces Article 9, Section 9-307. There are special rules on purchases of securities and negotiable instruments, see UCC Revised Article 9, Section 9-322 (money), Section 9-330 (chattel paper and instruments) and Section 9-321 (licensees and lessees): essentially they take free of the security interest whether or not in ordinary course of business - see Section 9-309. There are also provisions for purchasers of consumer goods but these bite only where the seller is not a trader and therefore do not seem relevant to a system applicable only to companies.

²⁸⁴ Section 1-201(9).

²⁸⁵ See below, paras 7.55 ff.

²⁸⁶ Crowther report para 5.7.72.

²⁸⁷ Diamond report paras 13.6.1-13.6.10. These reforms are outside our terms of reference, though we think the proposals are worthy of serious consideration.

force.²⁸⁸ Broadly similar rules appear in the Canadian²⁸⁹ and New Zealand legislation,²⁹⁰ although there are particular rules dealing with specific situations.²⁹¹

- 4.181 It would be unreasonably burdensome to expect a person who buys goods supplied by the seller in the ordinary course of its business (in the sense of stock-in-trade as opposed to sales of capital assets such as used equipment) to check the Company Charges Register. The buyer should take free of even a registered security interest unless the buyer knows that the disposition to her is in breach of the agreement. It will in fact be rare for the security interest to be relevant since stock-in-trade will normally be subject only to a floating charge; but if the floating charge has crystallised or if, unusually, the stock-in-trade was subject to a fixed charge, we think the buyer should take free of it unless she knows that the sale would be a breach of the agreement.²⁹²
- 4.182 Conversely, we see no need to give the same protection to a buyer who is buying capital equipment; she can be expected to check the register.²⁹³ However the Australian Law Reform Committee pointed out that it may be hard - particularly in cases of fraud by the debtor - for the purchaser to be sure that she has the correct name in which to search.²⁹⁴ This may be mitigated if, as we propose below, provision is made for charges over equipment that is identifiable by a unique serial number should have to give that number on the financing statement.²⁹⁵ However not all capital goods are identifiable in this way. Therefore it may be desirable to provide that a good faith buyer even of capital assets should take free of a registered but unknown security interest if she has taken reasonable steps to check. **We invite comment from consultees on whether a buyer of capital equipment should be expected to search the register.**
- 4.183 It might also be asked whether a consumer²⁹⁶ who buys a piece of used equipment (that is, an item that is not the company's stock-in-trade) from a company should be expected to check the register. This point does not appear to have been considered by the Diamond report, who considered only the case of a consumer buying from another consumer. (We will consider that case in Part IX when we

²⁸⁸ UCC Article 9, Section 9-307.

²⁸⁹ See, eg, the SPPSA, s 30. We have not addressed other provisions in the overseas systems that relate to purchasers who are consumers.

²⁹⁰ See the NZPPSA, s 53(1), which also applies to a lessor of goods.

²⁹¹ See, eg, the SPPSA, s 31 (money, instruments, securities, negotiable documents of title and chattel paper), and the NZPPSA, ss 94-99 (money, negotiable instruments, investment securities and chattel papers).

²⁹² The Australian Law Reform Commission considered whether the purchaser of particularly valuable property (eg, over \$40,000) should be expected to check the register and therefore should not be protected against registered charges. It concluded that such a provision was unnecessary: we agree. See ALRC 64, *Personal Property Security* para 9.11.

²⁹³ Although we have noted that, in the context of a floating charge, the position under the current law seems to be that sales of capital assets seem to be in the ordinary course of business: see above, para 2.61.

²⁹⁴ ALRC 64, *Personal Property Security* para 9.9.

²⁹⁵ See below, para 4.187.

²⁹⁶ Ie, a person buying for private use or consumption.

deal with security interests created by non-corporate debtors.) Private purchasers of motor vehicles are protected by Part III of the Hire-Purchase Act 1964.²⁹⁷ Should this be generalised? **We invite views on whether a consumer who buys goods (other than stock-in-trade, which is covered above) that are subject to a registered charge should take free of the charge unless she knows of the charge.**

- 4.184 The Crowther and Diamond report proposals went slightly beyond the rules in the UCC, Saskatchewan and New Zealand. They pointed out that the buyer of goods sold in the ordinary course of business should take free of security interests created not only by her seller but by prior owners also.²⁹⁸ Subject to the point about uniquely identifiable goods,²⁹⁹ we agree with this, because it will be practically impossible for the buyer to discover such an interest (against what name should she search?) and because, when the purchase is of stock-in-trade, we consider that the buyer who acts in good faith should normally be protected for the reasons given above.
- 4.185 **We provisionally propose that a buyer should not be bound by security interests in goods (other than those that are uniquely identifiable) created by prior owners.**

Uniquely identifiable goods

- 4.186 A number of the overseas systems contain a provision that security interests over certain types of uniquely identifiable assets such as vehicles, or goods with serial numbers - the types are usually listed by regulation - should be recorded as such in the financing statement, permitting in these cases searching by asset, rather than simply by debtor. We provisionally think that such a requirement would be helpful. It would be particularly useful where purchasers were concerned: under a debtor-based system, a security interest created by a previous owner over the asset will not appear from a search of the register in the name of the company seeking to sell-on the asset, and such a purchaser might not take free of that security interest, even if she had no way of finding out about it.³⁰⁰
- 4.187 This issue would become even more pertinent were quasi-securities to be brought within the notice-filing system, but in our view there may be an advantage in allowing registration by serial number even in a system applying only to charges. In such a case, the serial number should be a required particular for the financing statement.
- 4.188 **Where a financing statement identified an asset by serial number or other identifying mark, we would provisionally propose an exception to our**

²⁹⁷ See below, para 7.58. We consider the case of vehicles at paras 7.55-7.56 and 10.51-10.54 below.

²⁹⁸ Crowther report para 5.7.72; Diamond report para 13.5.4.

²⁹⁹ See below, para 4.186.

³⁰⁰ Although there is specific provision in the Hire-Purchase Act 1964 concerning vehicles sold whilst held on hire-purchase agreements. However, this aspect is more relevant to our discussion of quasi-securities in Part VII.

previous proposal that the purchaser should not be bound by security interests created by prior owners. We invite consultees' views.

- 4.189 The Diamond report recommended that the protection afforded to buyers (whether against an unregistered charge or a registered one under the exception for buyers in the ordinary course of business) should apply also to those who acquire ownership or possession under a hire-purchase agreement, lease, contract for work and materials or contract of barter - in short, all except those also taking a security interest, who may be expected to check the register. **We provisionally propose that persons acquiring ownership or possession of goods in the ordinary course of business under a hire-purchase agreement, lease, contract for work and materials or contract of barter should take free from a security interest in the same circumstances as buyers.**

Purchasers and property subject to registration in a specialist register

- 4.190 Where the charge should be registered in a specialist register,³⁰¹ the validity of the charge against purchasers should be determined by the rules of that register.
- 4.191 **We ask whether consultees agree with our provisional view that the validity of charges that should be registrable in specialist registers should be determined by the rules of that register.**

Purchasers of investment securities

- 4.192 We later provisionally propose that charges over investment securities should not be registrable.³⁰² If the secured party has the relevant certificates and transfer forms, it will appear to have authority to sell; if it registered as owner it will appear to have full power to sell. In the light of this, we think that it would be right to allow a purchaser to take free of the security interest unless she knows of it and that sale would be in breach of the agreement.³⁰³
- 4.193 **We ask whether consultees agree with our provisional view that a purchaser of investment securities should take free of the security unless she knows of it and that sale would be in breach of the agreement.**

Purchasers of receivables

- 4.194 Suppose that book debts are charged to a financier, who files a financing statement. The company then purports to sell the same book debts to a factor. In our view the factor should be expected to check the register and should not be protected merely because it does not know that the subsequent sale is in breach of

³⁰¹ We develop our provisional proposals in relation to the application of a notice-filing system to the specialist registers dealing with certain assets in the next section: see below, paras 4.199 ff.

³⁰² See below, para 5.28.

³⁰³ Cf SPPSA, ss 31(4) and (5); though s 31(6) limits this to a purchaser who buys in the ordinary course of the transferor's business. We do not find the latter qualification easy to apply to, for example, a bank that takes a charge over shares (that are registered in its own name) and then sells them.

the agreement - in other words, this should not be treated as a sale in the ordinary course of business by the company.

- 4.195 It seems to us that the same approach should apply to block-discounting.³⁰⁴ The Saskatchewan and New Zealand systems take a different approach. They provide that a purchaser of 'chattel paper' who takes possession of it in the ordinary course of the purchaser's business and for new value takes priority over a perfected security interest if the purchaser took possession without knowledge of it, or where the perfected security interest has attached to proceeds of inventory, whether possession was taken with or without knowledge of it.³⁰⁵ It is our understanding that in England and Wales block-discounting does not involve the physical transfer of documents and that therefore the Saskatchewan and New Zealand models cannot be transferred directly to our law. We think, however, that the result is similar to the one that we propose.
- 4.196 **We ask whether consultees agree with our provisional view that a factor or other person purchasing book debts should be expected to check the register and should not be protected merely because it does not know that the subsequent sale is in breach of the agreement.**

Purchasers of negotiable instruments/documents of title

- 4.197 The Crowther report noted that whilst interests over negotiable instruments can be protected by filing, a transferee who takes possession in good faith, even after perfection by filing, should take priority, the essence of such documents being that they are transferable or negotiable by delivery, or indorsement and delivery, and commercial transactions would be hampered if a search were required.³⁰⁶ Both the Saskatchewan and the New Zealand system give a purchaser of a negotiable instrument or document of title priority over a perfected security interest, where the purchase was for value and without notice,³⁰⁷ and where the purchaser has taken possession of the negotiable instrument.³⁰⁸ Our provisional view is that, as with the other systems, priority rules should not disturb the protection currently given to a holder in due course.

³⁰⁴ See below, para 6.28.

³⁰⁵ See SPPSA, s 31(7) and the NZPPSA, s 98. Similarly, UCC Revised Article 9, Section 9-330(a) provides that where the competing interest in the chattel paper is only in respect of the proceeds of inventory, the purchaser will take free if she is acting in the ordinary course of its business, is in good faith, purchases for value and takes possession of the chattel paper, providing that the chattel paper does not indicate that it has been assigned to anyone other than the purchaser. Where the competing interest in the chattel paper is in respect of anything other than proceeds of inventory, the purchaser who takes possession of the chattel paper will take free if in good faith, for value, in the ordinary course of her business and without knowledge that the purchase violates the rights of the secured party: Section 9-330(b).

³⁰⁶ Crowther report para 5.7.76.

³⁰⁷ For these purposes, where the sale is in the ordinary course of business, knowledge is defined as meaning knowledge that the transaction is in breach of the security agreement: see the SPPSA, s 31(6) and the NZPPSA, s 96(2).

³⁰⁸ See the SPPSA, ss 31(4) and 31(5) and the NZPPSA, ss 96(1) and 99(1).

- 4.198 **We ask whether consultees agree with our provisional view that the priority rules of a notice-filing system should not disturb the protection currently given to a holder in due course.**

OTHER REGISTERS

- 4.199 We noted in Part II that there are a number of specialist registers, wherein details of ownership of, or charges over, particular assets have to be recorded.³⁰⁹ A difficulty arises in considering the relationship between any new notice-filing register and the specialist registers. We have noted that under the current registration scheme, a charge taken over most of the assets registrable in a specialist register would also be registrable under the Companies Act 1985. However, the specialist registers have their own rules on priority, even though invalidity for non-registration in the Companies Register would affect a charge that had otherwise been validly registered in the specialist register. If a notice-filing system sets out a new system of priorities in the way that we envisage, and the specialist registers continue unchanged, conflicts may arise if the ‘specialist’ assets are required to be subject to all the same rules of a new notice-filing system as every other registrable asset.
- 4.200 We believe that there is a simple solution. We pointed out in Part III that there is no need for a charge to be registrable in the Company Charges Register if it will in any case be readily discoverable. Charges that are registrable in specialist asset registers should be readily discoverable. Therefore under the notice-filing system, charges over ‘specialist’ assets³¹⁰ should not be registrable in the Company Charges Register. If they were not, then conflicts over the two systems of priority would not arise.
- 4.201 This issue seems most apparent in respect of land. As we noted in Part II, where there is no conclusive certificate of valid registration from the Companies Registry, the Land Registry will register the charge over land but note on the Land Register that it is subject to the provisions of the Companies Act 1985, section 395.³¹¹
- 4.202 Whilst it would be possible to introduce a system that applied only to property other than land,³¹² this would result in the retention of the old scheme for charges over land, and the new system for all other charges or security interests. It would prove expensive and confusing in the case of security being granted over both sorts of asset to the same creditor.
- 4.203 The Steering Group in its consultation document made a very simple proposal: neither the validity nor the priority of charges over land should depend upon registration in the Companies Register. Thus the Land Registry would no longer have to note that registration of a charge over land was subject to the Companies

³⁰⁹ See above, paras 2.49 ff.

³¹⁰ Other than ‘floating charges’ that would cover such assets: see below, para 4.212.

³¹¹ See above, para 2.51.

³¹² As we noted earlier, neither the Crowther report nor the Diamond report envisaged the systems they proposed applying to security interests over land, and so this issue was not discussed in any detail. Nor do the overseas notice-filing schemes we have considered cover security interests granted over land (other than fixtures or mineral rights).

Act 1985, section 395. It suggested that in order to give a more accurate picture of the company's financial position, charges over land would have to be registered at Companies House and there would be penalties for default but the charge would still be valid if it were not registered.³¹³

- 4.204 These provisional proposals were welcomed by the Land Registry (in their response to the Steering Group's consultation document), which suggested that when it received details of charges over land for registration, it would be able to forward the relevant particulars to Companies House for registration.³¹⁴
- 4.205 A practical difficulty may seem to arise in respect of some registers, due to the means of searching that are made available. With some registers there would be no problem. As we understand it, the registers of land charges, aircraft, trademarks, registered designs and patents all permit a search by owner name. In other words, a person searching for information about a company's encumbrances would not need to know that the company owned a specific asset: it could search the register by the name of the company in the same way as it could a Companies Register operating a notice-filing system.
- 4.206 However, the Land Registry and the Shipping Registry do not generally permit searching by name of the owner.³¹⁵ A party searching would need to know that a company owned a particular piece of land or ship before it could search for encumbrances on it. This would mean that a person seeking information about the encumbrances of a company would not be able to find out if there were any charged assets in these registers simply by knowing the name of the company.³¹⁶
- 4.207 We doubt, however, whether this is a real problem. A party seeking information about a company (whether a potential creditor or investor or someone else) will need to enquire as to what assets the company appears to have. As soon as it appears, or is claimed, that the company owns a particular ship or piece of land, the enquirer has the necessary information to search the specialist register.
- 4.208 We therefore provisionally propose that the validity and priority of charges created by companies over land or other assets that are registrable in specialist registers should not depend on the filing of a financing statement in the Company Charges Register.

³¹³ Registration of Company Charges para 2.8.

³¹⁴ Although this was on the basis of an electronic means of passing on such information: the Land Registry's response to our provisional proposals may of course differ from its response to the Steering Group's consultation document.

³¹⁵ The Land Registration Rules 1925, r 9(2) provides that any person can apply for a search in the index of registered proprietors' names in respect of the name of a person "in whose property he is able to satisfy the Registrar he is interested generally (for instance as his trustee in bankruptcy or his personal representative)", although this search facility is necessarily limited.

³¹⁶ Of course, a party interested in a company could ask the company to provide details, or could consult the accounts, but for the party wishing to keep its enquiries from the company, or for the party wishing to know more about the assets themselves than are revealed by the accounts, this is not an option.

- 4.209 However, for the reasons given in relation to searches at the Land and Shipping Registries, we think the proposal to require additional registration at Companies House for 'public notice' purposes is probably unnecessary. To put it bluntly, what potential creditors and investors want to know is not what assets the company has already charged but what assets it has that are not charged to their full worth or are not encumbered at all. In other words it will have to ask about specific assets. Once it has this information it is easy to check the specialist register.
- 4.210 On the other hand, if the specialist registry were able to forward the information in a form that could appear on the Company Charges Register without significant further input,³¹⁷ then perhaps it would do no harm and might do some good to include it. (This form of 'notice' on the Company Charges Register would in effect be compulsory. Indeed if the company could somehow opt out of the 'forwarding' by the specialist registry the public notice purpose that this option assumes would be defeated.)
- 4.211 **We invite views from consultees on our provisional proposal to exclude all charges registrable in a specialist register from the notice-filing system. We would welcome views on whether the specialist registry should forward information about charges created by a company to the Company Charges Register for public notice.**
- 4.212 The changes will have little effect for floating charges which, we pointed out earlier, are likely to continue in some form under notice-filing. A floating charge may cover the company's 'undertaking' or 'all its assets', which would obviously include land and other items for which there are specialist registers. Normally lenders taking a floating charge will include in the same charge document a fixed charge over land and possibly other capital assets, but there is always the possibility that this will not be done or that the fixed charge will be unenforceable for some reason. At present a floating charge over unregistered land does not need to be registered in the Land Charges Register if it is registered at Companies House.³¹⁸ A floating charge over registered land can only be made the subject of a notice or caution on the Land Register.³¹⁹ Under a notice-filing system the floating charge will be valid against an administrator or liquidator, and have priority against other secured interests, only if a financing statement is filed. As far as the specialist registers are concerned we see no reason why the present approach should be changed. Registration of such a charge over an asset is unnecessary at the moment because a purchaser and subsequent chargee will always have priority. Under our proposed notice-filing system, that remains true of a purchaser, although a subsequent chargee will be subject to a registered floating charge. It is not practical to register a floating charge over a specialist asset because it can only cover those

³¹⁷ We do not think that this would be a particularly onerous task, particularly if the Companies Register were in electronic format. The Land Registration Act 2002 already contains a section (as yet unimplemented) giving power to the Lord Chancellor to make rules about the transmission by the Land Registrar to the Companies Registrar of applications under Part XII or Part XXIII, Chapter III of the Companies Act 1985: Land Registration Act 2002, s 121.

³¹⁸ See above, para 2.52.

³¹⁹ Land Charges Act 1972, s 3(7).

assets owned at the time.³²⁰ Therefore the chargee would be required to consult both the Company Charges Register and the specialist register. However, we do not think that this is worse than the present situation.

OTHER ISSUES RAISED BY A NEW SYSTEM

Record of search

- 4.213 Although the consequence of not submitting either the original or a copy of the charge instrument is that the registrar can no longer issue a certificate that is conclusive of anything other than that a financing statement was filed on a particular date, a form of verification statement could be issued to confirm the date or time of filing, or the absence of any filed statement.³²¹ This could be done automatically under an electronic system. An alternative approach is that taken by the SPPSA and the NZPPSA: a printed search result that purports to be issued by the registry is receivable in evidence as prima facie proof of its contents, including the date of registration and the order of registration as indicated by the registration number.³²² We provisionally favour the latter approach. Presumably an electronic system would indicate whether a filing had been accepted.
- 4.214 **We ask whether consultees agree with our provisional view that a printed search result should be receivable in evidence as prima facie proof of its contents, including the date of registration and the order of registration as indicated by the registration number.**

Liability of registrar for loss caused by registry errors.

- 4.215 We have explained that under the notice-filing scheme we envisage, the financing statement would be completed by the party filing (who would take responsibility for errors in it³²³) and be displayed automatically on the Company Charges Register. The scope for errors on the part of registry staff would thus be minimal but the possibility cannot be discounted altogether (for example, a fault in the software might result in an erroneous search result being revealed).
- 4.216 Under the current scheme it is unclear whether a person injured by an error on the part of the registry (such as a creditor who relies on the absence of a record of the

³²⁰ Cf the problem of registration in respect of after-acquired land.

³²¹ The Australian Law Reform Commission recommended that, whilst administration of searching any new register should generally be left to the registering authority in the light of available technology, the registering authority should issue a record of search which would be conclusive on the question of whether a security was registered, but only if the search revealed the existence of that security. If it disclosed no registered security it would not be conclusive, although it would be admissible as evidence that there was no such registered security, ALRC 64, *Personal Property Security* para 13.20

³²² See the SPPSA, s 48(2) and the NZPPSA, s 175.

³²³ See above, para 4.39.

charge) might have a remedy against the registrar. There is no statutory system of liability,³²⁴ but there have been suggestions that liability might exist.³²⁵

- 4.217 The Saskatchewan system provides that an action will lie against the Crown corporation to recover loss or damage suffered by that person because of an error or omission in the operation of the registry where the loss or damage resulted from reliance on a printed search result issued by the registry or from the failure of the registrar (except in certain circumstances, such as non-payment of fees) to register a printed financing statement submitted for registration.³²⁶ There is an exception from this liability in the case of oral advice (unless the maker was not acting in good faith), and in the case of a failure to register (correctly or at all) a financing statement in electronic form sent to the registry for the purpose of effecting a registration.³²⁷
- 4.218 The NZPPSA does not have a similar express section, but it does provide that if a person fails to discharge any duty or obligation imposed on that person by that Act, the person to whom the duty or obligation is owed and any other person who can reasonably be expected to rely on performance of the duty or obligation has a right to recover damages for any loss or damage that was reasonably foreseeable as likely to result from the failure.³²⁸ Although this provision would probably not include liability on the part of the supplier of information for inaccuracy of the financing statement (although there might be liability for this under other existing laws), it would presumably cover breach by the registrar of its various duties under the NZPPSA (although this is likely to relate to the duties to operate the system rather than the accuracy of the information contained in the financing statements). Unlike Saskatchewan, other forms of action are not barred.³²⁹ Our provisional view would be to adopt the New Zealand approach, although we would welcome the views of consultees on this point.
- 4.219 **We ask consultees whether the registrar should be liable in damages for breach of any duty or obligation imposed by the notice-filing system, to the extent of reasonably foreseeable loss or damage caused to those who can reasonably be expected to rely on performance of the duty or obligation.**

³²⁴ Cf the system of indemnity in respect of the Land Registry under the Land Registration Act 1925, s 83, and see *Prestige Properties Ltd v Scottish Provident Institution*, *The Times* 23 May 2002.

³²⁵ See the Diamond report paras 22.1.3 and 22.1.7 (referring to the Report of the Company Law Committee 1962, Cmnd 1749 (the 'Jenkins report')). See also W J Gough, *Company Charges* (2nd ed 1996) pp 720-721 and the New Zealand Court of Appeal decision in *First City Corp Ltd v Downsvie Nominees Ltd* [1990] 3 NZLR 265, 272. However, cf G McCormack, *Registration of Company Charges* (1994) p 117.

³²⁶ SPPSA, s 52(1).

³²⁷ SPPSA, s 52(2). Alternative forms of action in respect of the discharge or purported discharge of any duty or function pursuant to the SPPSA are prohibited: *ibid*, s 52(4). This would presumably preclude tortious actions for misrepresentation.

³²⁸ NZPPSA, s 176(1).

³²⁹ NZPPSA, s 176(2).

Liability for breach of duty

- 4.220 We noted above that the NZPPSA contains a provision to the effect that a person failing to discharge any duty or obligation imposed by that Act may be liable in damages for reasonably foreseeable loss to the person to whom the duty or obligation is owed, and we considered this provision in the context of the registrar's possible liability.³³⁰ However, we have also seen that there are some instances where the NZPPSA imposes a duty on the parties involved, such as in relation to responding to requests for further information being made. We would like the views of consultees as to whether they think a similar provision would be sensible, in the event that the notice-filing system we are provisionally proposing contains equivalent 'duties'. We make clear that we do not envisage such a provision would found a claim for damages in the event of inaccuracies in the filing of a financing statement (that would be governed by the estoppel provisions we noted earlier,³³¹ or possibly a claim under existing misrepresentation law), and would apply only where there was some form of obligation imposed (such as in relation to supplying further information following a request).
- 4.221 **We ask consultees for their views on whether there should be a provision to the effect that a person failing to discharge any duty or obligation imposed by the notice-filing system should be liable for reasonably foreseeable loss or damage caused to those who can reasonably be expected to rely on performance of the duty or obligation.**

Transitional provisions

- 4.222 The introduction of a notice-filing system for company charges would be a significant change for the business community and for Companies House. There would have to be a period for users to become familiar with the new system before it came into operation, particularly if the system were to operate - as we would envisage - on a wholly electronic basis.
- 4.223 The more difficult questions relate to the existing register of charges and to priority. It would obviously be unfair to introduce a new system that would cause prejudice to those companies and creditors that have already complied with the registration requirements currently in force. Nor, as we discuss below, would we want to make re-registration necessary to preserve priority.
- 4.224 We have considered how the overseas jurisdictions have dealt with the question of transition, although there are significant differences between the introduction of notice-filing for company charges, which is all that we are concerned with in this Part of our Consultation Paper, and the introduction of the much more far-reaching systems overseas.
- 4.225 New Zealand is the most recent jurisdiction to adopt a comprehensive system of notice-filing (the current SPPSA deals only with transition from an already existing notice-filing system which had been established under a previous PPSA (the

³³⁰ NZPPSA, s 176(1).

³³¹ See above, paras 4.43-4.46.

'original SPPSA'), which the later SPPSA repealed³³²). The NZPPSA sets out a transitional period of six months from commencement (1 May 2002), and provides a series of rules relating to registration and priority conflicts within this period. Effectively, prior security interests must be re-perfected during the transitional period, otherwise they become unperfected. In general, where these had priority under the old law (for example, by being registered elsewhere) priority is backdated to the original date of perfection. Other prior security interests (which we think would include previously unperfected interests as well as floating charges) seem to date their priority from being re-perfected during the transitional period. Certain specific priority rules operate during the transitional period (covering, for example, conflicts between interests that are deemed to be perfected and those that are otherwise perfected under the NZPPSA).³³³

4.226 As we have noted elsewhere, both the SPPSA and the NZPPSA set out complete systems covering the creation, attachment and perfection of security interests of all kinds, including quasi-securities, created by all forms of debtor. In such circumstances, where a whole new registry is created, some form of requirement to re-register security interests previously recorded under other statutes seems justifiable, particularly where, as in many cases, registration under the previous statutes was for a limited time only, and subject to renewal. However, in the first instance, at least, we are concerned only with the introduction of a more limited system that would apply to companies, and thus would affect only the Companies Register. Moreover, current registration is not done on the basis of a limited period which has to be renewed. We do not think that we can take the same approach as that used in Saskatchewan and New Zealand, particularly as the same registry will continue to register the charges or security interests that are registrable under notice-filing.

4.227 We initially wondered whether there would have to be two Company Charges Registers - the old and the new - operating independently, each of which having to be searched separately. However, we see no reason why the information currently held on the existing Company Charges Register should not be incorporated onto a new notice-filing register, or the new information be put onto the existing register (and its nature changed to an electronic version). Whether all the existing information held on the Company Charges Register should continue to be available, or whether the registrar should convert the information held into a financing statement format, is a point on which we have no firm view.³³⁴

³³² The transitional provisions of the original SPPSA are therefore probably of more assistance to us for these purposes. The original SPPSA contained a general provision that it applied to every security agreement made after it came into force, and to every existing prior security interest. It also applied to security interests created under certain transactions made after the original SPPSA came into force, and which dealt with renewal, extension, refinancing or consolidation, and to the continuation of revolving credit transactions: *ibid*, ss 71(1) and (4). A "prior security interest" was defined as "an interest created, reserved or provided for by a security agreement or other transaction validly created or entered into, before this section comes into force, that is a security interest within the meaning of this Act and to which this Act would have applied if it had been in force at the time the security agreement or other transaction was created or entered into": *ibid*, s 72(1)(a).

³³³ See the NZPPSA, ss 193-201.

³³⁴ Although, if the latter course were taken, we would envisage the date of the creation of the charge being added to the listed particulars on the financing statement. Although conversion

- 4.228 On priority, whilst the ‘old’ entries on the register would eventually become redundant over time, there are likely to be a number of charges on it that will be valid for a significant period. The register would need to distinguish between entries made before the new scheme came into force, and thus subject to the ‘old’ law, and those made after.

Existing fixed charges

- 4.229 Those parties which have already registered fixed charges under the existing scheme are unlikely to be affected adversely by subsequent entries made under a notice-filing system. Application of the normal ‘date of filing’ rule would mean that a party holding a security interest created after the commencement of the new scheme, even when registered under the notice-filing system, would not take priority over chargees who have already registered their interests under the current registration scheme. As between competing ‘old’ charges, priority will depend on the existing rules. In most cases it will depend on the date of creation, which is shown on the existing particulars.

Existing floating charges

- 4.230 Although no entry under the new register would take priority over an old one in respect of fixed charges, the situation would be slightly different in relation to floating charges. Under the current law, an uncrystallised floating charge is subordinated to subsequently created fixed charges, although not to subsequent floating charges.³³⁵ Under a notice-filing system, a floating charge’s priority would date from filing rather than crystallisation. Consequently, it would be possible for an ‘old’, uncrystallised floating charge³³⁶ to be subordinated in priority not only to a subsequently created fixed charge but also to a ‘new’ floating charge over part of the company’s assets.³³⁷ Although this would be a change from the current position, we do not think that in practice it is likely to lead to prejudice, given that those who take floating charges under the current law do so without an expectation of having priority over any other charge before crystallisation.
- 4.231 In any event, we would expect that an existing floating charge-holder would want to re-register the floating charge under the new system, so as to get the benefit of fixing priority from the date of re-registration. Thus we think that ‘old’ floating charges might disappear quite quickly. We return to the question of transition in respect of previously unregistrable charges and quasi-securities later in this Consultation Paper.³³⁸
- 4.232 **We welcome consultees’ views on whether to transfer all existing registrations to a new Company Charges Register or whether to keep the**

by the registrar would be an initial administrative burden, it would probably be cheaper and more effective to have the registrar conduct this task than to require the company or creditor to re-submit particulars in the form of a financing statement.

³³⁵ Although it may be if the first charge so permits: see above, para 2.40 n 95 and *Re Benjamin Cope and Sons Ltd* [1914] 1 Ch 800 and *Re Automatic Bottle Makers Ltd* [1926] Ch 412 (which suggests that a floating charge over part of the assets may be authorised impliedly).

³³⁶ Which would be subject to the ‘old’ law.

³³⁷ Having granted one floating charge the company would have no authority to grant a second over the same class of (eg, all) its assets.

³³⁸ See below, paras 5.126 and 7.77-7.80.

existing information on the present register. We ask whether consultees agree that there is no need to re-register previously registered charges.

CONCLUSION

- 4.233 We noted in Part III that we considered there was a need for reform to the current company charges registration system. It is our provisional view that a notice-filing system would be the best way of achieving what we saw as the aims of any modern registration scheme. A system of notice-filing would make it substantially easier for companies or, in practice, their creditors to register charges. Filing could be done electronically by completing a simple on-screen form and the information filed would appear on the public register without imposing on the staff of the Companies Registry the burden of checking the information submitted. Searching of the register could be done easily and accurately on-line. Although less information would have to be submitted, there would be little reduction in the practical value of the register as a source of information about the state of secured indebtedness of the company. The inter-relationship between the Company Charges Register and the various 'specialist registers' applying to specific assets would be simplified.
- 4.234 In addition to these benefits, a potential creditor could have confidence that any charge it filed would have priority over any earlier charge that does not appear on the register and any subsequent charge (other than purchase-money interests). Filing could be done in advance of the creation of the security, so as to preserve priority during negotiations; and a single financing statement could be filed to cover future transactions between the same parties, thus obviating the need to register successive securities as and when they are created. The amount of information available to the public might therefore be increased, as it would be possible to register charges that are currently excluded from the registration requirements because registration of each charge is impractical.³³⁹ The 'date of filing' approach (subject to the special position of the purchase-money interest) would make the determination of priority as between registered charges significantly easier. The position of purchasers of charged property would also be put on a more rational basis.
- 4.235 In subsequent Parts we consider whether - and provisionally recommend that - the notice-filing system we have provisionally proposed should be extended to make registrable a number of quasi-securities and should cover non-corporate debtors. However, even without considering these later points it is our provisional view that a notice-filing system for company charges would be a great improvement on the current registration scheme.
- 4.236 **We ask consultees whether they agree with our provisional proposal that a system of notice-filing should replace the current registration scheme for company charges. It would be particularly helpful if consultees could explain the practical and economic impact they envisage our provisional proposals having. We also ask consultees whether there are any additional matters that they consider should be dealt with as part of a notice-filing system applicable to company charges.**

³³⁹ Which types of charge should be exempt from filing requirements is considered in Part V.

PART V

REGISTRABLE CHARGES

- 5.1 In this Part we consider what charges should be registrable under a notice-filing system of the kind that we provisionally proposed in Part IV. We noted in Part III that the Steering Group's consultation document provoked a strong response to the effect that the list of registrable charges set out in the Companies Act 1985¹ does not reflect current commercial practice.² We reach the provisional but clear view that there should be significant amendment to the current list of registrable charges.³
- 5.2 We have also considered which charges should be registrable were reform to be effected not by adopting notice-filing but by amending the current scheme, as briefly canvassed (but provisionally dismissed) in Part III. We have concluded that the provisional proposals we make in this Part are equally applicable on this alternative approach.

A LIST OF REGISTRABLE CHARGES OR OF EXCLUSIONS?

- 5.3 A preliminary question is whether the approach should be to list those charges which are registrable (as under the current scheme) or whether there should instead be a requirement to register any charge that is not specifically excluded. This question was raised in the Diamond report in the context of interim amendments to the list pending the introduction of more fundamental reforms the report recommended. The Diamond report stated that it would not be sensible to require all charges to be registered, nor even to require registration of all charges except those on a list of exceptions, as not all the charges that might possibly be used in the future could be identified.⁴ The unimplemented reforms enacted by the Companies Act 1989 retained the 'list of registrable charges' format, although the list was amended.⁵

¹ We described the list (set out in the Companies Act 1985, s 396) in Part II: see above, para 2.26.

² See above, paras 3.12-3.15. The Steering Group noted that the proposals to update and extend the list of registrable charges embodied in the Companies Act 1989 "were welcomed, and the 1994 consultation confirmed ... this": Registration of Company Charges para 3.30. Although notice-filing could apply to the existing and unchanged list of registrable charges, it seems clear that this would be an unrealistic option, given the criticisms.

³ We consider whether the system should take a functional approach to what should be registrable, and thus be extended to include 'quasi-security' interests as recommended by the Crowther and Diamond reports and as introduced in the overseas systems, in Part VII.

⁴ Diamond report para 23.1.6.

⁵ The Companies Act 1989 would have substituted (insofar as relevant to England and Wales) a requirement to register:

"(a) a charge on land or any interest in land, other than –

(i) in England and Wales, a charge for rent or any other periodical sum issuing out of the land,

...

- 5.4 The Steering Group adopted the alternative approach.⁶ In its Final Report, after recommending that floating charges and all charges on goods⁷ should be registrable,⁸ concluded that charges over all forms of ‘obligations’⁹ should be registrable unless they were on a list of charges that it proposed should be exempt from registration (most but not all of which related to charges over intangibles).¹⁰
- 5.5 As between making all charges registrable except those listed as exempt and simply having a list of those that should be registrable, not much might turn on the method used if the list were carefully drawn. However, arguably the Steering Group’s approach is preferable: a system working on the basis that the parties to a transaction would expect most charges to be registrable unless on a finite list would perhaps be easier to operate and would reflect the commercial reality¹¹ that in practice most companies or creditors seek to register all charges ‘just in case’. In addition, such an approach would go towards making the section ‘future-proof’ in respect of security over new types of assets. This would avoid repetition of the difficulty apparently now felt over whether charges over, for example, computer software and film negative rights in film financing are registrable.¹² While we accept the Diamond report’s concern that we cannot identify future types of charge or asset that might be charged, we think it better that new types of charge or charges over new types of asset should be registrable unless exempted. We provisionally propose that there should be power to create new exemptions by Ministerial order.

(b) a charge on goods, or any interests in goods, other than a charge under which the chargee is entitled to possession either of the goods or of a document of title to them;

(c) a charge on intangible moveable property ... of any of the following descriptions –

(i) goodwill,

(ii) intellectual property,

(iii) book debts (whether book debts of the company or assigned to the company),

(iv) uncalled share capital of the company or calls made but not paid;

(d) a charge for securing an issue of debentures; or

(e) a floating charge on the whole or part of the company’s property.”

See the unimplemented Companies Act 1985, s 396 as inserted by the Companies Act 1989, s 92 for additional constructions of the list.

⁶ The Steering Group did not consider the question of a notice-filing system that made registrable more than just charges; however, we consider this aspect (the ‘functional approach’) below, in Part VII.

⁷ Including those on goods and other property situated overseas: Final Report para 12.55, and see below, paras 5.87 ff.

⁸ Final Report para 12.54.

⁹ This is the word used, but the list of proposed exemptions that follows includes items of property, so it seems that the Steering Group meant to include charges over all assets unless exempted.

¹⁰ Final Report para 12.60. See below, paras 7.35 ff.

¹¹ Or so we have been led to believe.

¹² These examples were given during the Steering Group’s consultation process.

- 5.6 **Our provisional view is that a notice-filing system applicable to charges should make all charges registrable unless excluded, rather than identifying only those charges that are to be registrable.**
- 5.7 Such an approach would deal with a point on which the Steering Group thought the list was in clear need of updating.¹³ Section 396(1)(c) of the Companies Act 1985 makes registrable a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale (a requirement first appearing in the Companies Act 1900, section 14). We agree that this cross-reference to the complex and outdated registration provisions relating to bills of sale¹⁴ is unfortunate. The Steering Group's suggestion that in principle all charges on goods should be registrable¹⁵ would remove the cross-reference. Even if it were decided to retain a list of registrable charges on the existing model we would propose to replace the reference in section 396(1)(c) with a stand-alone provision making all charges on goods registrable.
- 5.8 There should be an exception, however, for some securities over goods that fall into the categories currently exempted from the Bills of Sale Acts: in the words of the Diamond report, the exclusion should be:

in essence ... charges on goods abroad or at sea, or imported goods before they are delivered to a buyer or deposited in a warehouse factory or store.¹⁶

THE STEERING GROUP'S PROPOSED EXCEPTIONS

- 5.9 Using the approach suggested above as a working basis we now turn to consider the appropriateness of the Steering Group's proposed list of excluded items, noting that some of the exceptions listed are already excluded in section 396 of the Companies Act 1985, and others are suggested to clarify the existing position.¹⁷ The exemptions proposed by the Steering Group were:
- (a) simple retention of title clauses,
 - (b) a charge, as such, for the purpose of securing any issue of debentures,
 - (c) the deposit by way of security of a negotiable instrument given to secure the payment of a debt,
 - (d) charges over shares,

¹³ Final Report para 12.55.

¹⁴ See below, paras 8.7 ff.

¹⁵ Final Report para 12.55. This included those on goods (as well as other property) situated overseas: see paras 5.87 ff.

¹⁶ Diamond report para 23.9.18. Below we suggest that charges over insurance policies over such goods should also be exempt from registration: see below, para 5.40.

¹⁷ Our provisional views also relate to registrable charges under the alternative method discussed in Appendix A, unless indicated differently.

- (e) charges over insurance policies,
- (f) contractual liens over sub-freights, and
- (g) charges on cash or securities, including shares, bonds, money market instruments and units in collective investment schemes in such securities.

We will deal with each of these points but not in the same order. In particular, we will not deal separately with the items mentioned in (g).¹⁸ We understand that in practice a charge over cash will be safeguarded either by requiring that the cash be deposited, either in the chargee's possession or in a bank account over which the chargee has control. This is discussed below.¹⁹ Charges over the other assets mentioned raise the same issues as will be discussed in relation to shares.²⁰

- 5.10 The Steering group also proposed a special rule to deal with the rather unusual problem affecting corporate members of Lloyds. This is considered separately.²¹

Simple retention of title clauses

- 5.11 As the Steering Group noted in its consultation document, the broad thrust of the case law is to the effect that complex retention of title charges are registrable charges.²² Simple ones, even 'all-monies' clauses, are not.²³ To exclude 'simple' retention of title clauses might clarify the question of when a retention of title clause amounts to a registrable charge. The Steering Group was inclined to leave such questions to the courts. Respondents suggested that the current position is sufficiently clear and legislation should not be too prescriptive. Many respondents also noted the difficulty in attempting a precise definition which may risk raising a new set of uncertainties in this area. We provisionally suggest that a statutory definition of a registrable retention of title clause, or indeed a specific exemption for the 'simple' clause, is unnecessary.

- 5.12 **We provisionally propose that the question of whether a retention of title clause creates a registrable charge should be left to the courts.**

- 5.13 Later in this Consultation Paper we return to the question of retention of title clauses when we consider whether 'quasi-securities' should be registrable, and in that context we think all retention of title clauses should become registrable.²⁴

¹⁸ This exemption was apparently prompted by concerns of participants in the financial markets that a requirement to register charges over collateral typically used in such transactions would hamper the inherent liquidity and attraction of these markets - which is the same issue as for shares.

¹⁹ See below, paras 5.49-5.53.

²⁰ See above, paras 5.18 ff.

²¹ See below, paras 5.78 ff.

²² Registration of Company Charges para 3.41.

²³ See below, para 6.18.

²⁴ See below, paras 7.24-7.26.

A charge, as such, for the purpose of securing any issue of debentures

- 5.14 The Steering Group noted that it had been told that charges are no longer in practice given to secure issues of debentures, and that this made the requirement for their registration “arguably otiose”.²⁵ However, if it is the case that certain charges are not in common usage we see no necessity to specifically exclude them as a result of this. We are not provisionally inclined to have such an exception, but would welcome the views of consultees.
- 5.15 **We ask consultees whether they agree with our provisional view that charges given to secure the issue of debentures should not be specifically excluded from being registrable, even if in practice this method of raising capital is rarely used.**

The deposit by way of security of a negotiable instrument given to secure the payment of a book debt

- 5.16 The Steering Group was advised to retain the current exception relating to negotiable instruments²⁶ and we agree that these should be excepted. We have already expressed the provisional view that possessory securities should be outside the scope of the notice-filing system we envisage.²⁷ A pledge is not a charge, and the current law makes clear that the deposit of a negotiable instrument to secure payment of book debts is not to be treated as a charge over those book debts.²⁸ We provisionally propose to continue that exception.
- 5.17 **We provisionally propose that the deposit of a negotiable instrument by way of security to secure the payment of a book debt should continue to be exempt from registration.**

Shares and investment securities

- 5.18 In its consultation document the Steering Group noted that fixed charges over shares are not registrable under the current law,²⁹ but we have been told that in practice a charge over shares may be registered, since part of the charged property is the right to receive dividends, which are book debts and thus registrable under the Companies Act 1985, section 396(1)(e).
- 5.19 Whether charges over shares³⁰ ought to be registrable has been the subject of debate for many years. Clearly shares can constitute valuable assets of a company and in principle therefore it should be possible for third parties to discover whether the company has created charges over its holdings of shares. The Jenkins report

²⁵ Final Report para 12.59.

²⁶ Final Report para 12.59.

²⁷ See above, para 4.17.

²⁸ Companies Act 1985, s 396(2).

²⁹ Registration of Company Charges para 3.43, and see *Re Sugar Properties (Derisley Wood) Ltd* [1988] BCLC 146.

³⁰ The discussion in this part is confined to charges in the traditional sense. Whether ‘quasi-securities’ over shares (such as the ‘repo’, see below, paras 6.38-6.45) should be made registrable is discussed in Part VII: see below, para 7.50.

recommended that charges over shares in a subsidiary ought to be registrable and the Cork report recommended that all charges on shares be made registrable.³¹ However, the Diamond report (in the context of interim reform) rejected the idea of registering all charges on shares,³² as did the legislature, as it was thought that that registration would be impractical and the operation of the market could be severely undermined in cases where companies owned a changing portfolio of shares.³³

- 5.20 We pointed out in Part II that with certificated shares parties may attempt to create a charge by depositing the share certificate and a blank stock transfer with the creditor.³⁴ This is intended to work rather like the possessory security that may be created by depositing bearer shares. Not even possessory security is possible where the investment security is not represented by a physical document. As we also saw in Part II,³⁵ the traditional pattern of direct holdings of these securities (that is by either possession of bearer securities or transfer of legal title by register in the company share register) has been replaced by the evolution of indirect holdings through custodians. With the development of uncertificated securities, many transfers are effected by book entry.³⁶
- 5.21 The Steering Group considered whether the blanket exclusion ought to continue or whether all shares should be made registrable other than those where compelling commercial reasons dictated their exclusion. In its Final Report the Steering Group concluded that all shares ought to be exempt from the requirement to register.³⁷ It reached this conclusion for practical reasons and

³¹ See Insolvency Law and Practice (1982) Cmnd 8558 para 1520 and the Jenkins report para 301.

³² Diamond report paras 23.8.13-23.8.14.

³³ As per the Under Secretary of State for Industry and Consumer Affairs, Official Reports Standing Committee D (Companies Bill) 10th Sitting June 1989.

³⁴ See above, para 2.65.

³⁵ See above, paras 2.66-2.71.

³⁶ As one commentator has pointed out, the use of assets used in these markets through intermediaries and held with custodians has challenged traditional legal analysis, as computerised securities cannot be negotiable instruments and the lack of a tangible subject matter takes custody beyond the scope of bailment: J Benjamin, *The Law of Global Custody* (1996) pp 15-34. Rights in such securities are held through often multi-tiered, fungible and intangible arrangements. Consequently, academic legal analysis of such arrangements has alternated between recognising the owner as having proprietary and personal rights. The international, cross-border element means that conflict of laws issues are rife and indeed doubt surrounds the legal aspects of portfolios held in international contexts.

³⁷ Final Report para 12.60. Cf the position in Australia, where s 262(1)(g) of the Australian Corporations Act 2001 requires all charges on shares to be registered except where the charge arose by deposit of a document of title (defined by s 261(1)(g) to include share certificates) to the shares or where shares were registered in the chargee's name upon the company's own share register. However, it must be noted that most security over shares is achieved by these two methods. Similarly in England and Wales a legal mortgage is effected by transferring shares into the creditor's name and issuing a new share certificate. An equitable mortgage is achieved where a creditor takes custody of the share certificate along with a blank stock transfer. The creditor can then enforce the share security by filling in its name or selling on the shares. Security over bearer shares is given by delivery of the share certificate along with a memorandum of deposit, ie, a pledge.

because of the Draft EU Collateral Directive.³⁸ We will consider each of these reasons in turn.

Practical reasons

- 5.22 We are not convinced that the exemption of charges over shares or other investment securities would necessarily have to be continued under a scheme of notice-filing. In Part IV we pointed out that one of the advantages of the scheme would be that a single financing statement could be filed to cover a series of future transactions rather than, as at present, each new charge having to be registered separately as and when it is created. This would, we think, give sufficient flexibility to allow the chargor to continue trading the portfolio of shares, and in effect substituting new shares for old, without having to file a fresh financing statement each time (or reducing the charge to a floating charge).³⁹ We understand that under the schemes in New Zealand and Saskatchewan, security interests in investments securities are perfected by filing.⁴⁰
- 5.23 However, we think that there are good reasons of principle for making registration of charges over shares and investment securities unnecessary under a notice-filing system.⁴¹ (We will discuss below whether notice-filing should be a permissible alternative.⁴²) In Part III we set out the criteria that we think a modern system of registration should meet. One of these is to provide information about security over a company's property, particularly ones that third parties are unlikely to be able to discover easily from other sources. On the other hand, the register need not duplicate information from other sources or warn about securities that will be obvious to third parties. For example, it would serve no good purpose to require registration of pledges. These require that the creditor have possession of the goods or documents (including, for example, bearer shares). Any potential creditor will find this out easily. Equally, the goods or documents will not appear to potential investors to be among the debtor's assets.⁴³
- 5.24 A similar argument applies to shares. A mortgage or charge over shares may be created by a simple agreement,⁴⁴ but in practice the mortgagee or chargee will wish to protect the security interest against third parties. There are two ways of what amounts to perfecting a charge over shares. One is to take custody of any share certificates, usually together with a transfer form signed in blank by the share-owner. The other is to have the shares registered in the name of the mortgagee or

³⁸ See above, para 2.72.

³⁹ For the disadvantages of a floating charge over shares see above, paras 2.40-2.44 and 2.63.

⁴⁰ However, we understand that in Canada a Uniform Law Conference Working Group is preparing a Uniform Securities Transfer Act, which may provide a new regulatory scheme for security interests in investment property: see R Cuming and C Walsh, "Possible Implications of Revised UCC Article 9 for Canadian Personal Property Security Acts" (2001), para 42 (available at <http://www.law.ualberta.ca/alri/ulc/99por/eppsaucc.htm>).

⁴¹ Or under any amended version of the current scheme.

⁴² See below, paras 5.29-5.35.

⁴³ See above, para 4.15.

⁴⁴ Once the creditor has advanced the loan the agreement will be specifically enforceable and thus an equitable mortgage or charge will come into existence: see above, para 2.12.

chargee. (We pointed out in Part II that systems like CREST for trading of dematerialised shares do not allow for registration of interests less than ownership.⁴⁵) In either case, the position will be clear to third party enquirers, or at least readily ascertainable by them. As the UCC Article 9 puts it, the shares are under the control of the chargor; and Article 9 treats securities that are under the control of the secured party as perfected, just as it does possessory securities once the collateral is in the possession of the creditor. For reasons that we explain below,⁴⁶ it would not be appropriate simply to provide that a charge over shares should be treated as effective against third parties without any steps being taken to perfect it, but we think it is unnecessary to require the registration of charges over shares when the chargee has either taken possession of the physical certificates or has control by virtue of having been registered as the owner. In those circumstances the charge should be treated as perfected without filing. Thus it would be valid in the event of insolvency and would have priority over any subsequent security interest. (We would also exempt a charge over rights to dividends when this forms part of a charge over the shares concerned.⁴⁷)

Impact of the Draft EU Collateral Directive

- 5.25 The policy behind the EU Collateral Directive is that publicity requirements for perfection in differing jurisdictions are perceived as impractical, difficult and inconvenient when applied to financial markets.⁴⁸ The Draft Directive seeks to protect the validity of financial collateral arrangements that are based on the full ownership of the financial collateral.⁴⁹ The Draft Directive proposes a simplified framework in order to create legal certainty. This should lead to increased liquidity in these markets and in turn to more efficient price determination. The two specific measures designed to achieve this aim are, first, to permit agreements allowing the collateral-taker to reuse the collateral by on-pledging⁵⁰ and, secondly, to allow specifically for collateral substitution. The proposed regime would apply to both financial collateral arrangements that operate by title transfer (as to which, we discuss below, in Parts VI and VII) and those that employ security in the traditional sense.
- 5.26 In order to limit the administrative burdens, the only perfection requirement which national law may impose is that the financial collateral (which can consist of cash or financial instruments as defined in the paper) is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker (or a person acting on their behalf). Further the validity and perfection, enforceability or admissibility may not be made dependent

⁴⁵ See above, paras 2.69-2.71. The creditor may also take a power of attorney and have the shares placed in an escrow account, so that any funds raised by their sale will be held for the creditor, but this will not protect the creditor in the event of insolvency of the debtor: see above, para 2.71.

⁴⁶ See below, para 5.31.

⁴⁷ Whereas the Steering Group also excluded charges over shares it did not offer any clarification as to whether dividends constituted book debts.

⁴⁸ See “Proposed Directive on Financial Collateral Arrangements, frequently asked questions”.

⁴⁹ Amongst other things, it aims to eliminate the recharacterisation risk.

⁵⁰ Or ‘rehypothecation’.

on the performance of any formal act such as the execution of any document in a specific form or in a particular manner, the making of any filing with an official or public body or registration in a public register.⁵¹ The EU Collateral Directive aims to provide a balance between market efficiency and the safety of the parties to the arrangement and third parties, thereby avoiding the risk of fraud: this is achieved through the scope of the Directive covering only those financial collateral arrangements which provide for some form of dispossession where the provision of financial collateral is evidenced in writing or a durable medium and the collateral can be effectively traced.

- 5.27 Although the Collateral Directive has not yet been adopted, it seems likely that it or a similar measure will ultimately be adopted. Thus any reform should be compatible with its probable requirements.
- 5.28 **We provisionally propose that all charges over shares, and charges over rights to dividends when this forms part of a charge over the shares concerned, should be treated as perfected if the secured party has possession of the certificate or has control by being registered as owner.**
- 5.29 It has been suggested to us that there might be advantages in allowing a chargee the option of perfecting a security interest over shares by filing a financing statement. This would mean that neither of the methods described above would be necessary as a way of taking a valid charge over shares or other investment securities. This point requires careful explanation.
- 5.30 Under the present law a creditor may take a charge over shares without taking possession or control. For example, shares owned by a company will be within a floating charge over all its assets and, provided that the floating charge is registered, it will be valid against unsecured creditors in the event of insolvency. It will however be 'vulnerable' in the sense that the company may create a subsequent fixed charge over the shares that will rank ahead of the floating charge. A fixed charge over shares does not need to be registered (it is not on the list of charges that have to be registered) but, as we have explained, in practice the chargee will take possession or control.
- 5.31 Under a notice-filing system, one possibility would be to continue to exclude charges over shares from filing altogether. This would mean, however, that unsecured creditors and others might be affected by a charge that was not protected by possession of the certificates or control, and which they would therefore have no means of discovering. That would go against the policy of trying to ensure that third parties are alerted to the possibility of charges that are not evident. A second possibility would be to say that no charge over shares will be perfected unless the creditor takes possession of the certificates or control. This solution has the advantage of simplicity but it may seem to be restrictive. The third possibility is to provide that a charge over shares may be perfected by filing as an alternative to the other methods of perfection.⁵²

⁵¹ Recording a transfer on the issuer's register is not considered a formal act.

⁵² The draft EU Collateral Directive does not seem to preclude registration as an *alternative* method of perfecting a charge: see art 4. It applies only where the collateral has been

5.32 The advantage of giving additional choice has to be set against the risk that if such a method did not become common, third parties enquiring about charges over shares might not think to check the register. It would also create an additional complication. There would be the possibility that two charges over the same shares might be perfected in different ways - one secured party might have filed a financing statement and the other have taken control.

5.33 This issue is parallel to one that arises in relation to goods. Under present law goods may be subject to a floating or fixed charge to one creditor and then be pledged by the company to a second creditor. Who has priority under current law depends on the nature of the first charge; if it is floating, the pledgee has priority. Under a notice-filing system, this would change. If the charge were perfected first it would have priority over the pledge.⁵³ We think that this priority rule is appropriate for questions as between a charge over goods and a pledge of them, but we do not think that it is appropriate for shares or investment securities. Although shares are not negotiable instruments, it is very important that their ready transferability be maintained. As the Official Comment to the UCC puts it, with such collateral:

a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor.⁵⁴

Revised Article 9, which permits perfection of security interests over 'investment property' by either filing or control, provides that the party who has control will always have priority, even if the financing statement was filed first.⁵⁵

5.34 We think that, if the alternative of perfection by filing were to be permitted, such a rule would be desirable.⁵⁶ The result would be that a secured party could protect a charge over shares, without taking possession or control, by filing, and this would mean that the charge would be valid against unsecured creditors in the event of the debtor's insolvency. However, the charge would be 'vulnerable' to loss of priority to a subsequent creditor who perfected by taking possession or control - an outcome not very different to the present situation when shares are subject to a registered floating charge.

5.35 We see the attractions in this third approach, but we incline to the view that to permit perfection of security interests over shares and investment securities by filing may be an unnecessary refinement. We do not think creditors would often create such charges deliberately, as opposed to doing so as the unintended by-

transferred to the collateral taker, or its existence has been noted on the account or register where the collateral taker's interest is recorded. See the notes to art 4.

⁵³ See above, para 4.145.

⁵⁴ Section 9-328, Official Comment 3.

⁵⁵ Section 9-328 (1).

⁵⁶ It would probably be necessary were the draft EU Collateral Directive to be adopted in its present form. This applies as soon as the collateral is transferred into the name of the collateral taker, see above, para 5.31 n 52. It then prevents the imposition of further requirements that would impede enforceability by the collateral taker, art 4.

product of a general charge over all a company's assets. It would be simpler to say that any charge over shares or investment securities must be perfected by possession or control. **We invite the views of consultees on whether, under a notice-filing system, it should be possible to perfect a charge over shares by filing a financing statement as an alternative to either taking possession of the certificates or taking control. If so, should a charge protected by possession or control have priority over one protected by even an earlier filing?**

Charges over insurance policies

- 5.36 Charges over insurance policies currently do not require registration; case law has decided that they are not registrable as charges over book debts.⁵⁷ The existence of an insurance policy would not be entered onto a company's book as a debt before liability under the policy and the amount have been ascertained; moreover it is properly construed as a contingent debt.⁵⁸
- 5.37 The Steering Group's proposal would make charges over most insurance policies registrable. It noted that the 1994 DTI consultation document had proposed that all charges over insurance policies should be registrable and that this proposal had found strong support.⁵⁹ Whilst the Steering Group noted that a requirement to register such charges might deter parties from charging policies that include a confidentiality clause, it was of the view that the argument was one which did not justify excluding all insurance policies: it noted that publicity is an essential part of the registration of charges and an insurance policy containing a confidentiality clause is unlikely to be subjected to a charge.⁶⁰
- 5.38 The Diamond report had also recommended that charges over insurance contracts should be made registrable. However, the recommendation in the Diamond report was not followed in the unimplemented amendments of the Companies Act 1989, and the overseas systems also seem to have excluded security interests over insurance policies from being registrable. The UCC excludes such security interests from the scope of Article 9 (except to the extent they constitute proceeds under Section 9-109(d)(8))⁶¹ and the SPPSA seems to have also favoured such an exemption.⁶² The NZPPSA also excludes such security interests, except in relation to its rules relating to proceeds.⁶³ However, it has been noted that the decision to

⁵⁷ See *Paul and Frank Ltd v Discount Bank (Overseas) Ltd and Board of Trade* [1967] Ch 348.

⁵⁸ See below, para 5.54.

⁵⁹ Registration of Company Charges para 3.38.

⁶⁰ Final Report para 12.61.

⁶¹ However Revised Article 9 now covers health-care insurance receivables as originators of insurance receivables arising from the provision of health care services frequently sell them in financing transactions.

⁶² SPPSA, s 4(b) excludes from the scope of the Act "the creation or transfer of an interest or claim in or pursuant to a contract of annuity or policy of insurance except the transfer of a right to money or other value that is payable pursuant to a policy of insurance as indemnity or compensation for loss of or damage to collateral".

exclude insurance policies seems to be based on political rather than reasoned legal or practical reasons.⁶⁴

5.39 We see no reason why charges over insurance policies should be exempt from registration. **We provisionally propose that charges over insurance policies should in general be registrable.**

5.40 However, the Diamond report's recommendation was subject to exceptions with regard to marine insurance on goods to be exported and for charges on policies relating to other goods of a sort over which a charge would not be registrable.⁶⁵ The Steering Group also proposed that there should be exceptions in these cases.⁶⁶ We agree. **We provisionally propose that neither charges on goods nor on insurance policies on goods should be registrable where the goods are abroad or at sea, or are imported goods before they are delivered to a buyer or deposited in a warehouse, factory or store.**

Contractual liens over sub-freights

5.41 Contractual liens over sub-freights to secure performance of the master time charter payments over ships were never considered to be registrable charges until the decision in *Re Welsh Irish Ferries Ltd*⁶⁷ which held contractual liens over sub-freights constitute a charge. At the time Nourse J recognised that there may be "great practical difficulties" in requiring these to be registered.⁶⁸ The Diamond report recommended that charges on freight should not be registrable, as it was thought unlikely that persons extending credit to a charterer rely on that income, or would be unaware of the presence of a lien which is a standard clause in many charterparties, and hence little useful purpose would be served by added publicity.⁶⁹ Had the provisions been implemented, the Companies Act 1989 would have excluded ship-owner's liens from registration.⁷⁰ The Steering Group proposed this exception also on the basis of the Privy Council decision in *Agnew v Commissioner of Inland Revenue*⁷¹ which doubted the correctness of the decision in *Re Welsh Irish Ferries Ltd*.⁷² Whilst it may be that some of the practical difficulties of

⁶³ NZPPSA, s 23(e)(vi) provides that the Act does not apply to an interest created or provided for by a "transfer of an interest or claim in or under a contract of annuity or policy of insurance, except as provided by this Act with respect to proceeds and priorities in proceeds".

⁶⁴ G Gilmore, *Security Interests in Personal Property* (1965). In some cases different legislation may cover insurance policies.

⁶⁵ Diamond report para 23.5.4. For the charges on goods that would be exempt see above, para 7.00.

⁶⁶ Final Report para 12.61.

⁶⁷ See *Re Welsh Irish Ferries Ltd (The Uglan Traler)* [1986] Ch 471 and *Annangel Glory Compania Naviera SA v M Gobdetz Ltd (The Annangel Glory)* [1988] 1 Lloyd's Rep 45.

⁶⁸ See *Re Welsh Irish Ferries Ltd (The Uglan Traler)* [1986] Ch 471, 481.

⁶⁹ Diamond report para 23.4.15.

⁷⁰ The unimplemented Companies Act 1989, s 93 inserted a new Companies Act 1985, s 396(2)(g).

⁷¹ [2001] 2 AC 710, 727E-728D.

⁷² Final Report para 12.59.

registering a lot of such charges might be reduced by a notice-filing system permitting the filing of a single financing statement in respect of multiple transactions between the same parties, in the light of the questionable status of such liens, it may be sensible to make clear that such liens ought not to be registrable charges.⁷³ However, we would welcome the views of consultees on this point.

- 5.42 **We would therefore propose to make it clear that contractual liens over sub-freights are not charges and therefore are not registrable.**

OTHER EXCEPTIONS

- 5.43 In addition to the list of exceptions proposed by the Steering Group, there are a number of other issues relating to the list of exemptions. One common criticism of the current list of registrable charges is the distinction it draws between book debts and other debts; only book debts are registrable. Another point is that it is uncertain whether it covers bank accounts. There are also the issues of contingent debts and 'charge-backs'; of non-monetary obligations; and of charges registrable in other specialist asset registers. Which if any of the charges that are currently not registrable should remain exempt?

Book debts and other monetary obligations

- 5.44 Charges over certain types of monetary obligation, including uncalled share capital of the company or calls made but not paid and, more importantly, book debts are registrable charges.⁷⁴ It is also uncertain whether credit balances at a bank account are book debts and consequently whether a charge over a bank balance in favour of a party other than the bank⁷⁵ is registrable. Contingent debts, for example rights under insurance policies,⁷⁶ are currently not registrable as they are not regarded as book debts.⁷⁷
- 5.45 The Steering Group noted in its consultation document that the actual meaning of book debts has been the source of constant debate.⁷⁸ The 1994 DTI consultation document raised the question of whether the concept of book debts should be replaced by a wider concept of 'receivables' and proffered a suggested definition which would in effect have caught many of the transactions which have been held

⁷³ We would propose to exclude such liens from being registrable under the alternative reform outlined in Appendix A. Equally, because they do not purport to create proprietary interests, they should not be treated as quasi-security interests. See below para 7.51 n 78.

⁷⁴ Companies Act 1985, s 396(1)(e). However a charge over a negotiable instrument given to secure the payment of book debts is expressly stated not to be registrable: Companies Act 1985, s 396(2).

⁷⁵ Charges in favour of the bank itself ('charge-backs') are dealt with below, paras 5.49-5.51.

⁷⁶ See above, para 5.36.

⁷⁷ The relevant accounting standard, FRS12, states that contingent assets are not recognised in financial statements, which derives from the concept of prudence in SSAP2, ie, nothing is brought in until it has happened. This contrasts with the position on contingent liabilities that are known which are mentioned.

⁷⁸ Registration of Company Charges para 3.34.

not to be book debts.⁷⁹ The Steering Group did however note that even under an expanded definition uncertainties as to exactly what did constitute a 'receivable' would remain.⁸⁰ An alternative would be simply to require registration of charges over 'debts', which might still exclude some categories of money obligation.⁸¹ The final question posed to consultees was whether charges over all money obligations should be made registrable, and whether this should include contingent contract rights.⁸²

- 5.46 Responses to the Steering Group's consultation document were generally in favour of making charges over contingent debts registrable.⁸³ Responses on the other questions were more variable. A small number suggested that only book debts should be registrable while larger numbers suggested 'receivables' or 'all debts' should be registrable. The Steering Group's Final Report dealt with the issue by suggesting that all charges over obligations would be registrable save for specified exceptions. The exception specified in relation to 'debts' was the deposit by way of security of a negotiable instrument given to secure the payment of a debt, essentially a possessory security.⁸⁴
- 5.47 It is our provisional view that the present requirement to register charges over book debts should be replaced by a provision in effect requiring⁸⁵ registration of charges over any kind of money obligation⁸⁶ with specified exceptions. (This would be achieved simply by acceptance of our provisional proposal that all charges save those expressly excepted should be registered.⁸⁷) Thus not only traditional book debts but income from, for example, PFI schemes, would be within the registration scheme; so would contingent obligations.
- 5.48 We would create a number of exceptions, in accordance with our general approach that registration should be required only of charges that would not be immediately apparent to third parties.⁸⁸ These relate to charges over bank balances. (We have already proposed that charges over bonds and other debt securities, and equity

⁷⁹ Registration of Company Charges para 3.35.

⁸⁰ Registration of Company Charges para 3.35.

⁸¹ Registration of Company Charges para 3.36.

⁸² Registration of Company Charges para 3.37.

⁸³ Although it was also suggested that there was no pressing need to introduce this as an additional category of registrable charge, at least where the chose in action is not recorded in financial statements as an asset under accounting standards.

⁸⁴ Final Report para 12.60.

⁸⁵ We would remind readers that, if notice-filing were adopted, this would be a 'requirement' in the sense that if the charge were not registered it would be at risk of loss of priority and invalidity in the event of insolvency. There would be no criminal sanction. See above, paras 4.51-4.58.

⁸⁶ Thus including charges over uncalled share capital of the company or calls made but not paid.

⁸⁷ See above, para 5.6.

⁸⁸ See above, para 4.5.

share dividend rights when part of a charge over the shares concerned, should be exempt.⁸⁹)

Charges over bank balances

‘Charge-backs’

- 5.49 We begin with the charge over a bank account in favour of the bank itself. The *Re Charge Card* decision,⁹⁰ in which it was held to be conceptually impossible for a bank to take a charge over a customer’s account with the bank, was effectively reversed by the House of Lords in *Re Bank of Credit and Commerce International SA (No 8)*.⁹¹
- 5.50 Assuming that such charges are indeed possible,⁹² the question is whether the charge should be registrable. In our view this is probably unnecessary because it seems inevitable that any potential creditor considering taking security over the same account will discover the charge-back. It will not advance credit against the ‘security’ of the bank balance without obtaining the confirmation of the bank that the account exists and is in funds, and the bank’s agreement that the money will be paid out only to the creditor. The bank will reveal its own charge-back.
- 5.51 In this context we note the provisions of the UCC. Former Article 9 did not provide for a security interest in a deposit account. Revised Article 9 specifically brings within its ambit a security interest in a deposit account.⁹³ However, it is expressly stated that security interests over deposit accounts are not to be perfected by filing. Instead they may be perfected only by control.⁹⁴ In effect the fund is in the bank’s ‘control’, just as shares that are charged will normally be within the control of the chargee, and registration is unnecessary to warn potential secured

⁸⁹ See above, para 5.28.

⁹⁰ *Re Charge Card Services Ltd* [1987] Ch 150.

⁹¹ [1998] AC 214, 225-228. See above, para 2.74.

⁹² To ensure effective security over their own bank accounts (commonly referred to as ‘charge-backs’), practitioners commonly adopted a structure whereby the creditor purported to take a charge over the account but also relied on rights of set-off and restricted the depositor’s right to repayment until all obligations owed by the depositor or any associated company have been discharged (so that the account became a ‘flawed asset’). Practitioners noted that this was ‘convoluted’ (see, eg, M Hughes, “Assignments of choses in action” [2001] JIBFL 103) and used only in the absence of express statutory provision removing any doubts as to the effectiveness of such charges. (In Hong Kong, for example, the *Re Charge Card* decision was followed by an ordinance removing doubts which arose from that decision. We understand that this method is no longer favoured and now parties almost invariably rely on insolvency set-off; charge-backs are used only in rare situations where insolvency set-off does not operate.

⁹³ However Article 9 does not provide for a security interest in a deposit account in a consumer transaction, security over which can be obtained under the law outside Article 9: Section 9-102(a)(29).

⁹⁴ Control is obtained over a deposit account if the deposit account is maintained by the secured party, ie, automatically or the secured party becomes the bank’s customer with respect to the deposit account, or an agreement is entered into between the debtor, secured party and the bank providing that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent of the debtor.

creditors.⁹⁵ **We provisionally propose that a charge over a bank account in favour of the bank itself should be possible only if the bank takes ‘control’ of the account; and that it should be exempt from registration.**

Charges over bank accounts (in favour of parties other than the bank)

5.52 Equally we think that it is probably not necessary to require registration of a charge over a bank account in favour of a party other than the bank. As we have just explained, the secured party will in practice not lend against such security without securing the bank’s agreement to make payments out only to the creditor (so that in effect the bank account will be subject to the creditor’s control). If there is already a charge over the account this will surely be revealed. **We provisionally propose that a charge over a bank account in favour of a party other than the bank itself should also be possible only if the third party takes ‘control’ of the account; and that it too should be exempt from registration.**

5.53 **We ask consultees whether they agree that:**

- (1) charges over money obligations, including contingent obligations, ought to be made registrable; but that**
- (2) ‘charge-backs’ and charges over bank accounts should be possible only if the account is under the control of the secured party. The charge should then be treated as perfected without filing.**

Charges to secure a non-monetary obligation

5.54 The Diamond report indicated that in relation to Scotland, doubts had been raised whether a charge to secure a non-monetary obligation is registrable, as the Companies Act 1985, section 417(3)(b) refers to “the amount secured by the charge.” It pointed out that, although the issue had not been raised in relation to England and Wales, section 401(1)(b)(ii) also refers to “the amount secured by the charge”. It suggested that, if necessary,⁹⁶ it should be made clear that securities to

⁹⁵ Nor do we think that registration is essential to warn potential investors. As pointed out in the Diamond report, the amounts that a company has to its credit are not normally known and therefore it is unlikely that anyone will be misled by the existence of an unknown charge: Diamond report para 23.4.10. In relation to charges over shares we ask whether it should be possible to perfect the charge by filing as an alternative to taking possession or control. We do not think that an equivalent question arises in relation to charge-backs. UCC Revised Article 9 permits security interests over deposit accounts be perfected only by control: Section 9-312(b)(1). Where the secured party is the bank at which the deposit account is maintained, there is ‘control’ without more: see above, para 5.51 n 94 and Section 9-104(a)(1). We are not convinced that in English law the mere fact that the account was maintained with the chargee would suffice to create a fixed charge over the account: compare the requirement for a fixed charge over book debts that the proceeds be paid into an account that is ‘blocked’ by the chargee: *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, 729. A ‘blocked account’ would clearly be ‘controlled’ by the bank. It is possible that, in the absence of express provision, a charge-back over an account that was not blocked might operate as a floating charge, which (if perfected by filing) should be good against unsecured creditors. If so, we would have a ‘perfection by filing’ alternative, as for shares (see above, paras 5.29 ff). It would be much simpler to follow the UCC and say that a charge-back can be perfected only by control.

⁹⁶ It seems that this point was one of concern under the Scots law system, rather than for England and Wales.

secure a non-monetary obligation should be treated in the same way as those securing a monetary one.⁹⁷ This would be achieved by our proposal that charges generally should be registrable unless specifically excepted.⁹⁸

Charges registrable in specialist registries

- 5.55 We have noted earlier in this Consultation Paper our provisional view that charges registrable in specialist registries (such as those for aircraft, land or ships) should not be registrable in the Company Charges Register. Alternatively, we suggested that they might be required to be shown on the Company Charges Register (being forwarded on from the registry concerned), but that this should be for notification purposes only, and would not be affected by any other rules of a notice-filing system.⁹⁹

Charges created by trustee companies.

- 5.56 In its consultation document, the Steering Group noted that a company that is acting as a trustee may create a charge over the trust property. This may occur when there is a bare trust, under which the trustee merely holds the legal title to the property at the direction of the beneficiaries, or under more complex trust arrangements. A company may be the trustee of a unit trust and have power to charge the assets of the trust as security; or a company in a group of companies may act as custodian of all the registered securities owned by the group and have power to create a floating charge over all of them.
- 5.57 The registration of charges by trustee companies over trust property has given rise to difficulties. There seems to be doubt as to whether such a charge is registrable under the Companies Act 1985, section 395, since that section applies only to ‘a security on the company’s property’ and property held beneficially for another may not be ‘the company’s property’.¹⁰⁰ The current practice of Companies House is to register a charge submitted by a trustee and to record on the register that the chargor is acting as a trustee.¹⁰¹ The responses to the Steering Group’s consultation document pointed out that the position of commercial trustee companies under Part XII Chapter I of the Companies Act 1985 is unsatisfactory and should be clarified, but there was little agreement on the solution.
- 5.58 The Steering Group reported that it is “the general, but not universal, view” that a charge created by a trustee company is not registrable because in such a case the

⁹⁷ Diamond report para 23.2. It was suggested that there should be amendment to the requirement to enter “the amount secured by the charge” in the Companies Act 1985, s 401(1)(b)(ii), but we have already indicated that we do not think that this should be a required particular: see above, para 4.26.

⁹⁸ See above, para 5.6.

⁹⁹ See above, paras 4.209-4.210.

¹⁰⁰ These doubts are reflected in the responses that the Steering Group received to its consultation document, Registration of Company Charges.

¹⁰¹ See, eg, Registration of Company Charges para 3.61. It was pointed out that even if a trustee company chooses not to register, by virtue of section 399(1) of the Companies Act 1985 another interested party may exercise its option to register. As such registration does not require notice, the trustee company may be unaware of the registration by the interested party.

sanction of invalidity would be irrelevant. The liquidator would obtain no benefit if the unregistered charge were invalid against him. The trustee is not the beneficial owner of the property, so that it would not be available to the trustee company's creditors in any event.¹⁰² This means that a requirement to register against the beneficiaries may be impractical. Certainly this argument was used by several respondents as a reason why the charge should not be registrable. In our view this is a valid point but not decisive.

- 5.59 First, if the trustee company deals with the trust property in a way that is authorised by the trust deed, the beneficiary's interests are subject to those dealings.¹⁰³ Take the case of a unit trust scheme. If the trustee company has power to charge the assets of the trust, to that extent the assets are available to satisfy secured creditors, and to that extent the trustee company is in a similar position to the owner of the property.¹⁰⁴
- 5.60 Secondly, registration serves a number of purposes. Thus it warns third parties of the charge. More than one secured creditor may be interested in lending to the trust on a secured basis. If a charge created by the trust company is not registrable, it may not be apparent to subsequent potential creditors. Filing under a notice-filing scheme also protects the creditor who has filed. Creditors will be concerned to secure priority of their charges, and to protect their interests against purchasers of the assets charged. Enabling notice-filing by the creditor is the easiest way to meet these concerns.
- 5.61 Similar arguments may apply to the case of the company that is custodian for the group. We think that in principle charges created by a trustee company over trust property should be registrable against the trustee company. The scheme of notice-filing that we envisage would enable subsequent creditors to discover existing charges, and creditors who have filed would secure priority and protection against purchasers.
- 5.62 We noted that the current practice of Companies House is to record on the register that the company is a trustee. This warns potential lenders and others that the company's assets are not its own. Some respondents said that this is unnecessary as most trustee companies have no other function. We are not sure that this is always true, especially of bare trusts and other simpler arrangements. However, we do not think that the mere fact that the chargor company is a trustee rather than beneficial owner of the assets charged is by itself a sufficient reason to require that the charge be registered.
- 5.63 Therefore we see no need to require registration of a charge created by a trustee company unless the charge would be registrable were it created by a company over assets that it owned beneficially. In other words, the list of charges that would be exempt from registration¹⁰⁵ should apply to charges created by trustee companies.

¹⁰² Registration of Company Charges para 3.59.

¹⁰³ In contrast, the trustee is not entitled to charge trust property for non-trust purposes.

¹⁰⁴ Presumably the trust deed might also empower the trust company to incur unsecured debts that could be enforced against the trust property.

¹⁰⁵ See above, paras 5.9 ff.

For example, it would not be appropriate, and if the draft EU Collateral Directive is adopted would in many cases not be permissible, to require registration of a charge created over investment securities.¹⁰⁶ This would reduce the impact of requiring registration by trustee companies and would mean that charges created by the ‘group custodian’ referred to by the Steering Group would not have to be registered if the shares were in the ‘custodian’s’ control.¹⁰⁷ Charges created by trustee companies over land would similarly be exempt from registration.¹⁰⁸

5.64 In those cases in which the charge would be registrable, however, we think it would be useful for the financing statement to record that the chargor is a trustee, partly to warn creditors that the assets are not the company’s own and partly for a reason that we will explain below.

5.65 **It is our provisional view that charges created by a trustee company over trust property should be registrable against the trustee company unless the charge is on the list of charges that are exempt from filing.**

5.66 A different question is whether a charge created by a trustee company over assets that it holds for a beneficiary should be registrable by the secured creditor against the *beneficiary*¹⁰⁹ if the latter is a company. It may be necessary to draw a distinction between, on the one hand, investment schemes that operate via a trust, like unit trusts, and other trusts under which the trustees have exclusive management powers, and, on the other hand, those ‘bare trusts’ and other trusts under which the trustees act at the direction of the beneficiary.

5.67 In the case of a unit trust, for example, it seems to us to be quite unnecessary for a charge created by the trustee company over the trust property to be registrable *against the beneficiary*, even where the beneficiary is a company.¹¹⁰ Under the proposals just made, the charge (if it is not on the exempted list) will already be registrable against the trustee company. Not only would it be burdensome to require double registration, but we cannot see that registration against the beneficiary company would serve any useful purpose. The chargee will already secure priority, and be secure against purchasers, as the result of filing against the trustee company. Registering against the beneficiary might at first sight seem to warn potential lenders to or investors in the beneficiary that the pool of assets in which the beneficiary has an interest has been charged, but we do not think this is useful information to such parties. Potential lenders or investors will of course be interested in the units held by the beneficiary and their value, and liabilities of the trust, including any secured debts created by the trustee company, should be reflected in the value of the units. Whether the value of the units reflects charges created or simply the performance of the investments is irrelevant to the investor in or lender to the beneficiary.

¹⁰⁶ See above, paras 5.25-5.28.

¹⁰⁷ See above, para 5.24.

¹⁰⁸ See above, para 5.55.

¹⁰⁹ The equivalent under the current law would be that the beneficiary company would be under a duty to register the charge. See above, para 2.22.

¹¹⁰ Or if the notice-filing scheme is extended to other debtors, as proposed in Part X, any other beneficiary.

- 5.68 In the case of a bare trust, the position may be different. Assets that are held under a bare trust are in a very real sense under the beneficiary's control. It is accepted that if a company charges its assets, and the charge is not one that from its nature will be evident to third parties,¹¹¹ then in principle there should be some public record of it. We are not convinced that it should make a difference whether the company charges its assets directly or transfers them to a trustee company with directions that the trustee should charge them and, presumably, use the funds obtained for the beneficiary's purposes. In both cases the charge should be on record.
- 5.69 If it is always evident to third parties that a beneficiary company has acted in this way, and if the charge created by the trustee company were registrable against the trustee company, it might be thought that there would be no problem. The potential lender could simply check to see whether the assets had been charged by the trustee and thus would discover the charge. However, we are not sure that the arrangement will always be evident. Is there a danger that third parties will learn that a company has particular assets without learning also that the assets are held in trust by another company, will therefore search only under the name of the beneficiary company and, when no financing statement is found, will assume that the assets are unencumbered? We also suspect that there may be a second problem. If a single trustee company is holding assets for a number of corporate beneficiaries, it may be clear that the trustee company has created charges over trust assets but not which beneficiary's assets are involved. Therefore there seems to be a case for ensuring that charges created over assets held in a bare trust are registered in a way that will enable a third party to discover that the interests of the beneficiary company have been charged.
- 5.70 There seem to be two possible solutions. One would be to provide for registration against the beneficiary company. This might be difficult for the creditor. First, the creditor taking the charge may not have the necessary information to know to file against the beneficiary (it may not be particularly concerned with whether the property is owned by the chargor company beneficially or is held by it in trust but with a power to charge it, or know the identity of the beneficiary). Secondly, it would mean filing twice, unless in this case the trustee company were to be exempted from filing. The second solution would be to require that if a filing is made against the trustee company, the financing statement should state not only that the chargor is acting as trustee but for which corporate beneficiary. This would enable a third party interested to discover whether the beneficiary company has charged its assets to conduct a simple electronic search of the register to find both charges created by the company as beneficial owner and those created by trustees on its behalf. We think this second solution would be the better one.
- 5.71 We explained earlier that we do not think that registration against a beneficiary is necessary where the assets are held in a collective investment scheme like a unit trust. Equally we do not think that in such a case the financing statement needs to indicate whose assets are involved - indeed to do so would normally be impossible because the assets will be held in a pool for all the investors. The same would

¹¹¹ See above, para 3.5.

apply, we think, to a trustee company holding securitised assets for bondholders.¹¹² The critical distinction seems to us to be whether the beneficiary has power to direct the trustee as to the disposition of particular assets or a particular number of fungible assets.

5.72 We envisage that the electronic form for filing a financing statement would have boxes in which it would have to be stated that the chargor has confirmed:¹¹³

- (1) either that it is the beneficial owner of the property charged or that it holds it in trust; and
- (2) if it holds the property on trust, either that it has power to charge the trust assets without reference to the beneficiaries, or that it is charging property that holds it for another person on that person's direction and naming the person.¹¹⁴

5.73 If this solution were adopted there would still remain a problem. It would be easy for a corporate beneficiary to avoid any need to register by transferring its assets to trustees who are individuals. This would cease to be a problem if the notice-filing scheme were extended to individuals, as we propose in Part X. In the meantime we wonder whether there would be a case for applying the notice-filing scheme, and the provisions just proposed for registration of charges created by corporate trustees, to charges created by individual trustees over assets held at the direction of corporate beneficiaries.

5.74 We recognise that this scheme for ensuring that charges created by trustees at the direction of their corporate beneficiaries would not apply to a large number of cases, because charges over so many of the assets commonly held in trust (land and investment securities in particular) would be exempt from registration in any event. As we have said, we think that in principle charges that are normally registrable should not escape registration against the beneficial owner simply because the assets are held on trust and are charged by the trustees at the beneficiary's direction, but it may be thought that our proposed solution is the proverbial sledgehammer to crack a nut. We invite views.

5.75 **We provisionally propose that if the chargor company is acting as a trustee, that should be entered on the financing statement. We invite views on whether, if the trustee company is charging the assets at the direction of a corporate beneficiary, the beneficiary should be identified on the financing statement.**

¹¹² See above, paras 5.18 ff.

¹¹³ Were the information deliberately or recklessly incorrect, the party filing might be subjected to a criminal sanction; cf the confirmation that the chargor has consented to the filing, above, para 4.106.

¹¹⁴ Whether an omission of this would render the registration 'seriously misleading' (see above, paras 4.39 ff) would seem to depend on the circumstances.

Market charges

- 5.76 The Steering Group also suggested that there should be provision for voluntary inclusion on the financing statement of whether the charge is a “market charge” within the meaning of section 173 of the Companies Act 1989.¹¹⁵ A “market charge” means a charge, whether fixed or floating, in favour of a recognised investment exchange, for the purpose of securing debts or liabilities arising in connection with the settlement of market contracts.¹¹⁶ It is given special treatment in insolvency and, even if it is a floating charge, as against execution by unsecured creditors.¹¹⁷ Given that the floating charge is unlikely to continue in use, or at least will have very different priority rules, under a notice-filing system, we doubt whether there will be any need to indicate in the financing statement that a charge is a market charge.
- 5.77 **It is our provisional view that it is not necessary to state in the financing statement whether a charge is a “market charge” but we would welcome the views of consultees.**¹¹⁸

Lloyds’ trust deeds

- 5.78 The Steering Group considered a particular problem that is faced by corporate members of Lloyds.¹¹⁹ Lloyds’ corporate members are required to enter into a number of trust deeds in support of their underwriting business. We understand that the trusts fall into three categories. First, when a member commences business at Lloyds it must place funds in trust (for example, Lloyd’s Deposit Trust Deeds). Secondly, each member must create a number of premium trust funds,¹²⁰ including some for overseas business.¹²¹ These ‘working trust funds’ govern the day to day arrangements for collecting premiums and other receipts, and the payment of claims, reinsurance premiums and other expenses. The third category involves trusts that are on a different basis. Some overseas insurance regulators, particularly in the United States of America, require each syndicate to place funds in a separate trust fund. The majority of syndicates underwrite business in America. A member

¹¹⁵ Final Report para 12.28.

¹¹⁶ In summary, the Companies Act 1989, s 173 provides that a market charge is one (whether fixed or floating) granted in favour of a recognised investment exchange; The Stock Exchange; a recognised clearing house, or a person making payments resulting from the transfer or allotment of certain securities through a computer based system established by the Bank of England and The Stock Exchange. The charge must generally be for purposes specified in the section, such as securing debts or liabilities arising in connection with the settlement of market contracts or short-term certificates.

¹¹⁷ Companies Act 1989, s 180. Under s 178, which has not been brought into force, regulations could have been made to give a floating market charge priority over a subsequent fixed charge.

¹¹⁸ The suggestion that a market charge should be a required particular was made by one respondent, the Law Society. The unimplemented Companies Act 1989, s 103 would have substituted a new Companies Act, s 415(2)(b), allowing a market charge to be one of the prescribed particulars.

¹¹⁹ Final Report para 12.65.

¹²⁰ For domestic business, there must be separate funds for life and non-life business.

¹²¹ For example, the Canadian Trust deed.

of Lloyds will participate in many syndicates and may therefore have to execute a large number of these trust deeds.

- 5.79 The trust deeds in the first category expressly create charges over corporate members' future profits. We understand that Lloyds has been advised that the other trusts also constitute charges on the corporate members' property and are registrable as either floating charges or charges over book debts. The burden of registering just the trusts in the first two categories is significant even though each of those trusts is in principle 'once and for all'. The real problem comes, however, with the third category, since there are so many trusts. The burden of registering each one separately is very heavy, as is the annual cost to the corporate members, as each registration involves a fee of £10. We understand that Lloyds are one of the largest annual presenters of company charge particulars, and in January 2000 one trust deed project team made in excess of 37300 filings of charge particulars arising out of American trading arrangements.
- 5.80 A switch to notice-filing would not alleviate the problem significantly, even though it would be possible to file a single financing statement to cover a series of future transactions. The premiums trust deeds executed by corporate members of Lloyds create trusts of the corporate member's receivables, that is, the member's anticipated income. As we understand it, when payments are received these are held by trustees appointed by the Managing Agents in separate sub-funds. The money held in each type of trust may be applied to permitted trust outgoings, of which the most important is the satisfaction of claims by insureds against the relevant syndicate.¹²² In the case of the certain trusts for overseas business, the funds may be held by a nominated trustee for the fund (for example, the Royal Trust of Canada). Thus the funds are held in trust for purposes rather than named individuals, but in effect the beneficiaries are the insureds and other creditors of the syndicate. It is difficult to identify the chargees other than as the creditors (actual or future) of the syndicate. It would therefore not be possible to say that a single filing could be made to cover a series of transactions between the same parties.
- 5.81 We do not doubt the advice that trusts in all three categories constitute charges over the assets of the corporate members of Lloyds, particularly as the member will ultimately be entitled to any surplus. However, it is our view that these 'charges' have such unique characteristics that special treatment of them is justified.
- 5.82 Corporate members of Lloyds are not permitted to undertake any other business.¹²³ This does not mean that they do not sometimes need to raise finance. For example, there may be a gap in time between a syndicate paying out to insured parties who have suffered a loss and being reimbursed by a re-insurer. To maintain liquidity, managing agents may borrow from a bank and create a further charge to secure the loan - either a fixed charge over the receivables or a floating charge over the premium trust fund. We think that this charge to the bank should be

¹²² At a later stage surplus funds may be transferred to yet a further account, this time held by the Regulating Trustee (Lloyds itself) and may be used to pay losses on other syndicates in which the corporate member participated, or may be distributed as profit to the member.

¹²³ Except business that is ancillary to their underwriting. We understand that in practice this is of little significance.

registrable just like any other charge created by a corporate trustee.¹²⁴ This will preserve the bank's priority against any subsequent secured creditor who might take a charge over the same assets, and against any purchaser of the receivables; and will equally provide a warning to potential lenders or purchasers.

- 5.83 This does mean, however, that the trusts created by corporate members need to be registered. Because of the special situation, and because corporate members can do no other business, we do not think that any potential lender to the corporate member will possibly be misled into thinking that the member owns the assets in the pool outright. We are therefore of the provisional view that it is quite unnecessary to require (or enable) registration of the trust as a charge under the scheme we propose for other charges of a company's assets.
- 5.84 If (contrary to our provisional view) it is thought that the trust deeds should be filed as charges, we consider that it would be satisfactory were there to be much less detail on the Company Charges Register than even a standard financing statement would require. In their response to the Steering Group's consultation document, Lloyds suggested two alternatives. One was a single 'bulk' filing for the trusts in the first two categories, with, for trusts in the third category (those entered by syndicates), filing each year a single set of particulars of the standard form trust deed in respect of each category of business written by the company, together with a list of the syndicates on which the company writes business. The other was to allow just this special provision for trusts in the third category. They pointed to a precedent in section 397 of the Companies Act 1985, which permits a simplified form of registration for a series of debentures.¹²⁵ Under section 397 the particulars required are the total amount secured by the whole series; the dates of the resolutions authorising the issue of the series and the date of the covering deed (if any) by which the security is created or defined; a general description of the property charged, and the names of any trustees for the debenture holders. The Steering Group inclined to agree that the second solution suggested by Lloyds would provide "an acceptable balance of adequate notice to creditors and reduced compliance costs."¹²⁶
- 5.85 If Lloyds trust deeds are to be brought within the notice-filing system at all, we see no reason to disagree with the conclusion that this should be on a simplified basis. However, we would go further in the direction of simplification than the Steering Group's recommendation. First, we think that the first solution (a single bulk filing for the trusts in the first two categories) would be sufficient. Secondly, although many of the trust deeds required of syndicates by overseas regulators have to be renewed on an annual basis, we do not see why a single filing should not suffice to cover a series of annually-renewed trusts relating to the same kind of business. Thirdly, we do not see the need to append a list of the syndicates on which the member participates in relation to that business. We do not think that this

¹²⁴ This will involve the bank, or the Managing Agents, filing against each corporate member of the syndicate. This is itself a burden and we understand that in practice this (and the requirements of the Consumer Credit Act 1974 where the syndicate involves individual Names) may mean that no charge is taken. However we understand that no complaint is made about this. In this case registration in the usual way seems necessary.

¹²⁵ See above, para 2.22.

¹²⁶ Final Report, para 12.66.

information is needed in order to give adequate ‘public notice’ of the arrangements.

- 5.86 **Thus we provisionally propose that if (contrary to our main provisional recommendation) Lloyds’ trust deeds are to be brought within the notice-filing system, each corporate member should be obliged only to file a financing statement listing the members’ and premium trusts that it has created; and, for the third class of trust, describing (in the general terms required for any financing statement¹²⁷) the assets that the standard form trust deeds require to be held in trust for each class of business, and the names of the trustees. It should state that the trust is for the purposes of insurance at Lloyds. We invite consultees’ views.**

CHARGES OVER ASSETS IN OTHER JURISDICTIONS AND CHARGES CREATED BY COMPANIES IN OTHER JURISDICTIONS

- 5.87 We were asked in our terms of reference to include in our review the question of charges created by
- (a) companies having their registered office in England or Wales, wherever the assets charged are located; and
 - (b) overseas companies and companies having their registered office in Scotland, where the charge is subject to English law.

Charges by overseas companies

- 5.88 We consider first the question of charges created by overseas companies having their registered office in England, where the charge is subject to English law. The problems raised by the *Slavenburg* decision, as well as the situation of the current scheme applying to overseas companies, have been noted earlier in this Consultation Paper.¹²⁸ The Steering Group recommended in its Final Report that overseas companies whose place of business is registered¹²⁹ in England and Wales (including companies incorporated in Northern Ireland and Gibraltar) should be subject to the same requirements as companies registered in England and Wales. Charges created by a company that had not registered its place of business should not be registrable, even if the company should have registered its place of business.¹³⁰

¹²⁷ See above, para 4.25.

¹²⁸ See above, paras 3.37-3.40.

¹²⁹ Under the current law, there is a dual registration scheme under Part XXIII, applicable either to foreign companies that have a branch in Great Britain, or to foreign companies that establish a place of business in Great Britain. It has been recommended in the Steering Group’s Final Report that the law relating to Part XXIII should be reformed so as to replace the dual registration scheme (for either branches or places of business) with a single regime based on the existing concept of place of business and the Eleventh Directive: see *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* URN 99/1146 para 11.26.

¹³⁰ Final Report para 12.67. The Steering Group’s consultation document, Registration of Company Charges, was not the only document to suggest that the requirements of

- 5.89 However, when this recommendation was made in the earlier consultation document¹³¹ it drew some criticism from consultees. It was suggested that such a requirement would allow a company which had an established place of business, but which had not registered its place of business, to benefit from its own default in not complying with the registration requirements:¹³² default in such compliance would effectively exempt it from the requirement to comply with the charges regime.¹³³ Although this criticism was made in the context of a compulsory registration scheme, we believe that there would be a similar issue under a notice-filing system. Although the filing of a financing statement would not be compulsory, non-registration of the place of business would enable the company to avoid the normal sanctions of loss of priority and invalidity of the charge in the event of the debtor's insolvency.
- 5.90 Although we can see force in the argument that a company should not benefit from its own default, we question its applicability in this situation. So far as registration of charges is concerned, the company itself is not affected by questions of priority as between creditors nor, should the company become insolvent, by whether or not a charge over its property is valid against the liquidator. By avoiding the need to register charges, it may at first sight seem that the company can 'hide' existing charges and thus make it easier to raise further loans. However we very much doubt whether this is the case. A potential creditor will surely observe that the reason that there are no charges registered against the company on the Company Charges register is that the company has not registered its place of business. The potential creditor will then be on warning. It will either make particularly careful enquiries as to existing charges or refuse to provide credit.
- 5.91 In addition, to invalidate a charge created by a company that has a place of business in England or Wales but has not registered its place of business will cause difficulties to potential creditors of that company and thus to the company itself if there is uncertainty as to whether or not the company has a place of business here.

registration of charges should apply only to companies actually registered as overseas ones. The Steering Group also raised the question in a separate consultation document on overseas companies: see *Modern Company Law for a Competitive Economy: Reforming the Law Concerning Oversea Companies* paras 64-67. A majority of consultees to this document were also in favour of limiting the need to register company charges to those companies that were registered under Part XXIII of the Companies Act 1985. The unimplemented provisions of the Companies Act 1989 would also have restricted the charge registration provisions to those companies that had registered, rather than to those having an established place of business in England and Wales: Companies Act 1989, s 105 and Schedule 15, inserting Companies Act 1985, section 703A.

¹³¹ See Registration of Company Charges para 3.68.

¹³² The Companies Act 1985, s 697 sets out the penalties for non-compliance with ss 691-693 and 696.

¹³³ In reality, the question of benefiting from default is not so much addressed at the company (which is unlikely to be concerned over the outcome of priority or validity arguments between creditors), but is more aimed at permitting a secured creditor from taking advantage of the company's default in order to claim that it is not subject to the validity and priority rules of a notice-filing system. A company that has been incorporated outside Great Britain which carried on business, but has now ceased so to do, may be subject to the winding up provisions applicable to an unregistered company, even though it may have been dissolved under the laws of another country: see the Insolvency Act 1986, s 225. This would presumably apply to such a company that had defaulted on its obligation to register.

If the creditor assumes that it does not, but the assumption is incorrect, it will find its charge invalidated. It seems better to apply the more certain test: the charge should be registrable only if the company has registered its place of business.

5.92 We think that creditors would probably prefer to be able to file in order to take advantage of the relative certainty provided by the system of notice-filing¹³⁴ compared to the rather precarious position under the rules of common law and equity that would apply if the charge is not registrable. Thus if a notice-filing system were to apply only to overseas companies that had registered in England and Wales, creditors in England and Wales seeking to take security over a company's property in England would put pressure on a company to register if it had a place of business in England but had not registered.

5.93 **We would therefore provisionally propose that any notice-filing system should apply to those companies that have registered their place of business, whether they ought to have done so or not.**

5.94 We think that such a notice-filing system would also cover the current problem that arises where a charge has been created by an overseas company on property that was then outside the United Kingdom, but which is subsequently brought into the United Kingdom. Under the current scheme, we noted that this could cause problems where the 21-day period for registering the charge following its creation had passed before the property was brought into the United Kingdom: the registration requirements effectively could not be complied with.¹³⁵ A notice-filing system would not have a time limit for filing in the same way as the current registration scheme has: there would therefore be no similar problem.¹³⁶ In a notice-filing system that applied to charges over property that is subsequently brought into the United Kingdom, it would not be the case that such a charge or security interest could *not* be registered (as under the current scheme). Instead, a financing statement could be filed at any time.¹³⁷ **We provisionally propose that a charge that has been created by an overseas company on property that**

¹³⁴ See above, paras 4.118 ff.

¹³⁵ See above, para 3.39.

¹³⁶ The legislation in both Saskatchewan and New Zealand provides for the situation where the security interest in goods has been perfected in another jurisdiction and subsequently brought into the country. These systems allow for continued perfection if the security interest is perfected in Saskatchewan or New Zealand either within 60 days after the day on which the goods are brought into the country; 15 days after the day on which the secured party has knowledge that the goods have been brought into the country or before perfection ceases pursuant to the law of the jurisdiction in which the goods were situated when the security interest attached, whichever is the earliest: see the SPPSA, s 5(3) and the NZPPSA, s 27(1). The Saskatchewan legislation notes that the security interest is subordinate to the interest of a purchaser or lessee of the goods without notice and before it is perfected in Saskatchewan by possession or registration: SPPSA, s 5(3). Where such a security interest has not been perfected pursuant to the law of the jurisdiction in which the collateral was situated when the security interest attached and before the collateral was brought into the country, it may be perfected pursuant to the relevant Act: see the SPPSA, s 5(5) and the NZPPSA, s 28(2). There is also provision in New Zealand for temporary perfection in some cases: see *ibid*, s 28(1).

¹³⁷ Although validity against third parties would only occur on such filing.

was then outside the United Kingdom, but which is subsequently brought into the United Kingdom, should be registrable.

Charges created by companies registered in England and Wales over assets in other jurisdictions

- 5.95 The registration requirements imposed by the Companies Act 1985, section 395 apply whether the asset charged by the company is in England and Wales or elsewhere. The creation of charges over assets in other jurisdictions raises difficult questions of private international law. Questions arise whether the goods are located overseas or are in Scotland, though the rules that apply seem to be slightly different in the two cases.
- 5.96 The first point is that the validity of a fixed charge over an asset will normally be governed by the law of the place where the assets are at the time (the *lex situs*). Thus it is possible to create a charge only if it will be recognised by that law. For example, it is not possible for an English company to create a valid charge over goods (as opposed to a pledge of goods) that are in Scotland because Scots law does not recognise non-possessory security over goods.¹³⁸ Similarly a floating charge may be created by an English company even when the assets and the creditor to whom the charge is granted are in a jurisdiction that does not recognise the floating charge;¹³⁹ but it does not follow that the charge will be enforceable against the assets in that other jurisdiction. Thus before the floating charge was introduced in Scotland it seems to have been accepted that a floating charge created by an English company would not be effective against assets in Scotland.¹⁴⁰
- 5.97 The point that the validity of a charge over assets in another jurisdiction will be subject to the law of that jurisdiction is recognised by the Companies Act 1985, which refers (in the context of property in Scotland or Northern Ireland) to registration in the country where the property is situated being necessary to make the charge valid or effectual according to the law of that country.¹⁴¹
- 5.98 It seems to follow that questions of priority of competing charges over the same asset will also be subject to the law of the place where the asset is. Thus questions of priority of charges created by a company registered in England over land in Scotland would be subject to the priority rules of Scottish land law.
- 5.99 What, however, if the charge over assets in the other jurisdiction has not been validly registered in England? Under current English law, if the 21-day period for registration of the earlier charge has expired by the time the second charge is

¹³⁸ *Inglis v Robertson and Baxter* [1898] AC 616.

¹³⁹ *Re Anchor Line (Henderson Brothers) Ltd* [1937] Ch 483, a case before the floating charge had been introduced in Scotland.

¹⁴⁰ See L Collins, "Floating Charges, Receivers and Managers and the Conflict of Laws" (1978) 27 ICLQ 691, 701, who suggests that the position would be different now that Scotland recognises the floating charge, citing *Gordon Anderson (Plant) Ltd v Campsie Construction Ltd* 1977 SLT 7. See also *Norfolk House plc (in receivership) v Repsol Petroleum Ltd* 1992 SLT 235.

¹⁴¹ Companies Act 1985, s 398(4), which goes on to provide that delivery to the registrar in England of a copy of the certificate of registration in one of those countries will have the same effect as delivery of the instrument itself.

created, and the second charge is validly registered within 21 days of its own creation, the first charge will be void as against the second.¹⁴² Under the proposed notice-filing system, the first charge would lose its priority to the second.¹⁴³ Under either the current law or the proposed new system, a charge that has not been registered by the date of insolvency will in effect be void as against the unsecured creditors.¹⁴⁴ These rules on what we term ‘the effects of non-registration’ cut across the basic rules of priority. Suppose that the jurisdiction in which the assets are situated does not have any equivalent to these rules; will the courts of that jurisdiction simply allow the first creditor priority over the second or, where the debtor has become insolvent, to enforce an unregistered charge against the liquidator?

5.100 This depends on the *lex situs*, but for this purpose the *lex situs* will include that jurisdiction’s rules of private international law. It appears to be very difficult to give a definite answer as to whether the ‘foreign’ system will give effect to the English rules on the effects of non-registration. It is hard even to say how English law would deal with the converse case, that of a charge that is valid under English law but would be invalid under the law of the place of registration of the company that created it.

5.101 As between England and Scotland it is possible that the position is that the courts will apply each other’s rules on the effects of non-registration. First, in Scots law there are indications that the courts might enforce the English rules against the creditor who has failed to register, on the basis that a similar rule would apply to a purely Scots case. However it has to be admitted that the cases involve a different question, namely whether the Scottish courts should recognise the power of an English receiver to enforce a floating charge.¹⁴⁵

5.102 Secondly, the Insolvency Act 1986, section 426 provides:

(4) The courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having the corresponding jurisdiction in any other part of the United Kingdom or any relevant country or territory.

(5) For the purposes of subsection (4) a request made to a court in any part of the United Kingdom by a court in any other part of the United Kingdom or in a relevant country or territory is authority for the court to which the request is made to apply, in relation to any matters specified in the request, the insolvency law which is applicable by either court in relation to comparable matters falling within its jurisdiction.

This appears to mean that the English liquidator can apply to the English court for an order for possession or sale, the English court can then request the Scottish courts to assist and the Scottish courts may apply English law. This might enable

¹⁴² See above, para 2.27.

¹⁴³ See above, para 4.123.

¹⁴⁴ See above, paras 4.74 and 4.78.

¹⁴⁵ See cases cited above, para 5.96 n 140.

the liquidator to claim an asset subject to an unregistered charge. However, this is not wholly clear. ‘Insolvency law’ is defined as provisions under the Insolvency Act 1986,¹⁴⁶ which includes the liquidator’s power to get and sell the company’s assets,¹⁴⁷ but it assumes that the asset is the ‘company’s’ even though the company will take free of the charge only by virtue of the Companies Act 1985, to which there is no reference. Secondly, the duty on the court is only ‘to assist’; whether to do so and whether to apply the other country’s law is thus a matter of discretion.

5.103 If there is real uncertainty as to whether a failure to register under the current law, or a failure to file under the proposed notice-filing system, will affect the validity or priority of the charge over assets in another jurisdiction, it may be questioned whether there is any point in requiring that the charge be registered, or (under the proposed notice-filing system, under which filing would not be compulsory) enabling registration in England. The creditor who had filed could not be assured that it would have priority over any other, unregistered charge that might be given priority under the local law (for example, because it had been created earlier).

5.104 What alternative is there? The SPPSA section 5(1) provides simply that the validity, the perfection and the effect of perfection or non-perfection of security interests is governed by the law of the jurisdiction where the collateral is situated when the security interest attaches.¹⁴⁸ That seems to leave open the question whether that law will simply apply its rules that would apply to a purely domestic case, or should apply its conflicts rules - which might then refer to the SPPSA. The UCC Revised Article 9, in contrast, is explicit. While for non-possessory securities it is the law of the jurisdiction in which the debtor is located that governs questions of perfection,¹⁴⁹ it is the law of the place where goods or documents are located that governs the effect of perfection or non-perfection.¹⁵⁰ In each case it is the ‘local law’ that is to govern the relevant questions.¹⁵¹ We suspect, however, that these provisions are drafted primarily with a view to neighbouring jurisdictions that have very similar rules and a similar register, so that potential lenders can quite easily discover what security interests exist over assets in the local jurisdiction and the differences between the jurisdictions over the effects of perfection or non-perfection will be slight. With the exception of Scotland,¹⁵² we cannot be sure that this will be true for ‘foreign’ assets owned by companies registered in England.

5.105 Thus we cannot be sure that a failure to file a financing statement against a company registered in England and Wales that is charging assets outside the United Kingdom will result in the charge being invalid or the secured party losing priority. In our view, to enable filing and to apply, in principle, the usual sanctions

¹⁴⁶ Insolvency Act 1986, s 426(10)(a).

¹⁴⁷ Insolvency Act 1986, s 143(1).

¹⁴⁸ The NZPPSA applies New Zealand law if the asset is outside New Zealand but the secured party has knowledge that it is intended to move the collateral to New Zealand. The security agreement can also provide that New Zealand law will govern: see the NZPPSA, s 26(1).

¹⁴⁹ UCC Revised Article 9, Section 9-301(1).

¹⁵⁰ UCC Revised Article 9, Section 9-301 (3)(C).

¹⁵¹ UCC Revised Article 9, Section 9-103(1) and (3); and see Official Comment 3.

¹⁵² See below, para 5.108.

(loss of priority and invalidity in the event of insolvency) would still form a useful function for charges over such assets. In cases in which there is no other way in which a potential lender can readily discover that an asset is charged,¹⁵³ it will be useful to have the information on the register; and we can expect the register to be reasonably complete, because few creditors will wish to take the risk that the courts of the country where the assets are located may decide to invalidate the charge by applying English law under their rules of private international law.

- 5.106 It is of course unfortunate that such uncertainty exists, but it is a question of private international law that cannot be solved unilaterally by reform in England and Wales, let alone in the course of reform of company charges. In any event, the question is not related to a change from the current scheme or registration to one of notice-filing. The uncertainty exists already and the changes proposed should actually reduce it insofar as questions of the validity and priority of security over land and other assets for which there is a specialist register will cease to depend on registration at Companies House.
- 5.107 Should there be special provisions for property in Scotland? Our proposals for a notice-filing system will apply only to England and Wales. At present the charges we are discussing are not registrable in Scotland under current law simply because Scots law requires registration only of charges created by companies registered in Scotland. The Scottish Law Commission is considering the scheme of registration in Scots law, though we understand that it is considering modifications to the current scheme rather than a notice-filing system. It would be possible to ask the Scottish Law Commission to support a proposal that charges created by English companies over assets in Scotland be registrable there instead of in England and Wales. Alternatively, should they continue to be registrable only in England? Or should they be registrable in both jurisdictions?
- 5.108 We do not think that it would be appropriate to provide for registration in both jurisdictions. 'Dual' registration seems to us to cause additional cost with little extra gain. It is true that it might be marginally easier to discover information about charges over assets in Scotland were the charge to be registered there also, but the burden of searching the English register rather than either the Scottish or the English one cannot be great, especially if the register can be searched on-line. It is true that it would be simpler for the Scottish court to reach the conclusion that a charge that had not been filed in Edinburgh was invalid in the event of insolvency, as this would be a rule of Scots law, but given the ease with which potential creditors and investors would be able to search the English register under our proposed scheme, it does not seem justifiable to impose the 'sanction of invalidity' on a charge which has not been filed in both jurisdictions. Meanwhile, it is likely that the systems of priority in the two jurisdictions will remain different. It would certainly not be desirable to subject the charge to 'both' systems of priority. As the Americans have found to their cost, rules which result in claims to a single assets being subjected to rival rules produce chaos and it becomes necessary to introduce a rule as to which scheme of priority is to have priority.¹⁵⁴

¹⁵³ Cf above, para 3.5: thus we would only enable filing of charges that would be subject to filing were the assets in England.

¹⁵⁴ See Official Comment 7 to Section 9-301.

- 5.109 Thus the choice has to be between registration in Scotland and registration in England and Wales. To require registration in Scotland would solve the problem of whether a Scottish court would recognise that an unregistered charge should be invalid in the event of insolvency, but it would cause complications over priority. If as we provisionally propose, English law adopts notice-filing, the effects of non-registration will be different to those which currently apply, and which the Scottish Law Commission may recommend should continue to apply, in Scotland. Thus, unless Scots law were not only to require registration for charges created by a company registered in England and Wales but also to apply to them the English rules on the effect of non-registration, non-registration would have different effects on charges over a single company's property north and south of the border. This may not matter for assets that are static, but some assets may be moved from one jurisdiction to the other. Were a first charge created over them while they were in England and a second while they were in Scotland, complications would ensue. The first chargee, under English law, would be able to avoid losing its priority by registering its charge at any time before the second had registered; but the second chargee, under Scots law, would have 21 days after creation of its charge to register and maintain its priority.
- 5.110 Further, from the point of view of giving notice to the public it is our tentative view that it is probably more satisfactory that charges created by a company registered in England and Wales should be registered there even if the assets are in Scotland, for two reasons. Firstly, the information about all the charges created by a particular company would then be in a single register rather than divided between the two registers. Secondly, we have pointed out that assets may be moved from one jurisdiction to another. Were the assets to be charged while they were in Scotland but subsequently be moved to England, it might well not occur to interested parties to check the register in Scotland.
- 5.111 Thus we tentatively suggest that the current system requiring registration of the charges in question in England but not in Scotland is the better solution. We recognise that it is not certain at the moment that the Scottish courts would apply the sanctions of loss of priority and invalidity to a charge that was not registered. In such cases it would seem preferable for each of the jurisdictions to apply the rules of the other, as seems to be the idea behind the mutual co-operation envisaged by the Insolvency Act 1986, section 426. However, reform of the rules of private international law is outside the strict scope of this project.
- 5.112 In fact the range of charges involved may be rather limited. Under our proposals, charges over land and other assets for which there is a specialist register will not be registrable in the Company Charges Register. Nor, for different reasons, will charges over shares and similar securities (unless the option is adopted of allowing filing instead of taking control¹⁵⁵). As we have seen, an English company cannot create a valid charge over goods in Scotland. Floating charges will in practice be registered anyway since they will presumably cover assets on each side of the border. Thus effectively the only classes of charge in issue will be fixed charges over receivables and over some forms of intellectual property for which there is no specialist register.

¹⁵⁵ See above, paras 5.29-5.35.

- 5.113 **Thus it is our tentative view that a charge created by a company registered in England and Wales over assets in Scotland should be registrable in England and Wales if the same charge would be registrable were the assets in England. However we invite views. Before commenting on this point, consultees may want to consider the reciprocal question of charges created by companies registered in Scotland over property in England and Wales.**

Charges created by Scots companies over property in England and Wales

- 5.114 The provisions in the Companies Act 1985 relating to ‘oversea’ companies do not apply to companies registered in either England and Wales or in Scotland as against the other jurisdiction: a Scots company is not required to register a place of business in England and Wales under the Companies Act 1985 Part XXIII.¹⁵⁶ Equally, the provisional proposals for a notice-filing system in respect of charges created by oversea companies that we have outlined above would not apply to a charge created by a Scots company. A charge created by a Scots company over property in England and Wales is registrable in Scotland but not in England and Wales.
- 5.115 Thus charges created by Scots companies over property in England raise the mirror image of the problems discussed in the last section. Again, there seem to be the three possible solutions: to maintain the current position, to require registration in each jurisdiction or (with the agreement of the Scottish Law Commission) to cease to require registration in Scotland but to enable it in England and Wales under the notice-filing system we propose.
- 5.116 We provisionally reject ‘dual registration’ for the reasons given earlier.¹⁵⁷ Also, for the reasons given in the previous section and with the same hesitation, we suggest that the current system, under which a charge created by a Scots company over property in England and Wales is registrable in Scotland but not in England and Wales, is preferable to registration in the ‘other’ jurisdiction. As we indicated earlier, we think that if the liquidator of a Scots company approached the English courts for assistance, the latter might apply the Scottish rules on the effects of non-registration.¹⁵⁸
- 5.117 There may be a difficulty if a narrower range of charges is registrable in Scotland than in England and Wales. A charge created by a Scots company over property in England and Wales is registrable in Scotland only if the charge is of the types listed in section 410 of the Companies Act 1985. There is, for example, no requirement to list a charge over goods as Scots law does not recognise a non-possessory security over moveable property. If, as we proposed earlier, further types of charge are made registrable south of the border,¹⁵⁹ and if (as we propose in Part VII) ‘quasi-securities’ should become registrable, these differences will increase.

¹⁵⁶ Nor vice versa for an English or Welsh company operating in Scotland.

¹⁵⁷ See above, para 5.108.

¹⁵⁸ See above, para 5.102.

¹⁵⁹ For instance, charges over contingent debts and other money obligations that do not at present fall to be registered as charges over book debts.

- 5.118 Thus our earlier proposal for charges created by companies registered in Scotland may - like the present law - make it difficult to discover whether certain types of property (in particular, goods) that a Scots company claims to own in England and Wales have been charged, since the charge will not be registrable in either jurisdiction. The Steering Group noted the same difficulty, and proposed that Scots companies should register any registrable charges over property in England and Wales with Companies House in Edinburgh, even if the same charge were not registrable were it over property in Scotland.¹⁶⁰
- 5.119 The registration of charges created by companies registered in Scotland is a question that affects parties in Scotland as much if not more than in England and Wales. In any case, reform of the scheme of registration of company charges created by Scots companies is a matter for the Scottish Law Commission, which has a separate reference to examine the current scheme as it affects Scots companies. We understand that, under the Scottish Law Commission's current project at least, any reform is not likely to involve the sort of notice-filing system that we have been examining. However, the Scottish Law Commission will no doubt be considering the questions (1) whether to require registration of types of security interests over assets outside Scotland where the security interest is recognised by Scots law but does not require registration if the assets are in Scotland; and (2) whether to require registration in Edinburgh of charges over assets in other jurisdictions that are valid under the law of that jurisdiction, even though the charge is of a kind that cannot be created in Scotland.¹⁶¹
- 5.120 **We tentatively propose that charges created by Scots companies over assets in England and Wales should continue not to be registrable in England and Wales, but we invite views.**

UNREGISTERED COMPANIES

- 5.121 The Steering Group proposed that:
- registration of company charges should be included amongst the provisions of the Act that apply to unregistered companies.¹⁶²
- 5.122 There was widespread - although not universal - support for such a move amongst consultees and in its Final report the Steering Group recommended that registration of company charges should be included amongst the provisions of the Act that apply to unregistered companies.¹⁶³ We see no reason to differ.¹⁶⁴ **We**

¹⁶⁰ Final Report para 12.64.

¹⁶¹ We have been very much helped by discussions with our colleagues at the Scottish Law Commission and will continue to liaise with them on this issue.

¹⁶² Registration of Company Charges para 3.69.

¹⁶³ Final Report para 12.67.

¹⁶⁴ The response from Companies House had noted that whilst some unregistered companies appear on the public register kept at Companies House, they are in fact administered by other bodies (eg, companies incorporated by Royal Charter, whilst having an entry on the public record, are administered by the Privy Council). Companies House does not update the public record for a company of this type, and their response questioned how Companies House would deal with the filing of a charge for such companies, given that they are not incorporated under the Companies Act 1985. If, as we have proposed (see above, para 4.35-

provisionally propose that charges created by unregistered companies should be within the notice-filing scheme we have proposed.

SUMMARY OF CHARGES THAT WOULD BE REGISTRABLE

5.123 It may be useful to summarise the effect of our provisional proposals as to the charges that would be registrable under the notice-filing system.¹⁶⁵ Charges created by either a registered or an unregistered company¹⁶⁶ would be registrable, wherever the assets charges are located,¹⁶⁷ unless the charge falls on a list of exemptions.¹⁶⁸ The list of exemptions would be as follows:

- (1) charges over property for which there is a specialist asset register, (that is, land, aircraft and ships, and over patents, trademarks and registered designs);¹⁶⁹
- (2) charges over shares and investment securities where the secured party has possession of the certificate or has control by being registered as owner;¹⁷⁰
- (3) charges over bank accounts which are under the control of the chargee;¹⁷¹ and
- (4) charges on goods, and on insurance policies on goods, where the goods are abroad or at sea, or are imported goods before they are delivered to a buyer or deposited in a warehouse factory or store.¹⁷²

Deposits by way of security of a negotiable instrument to secure a debt would not be treated as a charge over the debt.¹⁷³

5.124 Thus the most important types of charge that would be registrable would in effect be:

- (1) floating charges;
- (2) charges over goods (save as mentioned in (4) above);

4.36), company charges would be registered in the separate Register of Company Charges, we think this problem would fall away.

¹⁶⁵ See above, paras 5.6 ff.

¹⁶⁶ See above, para 5.122.

¹⁶⁷ See above, paras 5.95 ff.

¹⁶⁸ See above, para 5.6.

¹⁶⁹ See above, para 5.55.

¹⁷⁰ See above, para 5.28.

¹⁷¹ See above, para 5.51.

¹⁷² See above, para 5.40.

¹⁷³ See above, para 5.17.

- (3) charges over monetary obligations of all types, including contingent obligations such as the proceeds of insurance policies (save as mentioned in (4) above);¹⁷⁴
- (4) charges on goodwill.

5.125 Thus the principal types of charge that would have to be registered and that are not registrable under the current law would be all charges over monetary obligations that are not book debts, including contingent obligations. It would be made clear that, if this is not the case already, charges to secure a non-monetary obligation are registrable. The principal new exemption from registration would be of charges that are registrable in a specialist register.

TRANSITIONAL PROVISIONS FOR PREVIOUSLY UNREGISTRABLE CHARGES

5.126 In Part IV we discussed the transitional provisions that would probably be necessary if the move to a notice-filing system were made. Whether or not any notice-filing is extended to cover 'quasi-securities' (a point which we discuss in the following two Parts), the list of charges that are registrable is likely to be wider than it is under the current scheme. Even if the system operated within the current framework of security there would have to be transitional provisions where a previously unregistrable security were made registrable under a notice-filing system. However, for convenience we deal with the question of transitional provisions for previously unregistrable charges when we deal with that for quasi-securities, as some of the points are the same.¹⁷⁵

¹⁷⁴ And uncalled share capital of the company or calls made but not paid.

¹⁷⁵ See below, paras 7.77-7.80.

PART VI

FUNCTIONAL EQUIVALENTS TO SECURITY

FUNCTIONALLY EQUIVALENT INTERESTS

- 6.1 In this Part we describe a number of transactions that as a matter of law do not fall within the categories of security that we described in Part II, but that seem to perform a very similar function. Like Part II, this Part is descriptive, and readers familiar with the subject may choose to move on to the next Part.
- 6.2 It has been widely recognised for some time that a number of transactions that are not usually treated by the law as creating a security interest do in practice act as a form of security.¹ These functional equivalents are sometimes known as ‘quasi-securities’ or ‘title finance’. Examples include hire-purchase, conditional sales, finance leases, consignment of goods and retention of title clauses. Sale and repurchase (‘repos’) also represent significant forms of financing in today’s modern markets.² In each case the financier retains (or in some cases obtains) full title to the assets rather than being granted a charge over the assets,³ and if the debtor fails to pay for the assets (or in other circumstances agreed in the contract) they can be repossessed or (in the case of repos) retained or sold. In addition there are many types of receivables financing including factoring, discounting of receivables and securitisation which seem to perform a ‘security function.’ In Part VII we will consider whether, under the new notice-filing system we provisionally propose, any of these quasi-security devices should be registrable. (In fact we will argue that for practical reasons some of them, in particular many of those used in relation to receivables financing, should not be made registrable). In this Part, after explaining in general terms the possible advantages and risks of using quasi-securities rather than true securities, we give a brief description of the principal types of quasi-security used in relation to goods and then turn to the transactions used in receivables financing. Some of the latter may be unfamiliar to many readers and we explain them in some detail.

Advantages of quasi-security

- 6.3 Originally transactions such as hire-purchase and conditional sales were created partly to avoid the complexities involved in creating mortgages and charges over goods as the result of the Bills of Sale Acts.⁴ These Acts do not apply to charges created by companies, and registration of charges under the Companies Act 1985 is much simpler than the registration of bills of sale. However, by using hire-purchase or a conditional sale a company can avoid registration at Companies

¹ See, eg, the Diamond report paras 3.4(ii) and 3.6.

² It has been suggested to us that stock-lending arrangements may also have a security purpose but we are not sure whether this is correct. See further below, para 6.46.

³ Hence such transactions are not registrable as charges under the Companies Act 1985.

⁴ See, principally, the Bills of Sale Act 1878 and the Bills of Sale Act (1878) Amendment Act 1882. On this see further below, Part VIII.

House altogether. Exemption from the current registration requirements means that quasi-security devices can be fast and cheap to use, which is particularly important in receivables financing and financial markets where the ability to trade swiftly is of the essence. In contrast the cost of registration of security proper under the current system can be burdensome, particularly for a company that creates many such interests.⁵ Not having to register the transaction at Companies House also means that there may be no publicity for the transaction.

- 6.4 The creditor may also get another advantage through taking such a quasi-security interest: if it repossesses the asset on default or breach of condition, it can keep the surplus on any future sale of the asset.⁶ Under a true security agreement, if the asset is sold for more than is owed to the creditor, the surplus must be returned to the debtor.
- 6.5 A further reason for preferring a quasi-security transaction may be to avoid the legal uncertainty as to whether a charge over assets that are changing is a fixed or floating charge.⁷ We noted this uncertainty in relation to charges over book debts earlier.⁸ In that case it is possible for the charge to be fixed provided that the creditor retains control over the proceeds. With inventory, in contrast, it would not be realistic to create a fixed charge as the debtor needs to be able to use or resell the inventory without constant reference to the creditor for permission to dispose of it. A charge that envisages the debtor disposing of the charged assets will be treated as a floating charge.⁹ Even if the charge over inventory is validly registered as a floating charge¹⁰ it is subordinated to preferential creditors and frequently to all fixed charges,¹¹ reducing the chances of recovery on insolvency. If a quasi-security can be employed instead of a charge, it will prevail over all other creditors.
- 6.6 A similar issue may arise in relation to investment securities, where it is common for the parties to want the facility to substitute other assets. By taking full title to the assets (for example via what is termed a 'repo'¹²) rather than taking a charge over them, the financier may be able to retain that facility without the risk that the charge will be held to be no more than a floating charge.¹³

⁵ See our recommendations for notice-filing where one financing statement can cover a multitude of transactions: see above, paras 4.116-4.117.

⁶ Although in practice there can be contractual requirements to account for the surplus, or the parties can vary the surplus rules contractually. Such a provision could in theory be one element in assessing whether there is a risk of 're-characterising' the transaction as a disguised security: see below, paras 6.8-6.10.

⁷ Culminating in the recent '*Brumark*' case: *Agnew v Commissioner of Inland Revenue* [2001] 2 AC 710, PC.

⁸ See above, para 2.18.

⁹ See *Re Bond Worth* [1980] Ch 228.

¹⁰ We will see that in the retention of title cases, the clauses in question were usually not registered.

¹¹ This depends on whether the subsequent fixed chargee takes with notice of a negative pledge clause, see above, para 2.42.

¹² See further below, paras 6.38 ff.

¹³ See further below, paras 6.41-6.42.

- 6.7 Quasi-securities over goods, at least, are most commonly used for ‘vendor-credit’, that is when the finance is provided to enable the buyer or hirer to obtain goods. However quasi-securities can also be used as a means of what is in effect securing borrowing on existing assets. A business may own a piece of equipment that it wishes to use as quasi-security. It may agree to sell it to a finance house and then to take it back on hire-purchase or under a finance lease (‘sale and lease-back’). The functional equivalence to taking a loan secured by a charge over the equipment is evident.

The risk of recharacterisation

- 6.8 There is always some small risk that the transaction may be recharacterised by the courts. The court will treat the agreement as a disguised security, and thus subject to the law governing security, where (a) the documents do not truly record the agreement of the parties and are therefore a sham or (b) though the documents genuinely record what the parties agreed, the terms are such as to show that the transaction is in law a security transaction, even if called a sale.¹⁴
- 6.9 Sale and lease-back transactions can be difficult to distinguish from a secured transaction. Lord Justice Romer set out the essential differences in *Re George Inglefield Ltd*.¹⁵ In a sale the seller has no right to recall the asset on repayment of the purchase price, whereas where a mortgage or charge is in place, until foreclosure the chargor or mortgagor has the right to the asset upon discharge of the underlying obligations. Further, a mortgagee realising the assets with a surplus has to account to the mortgagor, whereas a purchaser can sell on the asset with profit and has no liability to account back to the original seller. A mortgagor also has a liability where the proceeds of realisation produce a shortfall below the secured amount.¹⁶
- 6.10 However it must be emphasised that genuine sale and lease-back transactions, and the discounting and factoring of receivables by way of outright sale or other assignment, will not be recharacterised as security transactions.

TRANSACTIONS RELATING TO GOODS

Conditional sales

- 6.11 The Crowther report defined a conditional sale agreement as an agreement for the sale of goods under which the property in the goods remains in the seller until payment of the price or performance of the other conditions specified in the agreement.¹⁷ A similar but slightly wider definition (including the sale of land) is

¹⁴ See *Welsh Development Agency v Export Finance Co Ltd* [1992] BCC 270 for a discussion of the law of recharacterisation.

¹⁵ [1933] Ch 1.

¹⁶ [1933] Ch 1, 27-28. However, a similar result would also seem to be achieved under a sale and lease-back, where the lease was terminated for non-payment, leaving a shortfall.

¹⁷ Crowther report para 1.2.14.

given under the Consumer Credit Act 1974.¹⁸ Unlike a hire-purchaser, who merely hires the goods with an option to purchase them at the end of the hiring period, a buyer under a conditional sale is obliged under the terms of the agreement to purchase the goods.¹⁹ However under a conditional sale agreement that is 'regulated' within the meaning of the Consumer Credit Act 1974, the buyer has a right to terminate the agreement before the final payment falls due.²⁰

- 6.12 The requirements included in most conditional sale agreements are that the buyer make punctual payments of all instalments; the equipment is to be kept in the possession of the buyer and not sold or disposed of in any way; the equipment is to be insured comprehensively; and that no lien is to be created on it.²¹ A provision may be made in the agreement that will allow the seller the right to terminate²² the agreement upon the occurrence of defined events.²³ If the agreement is determined the seller may repossess the property.²⁴
- 6.13 Under the Sale of Goods Act 1979, a buyer who has been given possession of the goods that are still owned by the seller, and who resells them to an innocent party, can in certain circumstances pass good title to the innocent buyer.²⁵ Thus the 'security' of a conditional sale can be destroyed if the goods are resold. A major reason for the development of the hire-purchase agreement was to avoid the risk that the creditor would lose title to an innocent buyer: selling goods subject to a hire-purchase agreement will not pass title (unless, in some circumstances, the hire-purchase relates to a motor vehicle).

Hire-purchase agreements

- 6.14 A hire-purchase agreement is an agreement for the hire of goods under which the hirer is given the option - although not the obligation - to purchase the hired goods

¹⁸ The Consumer Credit Act 1974, s 189 defines such an agreement, for the purposes of the Act, as "an agreement for the sale of goods or land under which the purchase price or part of it is payable by instalments, and the property in the goods or land is to remain in the seller (notwithstanding that the buyer is to be in possession of the goods or land) until such conditions as to the payment of instalments or otherwise as may be specified in the agreement are fulfilled."

¹⁹ This distinction can have an effect on the rights of third party purchasers: see *Chitty on Contracts* (28th ed 1999) para 38.423.

²⁰ See the Consumer Credit Act 1974, s 99(1).

²¹ R Goode, *Commercial Law* (2nd ed 1995) p 764.

²² As an alternative to termination and repossession, some conditional sale agreements provide that the seller may elect to pass the property in the goods to the buyer and recover from the buyer the unpaid balance of the purchase price of the goods. See *Chitty on Contracts* (28th ed 1999) para 38.403.

²³ This includes breach of the obligations of the buyer and bankruptcy.

²⁴ Although this is subject to the principle of relief against forfeiture: for a recent example, see the decision of the House of Lords in *On Demand Information plc v Michael Gerson (Finance) plc* [2002] 2 WLR 919.

²⁵ See the Sale of Goods Act 1979, s 25(1); but note s 25(2), which for this purpose prevents a buyer under a conditional sale agreement that is a consumer credit agreement within the meaning of the Consumer Credit Act 1974 from using s 25(1).

at a certain point (usually after all repayments have been made).²⁶ It may alternatively be the case that the property will pass automatically when all the payments have been made; provided the hirer has the right to terminate before the date of final payment, this will not amount to a contract of sale.²⁷ The property in the goods remains with the owner whilst the agreement subsists and the hirer has no power to dispose of the property.²⁸ Usually, hire-purchase agreements allow the hirer to terminate the agreement at any time, by notice in writing; the hirer is then required to return the property to the owner in good order and to compensate the owner for any loss suffered as a consequence of the termination.²⁹

Finance leases

- 6.15 A lease of goods is a hire contract, with the essential characteristic of goods being bailed by one party to the other party in exchange for payment of rent.³⁰ Although the term 'lease' has no particular legal significance, the 'finance lease' is recognised as having a fundamentally different purpose to the shorter-term hire of goods often referred to as an 'operating lease'.³¹ The finance lease is a financial tool, a characteristic being that the minimum period of the lease is approximate to the estimated working life of the equipment, so that there is only one lessee.³² In addition, responsibility for maintenance of the equipment rests with the lessee, and

²⁶ See *Chitty on Contracts* (28th ed 1999) para 38-267, and see also the Crowther report para 1.2.14. However, see *Forthright Finance Ltd v Carlyle Finance Ltd* [1997] 4 All ER 90, where what was described as a hire-purchase agreement, which contained an option to purchase following payment of all the instalments, was held to be a conditional sale agreement.

²⁷ *Helby v Matthews* [1895] AC 471, HL. The Consumer Credit Act 1974, s 189 defines a hire-purchase agreement, for the purposes of that Act, as "an agreement, other than a conditional sale agreement, under which - (a) goods are bailed or (in Scotland) hired in return for periodical payments by the person to whom they are bailed or hired, and (b) the property in the goods will pass to that person if the terms of the agreement are complied with and one or more of the following occurs - (i) the exercise of an option to purchase by that person, (ii) the doing of any other specified act by any party to the agreement, (iii) the happening of any other specified event." However, this Act does not control all hire-purchase agreements. For a statutory exception relating to motor vehicles and covering both hire-purchase and conditional sale, see the Hire-Purchase Act 1964, ss 27-30.

²⁸ No disposition by the hirer even to a good faith purchaser exception will pass a good title to the latter; the rule that the seller cannot pass a good title unless he has a good title applies. The exception to this rule under Sale of Goods Act 1979, s 25 applies only to a *buyer* who is in possession of the goods.

²⁹ R Goode, *Commercial Law* (2nd ed 1995) p 767.

³⁰ R Goode, *Commercial Law* (2nd ed 1995) p 776.

³¹ Statement of Standard Accounting Practice No 21 (referred to in *On Demand Information plc (in administrative receivership) v Michael Gerson (Finance) plc* [2000] 4 All ER 734, 737, CA) sets out the distinction thus: "The distinction between a finance lease and an operating lease will usually be evident from the terms of the contract between the lessor and the lessee. An operating lease involves the lessee paying a rental for the hire of an asset for a period of time which is normally substantially less than its useful economic life. The lessor retains most of the risks and rewards of ownership of an asset in the case of an operating lease. A finance lease usually involves payment by a lessee to a lessor of the full cost of the asset together with a return on the finance provided by the lessor. The lessee has substantially all the risks and rewards associated with the ownership of the asset, other than the legal title. In practice all leases transfer some of the risks and rewards of ownership to the lessee, and the distinction between a finance lease and an operating lease is essentially one of degree." See also *Chitty on Contracts* (28th ed 1999) para 33-078.

³² In contrast to the operating lease, which typically has a series of lessees.

the rental is calculated on a basis that will enable the lessor to recoup the capital expenditure of the asset, together with interest. Although by the end of the lease the equipment is likely to have a low residual value, a finance lease should not contain provision for the lessee to acquire the equipment: to do so would turn the transaction into a hire-purchase agreement (although an option to renew the lease may be given).³³

Retention of title clauses

- 6.16 The forms of quasi-security described so far are used principally to enable the debtor to obtain possession of an item that it is expected to retain and use for a significant period of time. It is also possible for a supplier to retain title to goods that are supplied on the understanding that the buyer will resell them or use them in its production process, in other words for materials, 'stock-in-trade' or 'inventory'. Although always possible in theory, such clauses did not come into common use until after the decision of the Court of Appeal in *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd*.³⁴ In that case the court was faced with a clause in the conditions of sale of a Dutch company which in effect provided for the retention of title by the plaintiff, even if its goods were subsequently mixed or incorporated into other goods, and that the defendant had to account for the proceeds of sale of such goods. It was held that such a clause was, on the facts, not a registrable charge and was effective to give the supplier the right not only to the goods that were still in the buyer's possession but also to the proceeds of goods that had been resold. Such clauses are therefore often called 'Romalpa' clauses.
- 6.17 In its simplest form the Romalpa clause merely entitles the supplier to repossess goods supplied for which the buyer has failed to pay. However there are many variants and extensions of this simplest model. One writer identifies five types of clause.³⁵ The crucial question is how far the clause may reach without becoming a charge that must be registered if it is to be valid in the event of the buyer's insolvency.³⁶
- 6.18 First, the supplier may retain title to the goods supplied not only until the particular goods have been paid for but also until other obligations, whether under further sale contracts or otherwise, have been discharged. It has been held by the House of Lords in a Scottish case that such an 'all monies' clause does not convert the transaction into a charge and thus the clause need not be registered in order to be valid.³⁷

³³ R Goode, *Commercial Law* (2nd ed 1995) p 777. For more details on the finance lease, see *ibid* ch 28. See also the Crowther report para 1.2.14.

³⁴ [1976] 1 WLR 676.

³⁵ These are the simple clause; the current account clause; the extended (or 'continuing') clause; the tracing (or 'prolonged') clause; and the aggregation (or 'enlarged') clause. See G McCormack, *Registration of Company Charges* (1994) pp 68-69.

³⁶ As the buyer is expressly or impliedly permitted to use or dispose of the goods without further reference to the supplier, any charge would be a floating charge: *Re Bond Worth Ltd* [1980] Ch 228.

³⁷ *Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339.

- 6.19 Secondly, the clause may purport to give the supplier the property to products made using the goods supplied. It has been said in the Court of Appeal that such a provision may in theory be valid and not constitute a registrable charge,³⁸ though in practice this outcome is unlikely. This is because it would mean that the supplier would be exclusively entitled to the new goods despite the input of labour and possible materials by the buyer and of materials by other suppliers, which is not thought to be a result that the parties would have intended. It will almost invariably be found that the parties cannot have intended that the supplier should be entitled to a greater interest in the goods than would reflect what is owing to it - which constitutes a charge that must be registered if it is to be valid.³⁹
- 6.20 Thirdly, the clause may purport to give the supplier the right to any proceeds of re-sale of the goods. Although in the *Romalpa* case itself it was held that such a clause was effective on the basis that the buyers were bailees of the goods, sold them as agents for the suppliers and were fiduciaries of the money received, this aspect of the case is now doubtful. A 'proceeds' clause is more likely to be construed as a charge on book debts in that the assumed intention is that the seller will receive or retain only such part of the proceeds as equals what is due to it.⁴⁰ Moreover, if, as is usually the case, the supplier has given the buyer a period of credit during which the buyer would normally be free to use any proceeds already received as it wishes, it is much more likely that the buyer will be held to resell the goods in its own name and to enter a debtor-creditor relationship with the supplier rather than holding the proceeds for the supplier.⁴¹
- 6.21 It seems clear that the *Romalpa* clause is functionally similar to a security over the goods supplied and new goods or proceeds. However, the courts will sometimes interpret such clauses in a way that would prevent the creditor being able to take property worth more than the amount owed, or, if the property repossessed was worth more, to retain the excess. This happened in the case of *Clough Mill Ltd v Martin*,⁴² where Robert Goff LJ held that if the seller of goods chose to exercise its power under a retention of title clause to repossess goods that were worth considerably more than the outstanding debt, an implied term would prevent it repossessing and reselling more than was necessary to pay the outstanding debt. If it were to sell more it would have to account for the surplus.⁴³ This 'contractual' solution to the problem of the surplus was relied on by Robert Goff LJ to show that the retention of title clause need not be construed as giving rise to a charge

³⁸ *Clough Mill Ltd v Martin* [1985] 1 WLR 111, 119-120.

³⁹ As was held in the *Clough Mill* case itself.

⁴⁰ See *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150.

⁴¹ See *Re Andrabell* [1984] 3 All ER 407.

⁴² [1985] 1 WLR 111. The case involved the sale of yarn.

⁴³ However, if the buyer's delay in paying were to amount to a repudiation of the contract which the sellers were to accept, the sellers would then be entitled to repossess and resell the whole of the yarn still in the buyer's possession. Robert Goff LJ said that in these circumstances the sellers would "be bound to repay any part of the purchase price already paid by the buyer which must be appropriated to the goods sold, because such sum would be recoverable by the buyer on the ground of failure of consideration": [1985] 1 WLR 111, 117-118. Oliver LJ expressed provisional agreement with these solutions: *ibid*, p 124.

that would have to be registered under the Companies Act 1985, although the case also shows how the courts have sometimes tried to reduce the differences in effect between quasi-securities and security proper.

Consignment of goods

- 6.22 A consignment is also a form of title retention. A pure consignment occurs where goods are supplied to a dealer on the condition that title is retained by the supplier until the goods are sold or otherwise disposed of by the dealer, as authorised by the supplier; but the dealer does not incur any liability to the supplier for the price, unless and until the dealer sells the goods.⁴⁴ Thus the risk that buyers will not be found for the goods is borne by the supplier rather than the dealer. Once the goods have been sold the supplier may obtain title to the proceeds of sale, which are held by the dealer as agent for the supplier; or the relationship may simply be one of debtor-creditor.
- 6.23 A consignment may also be used as a means of financing a purchase by the consignee. There may be a master agreement under which the financing party authorises the consignee (for example, an equipment dealer) to buy goods from a supplier and take delivery of those goods acting as an agent for a financing party. The purchase price can then be paid by the financing party either to the supplier directly or indirectly via the dealer. Legal title is acquired directly by the financing party from the supplier. In the course of its business, the dealer is then able to sell the goods to other purchasers as an agent for the financing party. The dealer then holds the proceeds of the subsale in trust as an agent and fiduciary for the financing party to the extent of the moneys paid or advanced. This form of consignment is more akin to a retention of title clause than the pure consignment.

RECEIVABLES FINANCING

- 6.24 A major part of the assets of many businesses is in the form of obligations owed to the business, or 'receivables'.⁴⁵ Receivables form a very important asset from which the business may wish to raise finance by granting security or otherwise. This may take the form of a charge on, or assignment of, the receivables as security. We saw earlier that fixed or floating charges may be granted over book debts.⁴⁶ Receivables

⁴⁴ W J Gough, *Company Charges* (2nd ed 1996) pp 513-514. In other words, the goods are on 'sale or return'. Cars are frequently supplied by manufacturers to dealers on a sale or return basis. There is generally a provision that the dealer is deemed to purchase if it has not appropriated the goods within a certain time (such as 12 months, the latest point to which payment of Value Added Tax can be deferred). This deferment is one of the advantages of consignment. For further reading in this area, see, eg, R Goode, *Commercial Law* (2nd ed 1995) p 798.

⁴⁵ Receivables denote a debt or contract right. An account receivable is a right to a sum of money. Documentary intangibles are receivables embodied in a negotiable instrument, eg, a bill of exchange or negotiable certificate of deposit. They can therefore be mortgaged, charged, pledged and delivered by way of lien. Pure intangibles are receivables, eg, the right to payment under a contract and are therefore not capable of pledge or contractual liens. "Receivables form an integral part of the assets of every trading company. Mortgage and charge debts, car loans, insurance premiums, credit card debts, secured consumer loans, equipment loans, freights (including sub-freights), rentals from real and personal property, debts for good sold or services rendered, are all receivables." F Oditah, *Legal Aspects of Receivables Financing* (1991) p 2.

⁴⁶ See above, para 2.18.

financing also can take the form of an outright assignment in discharge or reduction of an existing indebtedness (effectively a sale), under arrangements commonly known as factoring and discounting of receivables.

- 6.25 Often in commercial transactions the practical distinction between the outright sale of receivables and their transfer by way of security is blurred. If the debt is 'sold' but on a recourse basis (so that if the debtor fails to pay, the seller must repurchase the debt or make good the loss) or if a similar effect is achieved through warranties given by the assignor,⁴⁷ the arrangement is functionally very much like a mortgage of the receivables. However, a mortgage of receivables is usually registrable whereas a sale is not.⁴⁸

Factoring

- 6.26 Companies use factoring in order to improve their cash-flow, as it enables the company to obtain funds faster than through awaiting payment from customers.⁴⁹ The factoring relationship is governed by a factoring agreement between a factor and a client who supplies goods and services to trade customers. The factor may merely provide a service of collecting the debts, or it may advance money to the client in advance of the debts being collected. The factor purchases the trade debts of the client.⁵⁰ Ownership of the debt is transferred to the factor by way of an assignment.⁵¹
- 6.27 An assignment may be either legal or equitable and the relevant interest may also be legal or equitable. Once there has been a legal assignment, the factor acquires the legal right to the debt (subject to equities having priority), all legal and other remedies for the debt and the power to give a good discharge for the debt without the concurrence of the assignor. However a legal assignment requires a writing under the hand of the debtor and express notice in writing to the debtor,⁵² and it cannot be effective until the debt comes into existence. An equitable assignment, in contrast, can be of future debts and may be purely informal without even notice

⁴⁷ The Crowther report pointed out that even a sale without recourse may contain warranties by the assignor "designed to ensure so far as possible that the receivables assigned are not only legally enforceable but likely to be paid. Since breach of these warranties may entitle the assignee to recover his loss from the assignor the distinction between sales with recourse and sales without recourse is not as clear cut as it might appear." Crowther report Appendix III, para 5.

⁴⁸ The distinction is important for other reasons. A sale of receivables attracts *ad valorem* stamp duty; and the asset sold is then off balance sheet and replaced by the proceeds of sale, which can be a major commercial reason for securitising assets. If a mortgage is used, the asset remains on the balance sheet of the mortgagor.

⁴⁹ For a more detailed discussion of factoring, see, eg, F R Salinger, *Factoring: The Law and Practice of Invoice Finance* (3rd ed 1999).

⁵⁰ Because the assignment is absolute, factored receivables are not currently registrable under the Companies Act 1985.

⁵¹ Such an assignment is by way of an agreement by a creditor to transfer its rights in a debt to the factor. The factor agrees to accept those rights. The consent of the debtor is not required unless the debt itself is stated to be non-assignable: see *Helstan Securities Ltd v Hertfordshire County Council* [1978] 3 All ER 262, QBD; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, HL

⁵² Law of Property Act 1925, s 136(1).

to the debtor. However a debtor who pays the assignor before learning of the assignment will be discharged. For this and other reasons⁵³ a factor may still want to give notice of an equitable assignment to the debtor. In contrast to an assignment at law, any form of notice is sufficient, provided the fact of the assignment is definitely brought to the mind of the debtor.⁵⁴ It is sufficient to show that the debtor has had knowledge of the assignment, regardless of the mode or source of that knowledge.⁵⁵

Discounting of receivables

- 6.28 Receivables may be discounted for immediate cash. In practice, for example, discounting of bills of exchange may be an important source of corporate refinancing. Additionally, discounting of receivables can be used by businesses that deal with their customers by way of hire-purchase or credit-sale agreements. This is often referred to as 'block discounting'. Block discounting is used by traders who supply goods to consumers on hire-purchase, credit-sale or rental and wish to obtain immediate payment instead of collecting instalments and rentals as they fall due. The essential feature of this service is that the trader sells its rights under the agreements to a finance house at their discounted value, guaranteeing performance by the customers and giving the finance house an indemnity against loss. Agreements are sold or offered for sale to the finance house in batches ('blocks') at agreed intervals. The assignment of the receivables takes effect in equity only, as notice of the assignment is not given to the customer, who therefore obtains a good discharge by paying the trader. But the finance house reserves the right to give notice and to convert the equitable assignment into a statutory assignment. In that event the customer comes under an obligation to make payment to the finance house instead of the trader. As assignee the finance house, like the factor, incurs no positive obligations to a customer but acquires its rights subject to any defences and rights of set-off she may have against the trader.
- 6.29 Block discounting is not in principle different from factoring, except that it relates to consumer receivables rather than trade receivables. The block discounting agreement is a master agreement which fulfils the same function as a factoring agreement. Block discounting, however, is generally on a non-notification basis (that is, the customers are not notified of the assignment) as the finance house does not want the bother of collecting large numbers of consumer receivables unless the trader defaults, while the trader does not want customers to know of the involvement of the finance house.

Securitisation

- 6.30 Securitisation has been described as a hybrid between a sale and a sub-charge of receivables,⁵⁶ or a sophisticated form of factoring or discounting of debts.⁵⁷ The

⁵³ To prevent the debtor being able to rely on other 'equities' that may arise as against the assignor, and to preserve priority.

⁵⁴ *Smith v Zigurds (Owners)* [1934] AC 209.

⁵⁵ *Ward and Pemberton v Duncombe* [1893] AC 369.

⁵⁶ F Oditah, *Legal Aspects of Receivables Financing* (1991) p 34.

⁵⁷ P Wood, *Law and Practice of International Finance* (2nd ed 1995).

term 'securitisation' describes a process whereby the revenue stream on a segregated pool of receivables or other income producing assets, rather than being assigned as security or sold to individual financiers, is repackaged into tradable securities⁵⁸ issued to investors.⁵⁹ The identity of the investors may thus change over the life of the notes. The trust device is the usual method by which this is achieved.

- 6.31 A standard transaction will involve the sale of the receivables by the owner (the 'Originator') to a purchaser, often a specially incorporated company or a specially established trust (the 'Special Purpose Vehicle' or 'SPV') that is structured so that it will not be affected should the Originator become insolvent.⁶⁰ The SPV will fund the purchase through the issue of debt securities, which are secured on the receivables by virtue of a security interest granted to a security trustee, who acts for the investors in the debt securities.
- 6.32 The intended economic advantages of securitisation can be numerous: for example, lower cost of funds through credit arbitrage;⁶¹ under contractual terms the Originator can continue to retain the benefit of the surplus income from the assets and may only bear losses up to a pre-determined limit, and most importantly balance sheet considerations.⁶²

⁵⁸ The term 'securities' here refers to the instrument which a borrower uses to acknowledge debt, or to investments such as shares, debentures, stock, bonds, bills of exchange and other forms of tradable debt.

⁵⁹ Recently reported examples of securitisations have included the future royalties on the music of David Bowie and the future admission fees to Madame Tussauds' Wax Museum: see *Business Week*, March 11, 2002, p 58.

⁶⁰ The SPV is structured so that it is not classified as a subsidiary of the Originator under companies legislation and its accounts are therefore not required to appear as part of group accounts.

⁶¹ That is, an originating company may be owed debts by other companies that are a better credit risk than is the originating company itself. If the Originator can borrow money solely against the credit risk of these receivables it will be able to borrow more cheaply than if its lenders have to take the risk of the Originator's own default as well as any risk involved in the receivables.

⁶² Prior to Financial Reporting Standard 5 ('FRS 5') (issued by the Accounting Standards Board in April 1994 and mandatory for accounting periods ending on or after 22 September 1994, applying to all transactions whenever they were entered into), one of the principle benefits of securitisation was to remove the securitised assets from the Originator's balance sheet, with the proceeds then appearing as cash. FRS 5's stated objective was to ensure the substance of a transaction was recorded. The Accounting Standards Board (a committee of the Accounting Standards Board Ltd, a prescribed standard setting body for the purposes of the Companies Act 1985, s 256(1)) expressed the view that "financial statements should represent faithfully the commercial effects of the transactions they purport to represent. This requires transactions to be accounted for in accordance with their substance and not merely their legal form, since the latter may not fully indicate the commercial effect of the arrangements entered into": see "The Development of FRS5" Appendix III to *Accounting Standards and Guidance for Members 2000*. FRS 5 was therefore developed to give guidance as to how to account for these structures. It adopted new definitions of assets and liabilities which did not rely on legal ownership and gave three possible accounting treatments which must be considered for securitisations, these being off balance sheet, linked presentation and fully on balance sheet.

Legal issues in securitisation

- 6.33 Securitisation is a large and often complex area of legal practice. In this Consultation Paper we refer only to aspects that are directly relevant to reform of the scheme of registration of security interests.

TRUE SALE

- 6.34 Partly because rating agencies will rate the credit risk of the transaction on the assumption that immediately following the sale the Originator will become insolvent, structures must be devised to ensure that the transfer of receivables will survive the liquidation of the Originator and that the assets cannot be clawed back by the liquidator or any of its creditors. It is important that a liquidator should not be able to argue that the transaction was not a sale at all, but rather a secured financing arrangement that has not been properly perfected, for example by registration. This is known as recharacterisation risk.⁶³

- 6.35 We have seen already that the courts may recharacterise what they see as a security agreement that has been 'disguised' as a sale or other quasi-security, but only when it is clear that this is the case. Where this happens the security would usually be void for want of registration. Under English law it has been established that a sale of receivables even with recourse is not a loan secured on the receivables requiring registration.⁶⁴ Other methods of transfer such as novation or subparticipation may also be used; it is not thought that these involve any increase in the risk of recharacterisation.

PRIORITY

- 6.36 A particular problem for some forms of securitisation relates to the way in which priority can depend upon the date on which notice was given to the debtor. We focus here on assignment. In practice in securitisations, notice is not normally given to debtors because of the administrative burden, involving time and expense, and because the Originator may wish to maintain a commercial relationship with the debtors and to continue to collect the receivables. If no notice is given to the debtor the assignment will be equitable.⁶⁵ This does not prevent it being valid as against the Originator should the latter become insolvent. However, we have seen that with assignment of debts, which does not amount to a registrable charge,⁶⁶

⁶³ Achieving a true sale and thus avoiding recharacterisation is not only a matter of ensuring that legal title to the receivables is properly transferred but also involves other aspects of the transaction such as recourse to the Originator, representations and warranties given by the Originator to the SPV, and the parties' intent. Achieving a true sale is also of utmost relevance for the purposes of capital adequacy regulations of the Originator, and the taxation consequences of the transaction. The rules for determining what is a true sale in each of the above aspects differs in each case.

⁶⁴ See, eg, *Olds Discount Co Ltd v John Playfair Ltd* [1938] 3 All ER 275; *Re George Inglefield Ltd* [1933] Ch 1; *Lloyds and Scottish Finance Ltd v Prentice* (1977) 121 Sol Jo 847, affirmed HL, *The Times*, March 29, 1979; and *Welsh Development Agency v Export Finance Co Ltd* [1992] BCC 270.

⁶⁵ It would be necessary to join the Originator in any action against the debtors but this is not seen as a significant problem.

⁶⁶ Notice to the debtor is only required if there is no registration requirement or registration is not effected. Where it is, a subsequent assignee will have notice, so that the rule in *Dearle v Hall* (1823) 3 Russ 1 is displaced.

priority depends on the date of notice to the debtor.⁶⁷ Thus if notice of the assignment to the SPV is not given, the SPV may lose priority if the Originator charges the assets further or sells them to a third party who does not know of the earlier securitisation assignment and the third party gives notice to the debtor before the SPV does. In addition, debtors without notice can continue to acquire set-off rights and defences that can be exercised against the assignee.

- 6.37 There is the further point that the investors in the securities issued by the SPV will require that their lending to the SPV is adequately secured on the SPV's assets - for example, the receivables themselves, guarantees of the receivables and any security for the receivables (for example, building mortgages), any insurances and the SPV's bank account. In a security package the objective will be to take fixed security where possible but where it is necessary to allow substitution, so that as receivables are redeemed they can be replaced, the charge may have to be floating.

'Repos'

- 6.38 'Repos' (the current market terminology for sale and repurchase arrangements) are a form of title finance whereby a seller raises capital on an asset by selling it to a buyer, with the seller paying a repurchase price equal to the purchase price and a financing charge.⁶⁸ The agreement requires the seller to repurchase the assets, or equivalent assets, at a future date or possibly upon demand.⁶⁹ Repos are normally used where the assets are investment securities (by which we mean instruments that a borrower uses to acknowledge debt) or investments such as shares, debentures, stock, bonds, bills of exchange and other forms of tradable debt.⁷⁰

Why use a repo rather than traditional security?

- 6.39 The repo mechanism can be employed for a variety of purposes, not all of them related to security. For example, the buyer may wish to have title to a block of shares temporarily, in order to gain control of the accompanying voting rights.⁷¹

⁶⁷ See above, paras 6.26 ff. An assignee who knew at the time that the debt had already been assigned cannot gain priority by giving notice to the debtor before the earlier assignee, but this is not a likely situation with securitised receivables.

⁶⁸ The repurchase price therefore increases during the term of the transaction, with the increase being calculated by applying a notional interest rate (the 'repo rate') to the purchase price. Although the purchase price is related to the market price at the time of the initial purchase, fluctuations in the market value after the initial purchase have no impact on the repurchase price (although they may be relevant for triggering obligations in relation to the 'margin', whereby the net credit exposure of the parties can remain constant throughout the term of the transaction).

⁶⁹ Most repo transactions in the London market are conducted under the terms of the Global Master Repurchase Agreement of the Public Securities Association (New York) and the International Securities Market Association (Zurich), November 1995 edition (there is now an October 2000 version). Swaps and Derivatives under the Master Agreement of the International Swaps and Derivatives Association Inc can be secured either by a security interest or by a title transfer under the 1995 edition Credit Support Annex, which forms part of the main ISDA Agreement. Here, rather than effecting a sale and repurchase, the collateral is transferred if a party's net exposure to the other exceeds a prescribed amount and retransferred where there is a surplus, called respectively the Delivery Amount and the Return Amount.

⁷⁰ Although theoretically this form of title finance may be used for land, goods or receivables.

⁷¹ In this case the transaction is similar to a stock loan; see below, para 6.46.

More usually however a repo is a way of raising capital or is used for purchasing a particular portfolio of securities or indeed for both purposes together. It may also be used to provide security to minimise the risk inherent in financial market transactions. They can be very short term. Arrangements may be established under a master agreement between two parties, under which a number of transactions are secured or supported by the same 'collateral' arrangement and pool of 'collateral' assets. The collateral arrangement is designed to secure or support the net exposure of a party. In some circumstances this net exposure varies over time, so that at different times a party may be a net debtor or a net creditor. Therefore the collateral arrangements may be bilateral, in that at any given time during the term of the master agreement either party may be required to provide collateral (in the form of security or by transfer of title) to the other party.

- 6.40 Collateral arrangements in the financial markets may be based on either the creation of a security interest or on transfer of title to the relevant collateral. There are a number of reasons for using the repo form rather than more traditional forms of security.
- 6.41 One of the essential features of the financial markets is liquidity (that is, the ability to trade swiftly in such assets). Security over investment securities is attractive due to their liquidity and ease of valuation. A key feature then in security arrangements over such securities is maintaining this liquidity. Managing a portfolio of assets is generally more profitable than having 'frozen' securities. It may be desired either that the secured party will be able to deal with the assets as its own, perhaps by using the securities as collateral in further transactions with third parties or by being allowed to redeliver securities of the same number and type; or that the party granting the security will be able to continue to deal with them and have a right of substitution; or both.
- 6.42 Were the parties to employ a charge agreement under which the chargor had the right to continue to deal in the investment securities, the charge would probably have to be a floating charge. The disadvantages of floating charges in terms of priority and status vis-à-vis preferential creditors⁷² mean that in practice they are not favoured.
- 6.43 There is doubt whether it is possible to use a fixed charge in this situation. One might envisage it as a charge over a pool of assets that remains under the chargee's control,⁷³ but the right of use raises problems under English law in relation to the characterisation of the charge.⁷⁴ If title is conferred along with equivalent redelivery provisions, and the chargee may dispose of the original securities free of any

⁷² Such as ranking after preferential creditors, and avoidance under the Insolvency Act 1986, s 245.

⁷³ Cf the problem of the fixed charge over book debts, above, para 2.18.

⁷⁴ Some practitioners doubt the effectiveness of a right of use on the basis that it is likely to amount to a clog on the equity of redemption if the chargee may deliver back securities different from the original ones charged (ie, no continuing proprietary interest can be traced). However, others consider that the right of use, if clearly conferred, is effective on the basis that the chargee conveys both its own interest and, in an agency capacity, the chargor's interest (a view that seems to be supported in case law: see, eg, *Kreglinger v New Patagonia Meat and Cold Storage Company* [1914] AC 25). The possibility of an effective right of use is also assumed in the most recent rules made by the FSA on client assets - see COB 9.4 of the FSA's Handbook of Rules and Guidance.

interest of the chargor, it is questionable whether the chargor retains the equity of redemption in the securities it charged. Naturally this is a topic of intense current interest to lenders, such as 'prime brokers', who provide finance for securities dealing operations and take portfolios of securities as their security. Further, even if the charge were fixed rather than floating there would be uncertainty whether it would be registrable on the basis that debt securities or equity share dividend rights are book debts.

- 6.44 Under a repo contract, in contrast, the situation is different. The 'chargee'/buyer is the registered owner of the investment securities; it thus has the power to deal with or dispose of them as it wishes, and will be able to redeliver equivalent securities under the terms of the repo agreement. Meanwhile the 'chargor'/seller will be given the right to terminate the transaction early, thereby accelerating its right to the delivery of equivalent securities (provided that it is prepared to replace the securities with other acceptable securities).
- 6.45 The dominant forms of transactions in relation to investment securities are repos and other forms of title transfer, although there are some financial institutions that choose to use charges. Moreover, in the case of certificated securities (for example, share certificates plus a signed transfer form) or cash provided as collateral there may be delivery to the chargee or its custodian, in effect creating a possessory security interest.

Stock-lending

- 6.46 In stock or securities lending a lender transfers securities to a 'borrower' with an agreement to replace the securities in due course on a specified future date. A typical agreement would require the 'borrower' to pay a fee to the lender and also provide collateral in the form of cash or other securities. The collateral is transferred through a title transfer arrangement, which enables the collateral to be further used. It is usual to require the value of the collateral to be adjusted to the market value of the main securities during the term of the agreement. If this is a two-way collateral transfer, if either party defaults the other party can set off the obligation against the assets that are held.⁷⁵ Stock lending is commonly used by institutional investors. We do not think that it is in essence a quasi-security although we understand from practitioners that it may be employed to serve this purpose in specific (but uncommon) transactions.⁷⁶

⁷⁵ There is clearly a risk of recharacterisation as a security agreement. If such reclassification were to occur then the security would be void for want of registration. Even if such security were registered then the charge over it has the characteristics of a floating charge which, as stated above, carries perceived disadvantages for the parties. Recharacterisation will occur if the agreement between the parties is a sham intended to mask the true agreement between the parties: *Orion Finance Ltd v Crown Financial Management Ltd* [1996] 2 BCLC 78. There is a greater risk of recharacterisation in stock lending if the agreement is less than an outright assignment of the securities.

⁷⁶ The 'security' element is because collateral is given.

Transactions which do not create a proprietary interest

- 6.47 There are a number of transactions which do not seem to amount to security interests, even under a functional approach (although as we shall see, in one case it is possible that a charge might be created).

Contractual set-off arrangements

- 6.48 Contractual set-off is usually aimed at extending rights of set-off beyond those given at law⁷⁷ or in equity. A contractual set-off is not a security interest as it gives no right over the debtor's property, merely an entitlement to set-off one personal obligation against another; the *Re Charge Card* case held at first instance that it was not therefore a registrable interest.⁷⁸ However, contractual set-off may fulfil a security function.⁷⁹ A bank that wishes to lend against the 'security' of the borrower's money reserves may require that these be paid into a deposit account with it, and give itself the right to set-off the amount loaned against the sums it is bound to repay to the borrower under the deposit account.⁸⁰

Restrictions on right to withdraw deposit

- 6.49 In addition to (or instead of) taking a charge over a bank deposit or employing contractual rights of set-off, banks now may stipulate that sums deposited can only become repayable once all underlying obligations which are identified have been discharged. The sums deposited are then commonly referred to as 'flawed assets'. The effect is to qualify the bank's repayment obligation without giving it any rights over the credit balance. It is possible for such an arrangement to provide perfectly good security without operating as a charge.⁸¹

Subordination

- 6.50 Goode describes a subordination agreement as the obverse of a negative pledge; that is, instead of trying to obtain priority over other parties the creditor voluntarily agrees to subordinate its right.⁸² For example, a subordinated creditor might agree that it should not be paid by the debtor until other specified creditors (that is, the 'senior' creditors) have been paid. This may be in the subordinated ('junior')

⁷⁷ Statutes of Set-Off were repealed but their effect remains in the Supreme Court Act 1981, s 49: see R Goode, *Commercial Law* (2nd ed 1995) p 657.

⁷⁸ *Re Charge Card Services Ltd* [1987] Ch 150.

⁷⁹ See R Goode, *Commercial Law* (2nd ed 1995) p 657.

⁸⁰ It may be preferable to take this course rather than simply using the cash itself: the value of the cash deposited may be much less than the actual borrowings and may just be one element of the security package. Moreover, the cash, even though deposited with the lender (with perhaps restrictions on withdrawal) will still feature as an asset of the borrower on its balance sheets, and as such will go some way towards meeting liquidity ratios, such as those set by the Bank of England. In the context of insolvency where contractual rights of set-off seek to extend the rights of set-off beyond those allowed under the Insolvency Rules 1986 r 4.90 it goes against the principle of *pari passu* distribution in that its effect would be to use a purely personal cross claim to ring-fence assets away from those available for unsecured creditors.

⁸¹ See *Re Bank of Credit and Commerce International SA (No 8)* [1997] 3 WLR 909, 918E.

⁸² See R Goode, *Commercial Law* (2nd ed 1995) p 663. For further details on the law of subordination, see P Wood, *The Law of Subordinated Debt* (1990).

creditor's interest, if the borrower has a better chance of doing well if it receives additional funds that the junior creditor is unable or willing to advance but that the senior creditor will lend provided that it has priority. Clearly then it is of paramount importance that the subordination agreements are effective prior to and upon the insolvency of the debtor.⁸³

- 6.51 The mechanics of subordination can vary from contract to contract, for example, the subordinated creditor can agree with the debtor that it will not be paid upon the insolvency of the debtor until all other specified creditors have been paid.
- 6.52 In a subordination *simpliciter*, or complete subordination, a subordinated creditor agrees to postpone receipt of payments until the debt payable to the senior creditor has been discharged. A variation of this is that the subordinated creditor is entitled to payments until the occurrence of a specified event, such as an event of default under a senior finance document. No question of security interest arises as the undertaking to subordinate is purely personal and does not involve rights over any sums themselves. A breach of the undertaking would prompt a claim for breach of contract.
- 6.53 In 'contractual' subordination a creditor agrees with a debtor to postpone its right to be paid upon the insolvency of the debtor until the senior creditors have been paid in full. This is often a feature of documents surrounding bond issues in financial markets. An undertaking not to prove in the debtor's winding up has been held not to contravene any principle of insolvency law⁸⁴ as the subordination agreement is merely a contractual variation of *pari passu* rights as between junior and senior creditors.⁸⁵
- 6.54 However an undertaking to account for dividends may be intended to take effect as a trust under which the junior creditor holds sums received from the borrower in trust for the senior creditor. The question of whether the agreement ought to be registered (as a charge against the junior creditor, rather than as against the borrower) is dependent upon whether the entitlement to a dividend in a winding up is a book debt. Goode contends it is not, as the book debt is that which produced the dividend rather than the dividend itself.⁸⁶ However, on the approach we advocate in Part V, under which any charge would be registrable unless exempted, such trusts might be registrable.
- 6.55 'Turnover' subordination is where the subordinated creditor agrees to hand over any monies paid in satisfaction of the subordinated debt to the senior creditor until the senior debt has been discharged. Commentators and practitioners view this as taking effect as a trust or a proprietary transfer of proceeds which confers on the

⁸³ Along with the forms of subordination we mention, subordination may be achieved in other ways. For example, the 'junior' creditor might invest in equity in the borrower rather than lend to it, thus ranking as an unsecured creditor vis-à-vis secured creditors; or it might lend to a parent company whose assets are the shares of its subsidiaries rather than lending direct to the subsidiaries.

⁸⁴ Eg, in some jurisdictions such agreements may conflict with mandatory insolvency rules which state that unsecured debts must be paid on a *pari passu* basis.

⁸⁵ See R Goode, *Commercial Law* (2nd ed 1995) p 665.

⁸⁶ See R Goode, *Commercial Law* (2nd ed 1995) p 665.

senior creditor an *in rem* claim effective upon the junior creditor's insolvency and against its creditors.⁸⁷ On the approach we propose in Part V, this also would seem to amount to a registrable charge.

⁸⁷ See R Goode, *Commercial Law* (2nd ed 1995) p 664.

PART VII

A FUNCTIONAL APPROACH TO SECURITY

INTRODUCTION

- 7.1 In Part IV we discussed the introduction of notice-filing for company charges, and in Part V we considered which charges should be registrable under such a system. However, the Crowther and Diamond reports recommended, and all the overseas notice-filing systems that we have considered provide, that all transactions that have the effect of securing repayment of a loan or performance of an obligation - the 'quasi-securities' described in Part VI - should be brought within the scheme (though not necessarily registrable), whether or not the transaction is traditionally considered to create a security.
- 7.2 A major criticism of the current law, made by the Crowther and Diamond reports and underlying all the overseas schemes to which we have referred, is that the current law does not have a functional basis. The law decides what should be registrable as a security, and to some extent the effects of the transaction, on the form of transaction the parties have chosen to use, rather than looking to the purpose that the transaction is designed to achieve.¹ In this Part we consider whether the notice-filing system we have provisionally proposed for company charges should take the 'functional approach' envisaged by the Crowther and Diamond reports and put into practice in the overseas systems.
- 7.3 The lack of functionality in the current law manifests itself in two ways. The first is that, as we saw in the last Part, there are a number of transactions that operate, in purpose, as securities, but that are not regarded by the law as creating a security. One obvious example is a sale and lease-back of goods, whereby the owner of goods sells them to a finance house and enters into, for example, an equipment lease with the finance house in respect of those goods.² The effect of this agreement is very much the same as a mortgage of goods to secure a loan.³ A much more common example is that of the hire-purchase agreement. As the Diamond report noted:

¹ The Crowther report's proposed reforms rested on two fundamental points. First, "Recognition that the extension of credit in a sale or hire-purchase transaction is in reality a purchase-money loan and that the reservation of title under a hire-purchase or conditional sale agreement or finance lease is in reality a chattel mortgage securing a loan." Secondly, "Replacement of what are at present distinct sets of rules for different security devices by a legal structure applicable uniformly to all forms of security interest": *ibid*, para 5.2.8. The Diamond report noted that the division of the law of security into rigid compartments made the law fragmented and incoherent. This causes problems in attempting to create a security, in that a method appropriate for the property must be chosen, and also for enforcement, whereby the rules are very different depending on whether the law recognises the transaction as a security or not: Diamond report paras 8.2.4-8.2.6.

² See above, para 6.15.

³ See R Goode, *Commercial Law* (2nd ed 1995) p 652. However, in some cases such an agreement entered into by a company might be held to be a disguised bill of sale, and void for non-registration: see *ibid*, p 653, and see above, paras 6.8-6.10.

although a hire-purchase agreement takes the form of a letting of goods on hire, and the debtor has merely an option to purchase those goods, it is generally acknowledged today that the real objective of the parties is a sale of the goods from the creditor to the debtor, the debtor paying by instalments. Neither the creditor nor the debtor looks on the agreement as a true hiring, the agreement taking the form it does to enable the creditor to repossess the goods if the debtor defaults and to get back the goods from a purchaser if the debtor wrongly sells them.⁴

- 7.4 However, a mortgage of a company's goods would be a registrable charge whereas a sale and lease-back or a hire-purchase agreement between a company and a lender is not a charge and therefore is not registrable. Further, were the company to default and the lender to enforce its 'security', and were the goods to be worth more than the amount still due to the lender, the outcome would be different.
- 7.5 The second point is one that we made also in relation to charges: the law treats what are actually different situations as being the same, in that it fails to distinguish between a security that is a 'purchase-money interest' and one that is not.⁵ A secured loan taken out for the purpose of buying a specific piece of equipment (such as a vehicle or computer hardware) which then becomes a possession of the company has not made the company's position, or that of the other secured creditors, any worse, in that the debt is counter-balanced by the addition of the purchased equipment to the company's pool of assets. However, such a loan is treated by the law in the same way as a charge over property that is already owned by the company to secure an outstanding loan to the company - an arrangement that is potentially more detrimental to other secured or unsecured creditors. This point would become even more important were quasi-securities to be brought within the notice-filing system, because many quasi-securities are in fact purchase-money interests which, on a functional approach, should be given priority. This is not true, however of all quasi-securities, as is shown by the example of the sale and lease-back. The present law gives effective priority according to the form of the transaction (whether it is in form a security or a quasi-security) and not according to function (whether it is a purchase-money interest).
- 7.6 This lack of functionality led the Crowther and Diamond reports to recommend that the law in relation to security, like the overseas systems, should take a different approach to the question of security interests: it should deal with both securities and quasi-securities, and it should distinguish between charges that secure purchase-money interests and those that do not.⁶ However, although this important aspect was recognised to be an issue by the Steering Group when it

⁴ Diamond report, para 3.4.

⁵ See above, paras 4.155 ff.

⁶ The Crowther report para 5.5.9 noted that: "The assimilation of the various security devices does not, of course, mean that all forms of security will be treated in the same way, but simply that distinctions will be drawn on a functional basis, according to the nature and purpose of the security itself rather than according to the form of the security instrument."

recommended notice-filing in its Final Report, it was not considered in any depth either there or in its earlier consultation document.⁷

- 7.7 Given the criticisms of the current law and the way this area has been approached overseas, our terms of reference were drafted so as to enable us to look beyond a system that simply encompasses company charges, and to consider the wider question of whether a functional approach could be taken, which would include quasi-securities within the scope of any new system.⁸

CRITICISMS OF THE PRESENT LAW

- 7.8 One of the major difficulties resulting from the way the current law deals with quasi-securities is that, as they are not required to be registered under the Companies Act 1985, their existence will not be apparent to a person searching the Company Charges Register. Potential creditors, investors and purchasers of a company's assets will therefore not know, in the absence of information from the company itself, that, for example, receivables or other assets that are apparently free from registered charges are in fact not the absolute property of the company, and will thus not be alerted to the existence of what amounts to a security over such assets of the company.⁹
- 7.9 In addition to not being registrable, quasi-securities are treated differently from securities in that the former are not subject to the same rules on default. Under a mortgage, for example, any surplus achievable on resale would have to be returned to the debtor; under a quasi-security such as a sale and lease-back it would be retained by the lender.¹⁰ Despite both transactions being designed to achieve the same purpose - acting to secure repayment or the performance of an obligation - they are treated in different ways by the law.
- 7.10 Apart from the criticisms caused by the lack of functionality in the law, there is another factor that would be appropriate at least to consider when deciding the scope of any new notice-filing system, and that is the international dimension. To introduce a system that relates only to charges - as with the current registration scheme - would be to ignore the developments made in many overseas countries when addressing the question of the creation and registration of security interests.

⁷ Final Report para 12.8.

⁸ We consider whether the introduction of a functionally-based system of notice-filing should mean that there should be a restatement of the law of security later in this Consultation Paper: see below, Part XI and Appendix B.

⁹ This restriction is minimised to a certain extent in the case of purchasers of vehicles held on hire-purchase agreements, where the existence of the HPI system will indicate that certain vehicles are subject to hire-purchase agreements: see below, para 7.58 n 89. The Diamond report considered hire-purchase agreements to be security interests: *ibid*, para 3.4. See also the Crowther report para 5.2.8. The Diamond report noted that the evidence received during consultation fell far short of showing any real inconvenience arising from the fact that hire-purchase agreements were not registrable under the current scheme, but it suggested that as a matter of principle such agreements should be registrable. This recommendation was made in the context of reforming the current scheme of registration of company charges pending the introduction of the wider reforms to the law of security and to the notice-filing system: Diamond report paras 23.7.3-23.7.4.

¹⁰ Although we understand that there are sometimes contractual provisions dealing with the question of surplus.

The United States of America, Canada and New Zealand have all adopted systems that take a functional approach, and similar reform proposals are being examined in Australia. In addition, the system of security is also currently being examined by bodies such as UNIDROIT and UNCITRAL.¹¹ We wonder whether there might be a risk that in time overseas investors may be hesitant before investing in United Kingdom companies if we persist in having a system that does not take a functional approach, instead retaining the application of any system only to charges. We do not know how great such a risk might be, but we certainly think it is a factor that should be considered.

A RADICAL RE-THINK: QUASI-SECURITIES

- 7.11 Over the following paragraphs we consider in more detail how a system that took a functional approach might operate.¹²
- 7.12 The approach of the Crowther and Diamond reports was that any transaction that was designed to perform a security function should, in principle, be treated as a security and registrable accordingly:

The definition of security interest should be such that it would include not only mortgages, charges and security in the strict sense but also any other transfer or retention of any interests in rights over property other than land which secures the payment of money or the performance of any other obligation.¹³

The intention to create a security should be all-important, and it would not matter what form of agreement was used, provided that the intention was manifested.¹⁴ The new legislation proposed would not determine whether title to the secured property was in the creditor or debtor; where title lay would not affect the rules of the proposed system.¹⁵

Other notice-filing systems and registrable security interests

- 7.13 All of the overseas systems which we have considered contain a section setting out the scope of the application of the statute concerned, and all take a functional approach to what amounts to a security interest. The UCC, Saskatchewan and New Zealand systems all apply to a transaction that creates a security interest in personal property, regardless of its form.¹⁶ In addition, express provision is made in some of these systems that the relevant legislation applies to particular situations.

¹¹ See above, paras 1.45-1.46.

¹² In this section we consider whether quasi-securities should be registrable and, if so, whether there should be exceptions. Later in this Part we return to the question of purchase-money security interests, which we first considered in Part IV: see above, paras 4.155-4.162 and below, paras 7.68-7.70. (The implications for the rules on security of taking a functional approach we consider in Part XI and Appendix B.) The provisional recommendations that we make in this section are on the assumption that quasi-securities in general should be registrable under the notice-filing system we proposed in Part IV.

¹³ Diamond report para 9.3.2.

¹⁴ Diamond report para 10.7.6.

¹⁵ See the Diamond report paras 10.7.7-10.7.8.

¹⁶ See UCC Revised Article 9, Section 9-109(a)(1).

Although not every system is identical, common inclusions are floating charges, chattel mortgages, conditional sale agreements (including an agreement to sell subject to retention of title), consignments, leases, and assignments.¹⁷

7.14 Thus the SPPSA applies:

(a) to every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral; and

(b) without limiting the generality of clause (a), to a chattel mortgage, conditional sale, floating charge, pledge, trust indenture, trust receipt, or to an assignment, consignment, lease, trust or transfer of chattel paper that secures payment or performance of an obligation.¹⁸

7.15 “Security interest” is defined to mean an interest in personal property that secures payment or performance of an obligation,¹⁹ but also includes certain interests even though they do not secure payment or performance of an obligation.²⁰

7.16 The NZPPSA is similar, defining security interest as:

(a) ... an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to

(i) the form of the transaction; and

(ii) the identity of the person who has title to the collateral;²¹

It also includes certain interests within the definition, whether or not they secure payment or performance of an obligation.²² To “avoid doubt”, and without limiting the definition of security interest, the NZPPSA applies:

to a fixed charge, floating charge, chattel mortgage, conditional sale agreement (including an agreement to sell subject to retention of title), hire purchase agreement, pledge, security trust deed, trust

¹⁷ See, eg, the SPPSA, s 3 and the NZPPSA, s 17.

¹⁸ SPPSA, s 3(1) (subject to s 4).

¹⁹ SPPSA, s 2(1)(qq). However, this specifically does not include “the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods”: *ibid*, s 2(1)(qq)(i).

²⁰ The interests are the interest of a transferee of an account or chattel paper; a consignor delivering pursuant to a commercial consignment, and a lessee for a term more than one year: SPPSA, ss 2(1)(qq)(ii)(A)-(C).

²¹ NZPPSA, s 17(1).

²² These are an interest created or provided for by a transfer of an account receivable or chattel paper, a lease for a term of more than 1 year, and a commercial consignment: NZPPSA, s 17(1)(b).

receipt, consignment, lease, an assignment, or a flawed asset arrangement, that secures payment or performance of an obligation.²³

7.17 It should be noted that not all transactions falling within the definition of security interest in the overseas legislation will be registrable: the comprehensive systems they set out allow for perfection of some security interests by means other than registration, such as possession.²⁴

7.18 It does not make any difference whether title to the property is in the creditor or the debtor.²⁵ UCC Revised Article 9, Section 9-202 provides that:²⁶

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

The systems in Saskatchewan and New Zealand contain similar provisions.²⁷

7.19 It is our provisional view that, were the notice-filing system to be extended to take a functional approach, the meaning of ‘security interest’ should be defined in a way similar to that of the overseas systems, so that it would apply to interests in personal property that secured payment or performance of an obligation. We are therefore provisionally in favour of following the approach of the SPPSA or the NZPPSA. However, as we have noted, not all transactions falling within the definition of a security interest would necessarily be registrable.²⁸ We will go on in this section to consider particular ‘quasi-security’ transactions. In addition with certain transactions there is a question whether they should be registrable even though they do not seem to have the aim of securing payment or performance of an obligation.

7.20 **We ask consultees whether they agree with our provisional view that if there is to be a functionally-based notice-filing system, the approach taken by the overseas systems as to the meaning of ‘security interest’ should be followed, so as to apply, in general, to transactions that secure payment or performance of an obligation.**

²³ NZPPSA, s 17(3).

²⁴ Conversely, some transactions may be registrable but not subject to other aspects of the legislation, such as the provisions dealing with default: for example, see assignments of receivables, below, paras 7.35 ff.

²⁵ Cf the recommendation of the Diamond report, see above, para 7.12.

²⁶ The earlier version of UCC Article 9, Section 9-202 in force at the time of the Diamond report stated that: “Each provision of this Article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party of the debtor”. The Diamond report had noted that old Section 9-202, “was an important one”: Diamond report paras 4.12 and 10.7.1.

²⁷ See the SPPSA, s 3(1) and the NZPPSA, s 24.

²⁸ Whether non-registrable security interests should come within the new system at all depends on whether there should be a general restatement of the rules of security in the way discussed in Part XI and Appendix B.

Common forms of quasi-security

- 7.21 In this section we deal with some of the most obvious forms of quasi-security. However, we recognise that the taking of a functional approach to the question of what amounts to a security interest cannot hope to solve all problems of classification: there will still be disputes as to whether a particular transaction will fall within any functional definition. We address some of the difficulties below, including those in relation to finance leases²⁹ and sales of receivables.³⁰

Hire-purchase agreements and conditional sales

- 7.22 Both the Diamond and Crowther reports suggested that the reservation of title under a hire-purchase agreement or in a conditional sale should take effect as a security agreement. As we have noted above, such agreements and sales often also feature expressly within the scope of the overseas notice-filing systems.³¹ We provisionally propose that transactions of hire-purchase and conditional sale should be registrable against the hirer or buyer company.

- 7.23 **We ask whether consultees agree with our provisional proposal that transactions of hire-purchase and conditional sale should be registrable against the hirer or buyer company.**

Retention of title (Romalpa clauses)

- 7.24 Retention of title clauses of the kind often known as Romalpa clauses³² were not in use in the United Kingdom at the time of the Crowther report but were considered in detail in the Diamond report.³³ The Cork Committee had already said that:

the absence of any provisions requiring disclosure of reservation of title clauses is unsatisfactory and should be remedied as soon as possible.³⁴

The Diamond report agreed. Retention of title clauses serve a clear security purpose (indeed in the case of ‘all monies’ clauses, security is effectively being

²⁹ See below, paras 7.30-7.34.

³⁰ See below, paras 7.35 ff.

³¹ See, eg, the NZPPSA, s 17(3) and the SPPSA, s 3(1)(b).

³² See *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676.

³³ Diamond report paras 17.1 and 17.2. It was noted that there was a “fair amount” of support on consultation for the view that retention of title clauses should be registrable as if they created charges, under the Companies Act 1985 (these comments were made in the context of changing the existing scheme as an interim measure pending the introduction of the wider reforms advocated in the report); it was also noted that such clauses were very controversial: see *ibid*, paras 17.5 and 23.6.4. The Australian Law Reform Commission also recommended that title retention devices of all kinds should be subject to the new regime of security and registration that it proposed: see ALRC 64, *Personal Property Security* para 5.24.

³⁴ Insolvency Law and Practice (1982), Cmnd 8558, para 1639, quoted in the Diamond report para 17.4.

taken over goods already delivered and paid for). **We provisionally agree that retention of title clauses should be registrable.**³⁵

7.25 The Diamond report suggested that, as in several of the overseas systems, there should be an exception to the rule that a seller's reservation of title should be regarded as a security interest. This is where a seller ships goods to the buyer under a bill of lading, and either has the bill of lading made out to the seller or order, or has the bill made out to the buyer but retains the right to possession of it until payment, for example, by means of a documentary bill of exchange. It was suggested that these were such well-established types of commercial transaction that it would be unwise to interfere with them.³⁶ The SPPSA and the NZPPSA expressly exclude from the definition of security interest:

the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods.³⁷

7.26 **We provisionally agree that the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller should not be regarded as a security interest, unless the parties have evidenced an intention otherwise.**

Consignment of goods

7.27 As we noted in Part VI, a consignment may be for a financing purpose or for some other commercial purpose.³⁸ Where cars are consigned on sale-or-return, with the dealer paying a deposit equal to the price less tax, this in itself does not seem to have a security purpose. However, the arrangements may include a finance house that provides the deposit, in which case the manufacturer may agree to consign the cars to the finance house which then sub-consigns them to the dealer. If the dealer defaults the finance house can then take back the cars.³⁹ This amounts to a form of security for the loan. The question is, then, whether all consignments should be made registrable or only those with a security purpose.

³⁵ Cf Part V (our discussion of what should be a registrable charge), where we said that we would exclude 'simple' reservation of title clauses from being registrable: this would obviously not be the case under a functional approach, and such security interests would be registrable whether they were simple or complex.

³⁶ Diamond report para 17.19. The system operating in Saskatchewan was given as an example of a similar exclusion. See also ALRC 64, *Personal Property Security* para 5.13.

³⁷ See the SPPSA, s 2(1)(qq), and the NZPPSA, s 23(a). See also NZPPSA, s 50.

³⁸ See above, paras 6.22-6.23.

³⁹ See R Goode, *Commercial Law* (2nd ed 1995) pp 798-799.

7.28 The systems in Saskatchewan and New Zealand provide that the definition of security interest includes an interest created or provided for by a commercial consignment,⁴⁰ whether or not it secures payment or performance of an obligation.⁴¹ However, the Saskatchewan and New Zealand systems do not subject commercial consignments that do not secure payment or performance of an obligation to the legislation on enforcement and default.⁴² The consignor's interest under a commercial consignment is also expressly made a purchase-money security interest, and thus would have the priority given to such interests.⁴³ We consider the question of enforcement and default further in Part XI and Appendix B. For the purposes of validity and priority (as opposed to enforcement and default), we would welcome the views of consultees on whether consignments should be registrable only if they secure payment or performance of an obligation, or whether all consignments should be registrable.

7.29 **We ask consultees for their views on whether a consignment should be registrable under a functional system only if it secures payment or performance of an obligation, or whether it should be registrable whatever its purpose. Should a consignment be expressly stated to be a purchase-money security interest?**

Finance leases

7.30 Leases also pose a difficulty because they are used both to finance the acquisition of property and for transactions that have nothing to do with financing.⁴⁴ In Part VI we noted that a distinction was drawn between the finance lease and the operating lease.⁴⁵ A finance lease has a security purpose (and hence would amount to a security in a system taking a functional approach); an operating lease does not. Thus the short-term hire of a car for a few days, for example, does not create a security interest but a finance lease for the economic life of the goods could. However, the difference is not always easy to define.

⁴⁰ In New Zealand, this is defined as meaning a consignment where a consignor has reserved an interest in the goods that the consignor has delivered to the consignee for the purpose of sale, lease, or other disposition; and where both consignor and consignee deal in the ordinary course of business in goods of that description (but does not include an agreement under which goods are delivered to an auctioneer for the purpose of sale). See the NZPPSA, s 16(1).

⁴¹ See the NZPPSA, s 17(1)(b), and the SPPSA, 2(1)(qq)(ii)(B). The Australian Law Reform Commission made a similar recommendation: ALRC 64, *Personal Property Security* para 5.27. In making this recommendation, it was thought that a clear and simple rule would be preferable to the difficulty of distinguishing the case where the transaction had a security purpose, and that third parties might be misled by the consignee's possession. The similar approach taken by the New Zealand Law Commission influenced this decision.

⁴² See the SPPSA, ss 3(2) and 55(2), and the NZPPSA, s 105(b)(iii). See also below, paras 7.33 and 7.37.

⁴³ See the SPPSA, s 2(1)(jj)(iv) and the NZPPSA, s 16. See also below, para 7.68.

⁴⁴ ALRC 64, *Personal Property Security* para 5.31. Consequently, the Australian Law Reform Commission questioned the benefit of adhering to a purely functional approach when dealing with leases.

⁴⁵ See above, para 6.15. See also the Diamond report para 9.7.1.

- 7.31 The distinction between finance leases and operating leases might be drawn in one of at least three ways. The first would be to determine the function of the lease in each individual case; the second would be to take a rigid approach depending on the length of the lease; and the third approach would make longer leases registrable, but not necessarily subject to all the provisions of the system if it is shown that the particular lease is not a finance lease.
- 7.32 The approach of the UCC has been to set out that whether a security interest had been created was to be determined by the facts, but to provide a number of situations where a lease would constitute a security interest, including where the original term of the lease is equal to or greater than the remaining economic life of the goods.⁴⁶
- 7.33 The third approach is the one taken in Canada, and the Diamond report suggested following the Canadian system. The parts of the legislation dealing with priorities and registration apply to every lease of more than one year (the Diamond report suggested three years⁴⁷), but the parts of the legislation dealing with rights and remedies on default apply only to those leases that secure payment or performance of an obligation. A similar system is used in New Zealand.⁴⁸ In placing a minimum time limit for the life of the lease, the problems of including short term hiring (which are the transactions least likely to act as a security) can be reduced. As with consignments, we would like the views of consultees on whether a true functional approach should be applied, or instead whether leases over a certain minimum period should be registrable. As with consignments, we do not deal at this stage with the application of enforcement or default provisions.
- 7.34 **We ask consultees for their views on whether all leases should be registrable (if over a certain minimum period) or whether only those leases that perform a security function should be registrable.**

Receivables Financing

- 7.35 A security over receivables should be registrable under a notice-filing system as a charge. However, as we pointed out earlier, in practice there may be little distinction between such an arrangement and an outright sale.⁴⁹ The overseas systems again try to avoid the difficulty of distinguishing between sales that have a security function and those that do not by bringing both such situations within their scope, as we shall see, but only for some purposes.⁵⁰ Three particular transactions over receivables which might be subjected to a requirement to register are those of the factored debt, block discounting and transfers as part of a securitisation.

⁴⁶ UCC, Section 1-201(37)(a).

⁴⁷ See the Diamond report para 9.7.16.

⁴⁸ Diamond report para 9.7.11. See, eg, the SPPSA, ss 3(2) and 55(2)(a), and the NZPPSA, ss 17(1) and 105(b)(ii). The Australian Law Reform Commission recommended that a lease for more than a year should be subject to the regime, as should one of a shorter duration if it satisfied the functional definition: ALRC 64, *Personal Property Security* para 5.31.

⁴⁹ See above, para 6.25.

⁵⁰ See below, para 7.37.

FACTORED DEBTS

- 7.36 Despite being an outright sale, the case for treating the factoring of debts as creating a security interest stems from the concept of assignment with recourse (that is, an assignment for cash coupled with an obligation to repurchase the account if the debt assigned is not paid) or with warranties that have the same effect.⁵¹ Such cases are examples of transaction being akin to a loan secured on accounts receivable.⁵²
- 7.37 The overseas systems require registration of all sales of receivables. Under former UCC Article 9, Section 9-102, transfers of an interest in “accounts” and “chattel paper” - whether or not a transfer for security or a sale transfer - had to be perfected by filing. Similarly, UCC Revised Article 9 continues to apply to the sale of “accounts”.⁵³ Revised Article 9 (like its predecessor) extends to cover sales of accounts only in order to apply the filing requirement. It does not make the transaction a security transaction, which would have the effect of attracting restrictions on default remedies, including accountability to the seller for a surplus. These are thought to be inappropriate when the buyer has become the full owner and has paid the price of the accounts. As we have seen, the SPPSA and the NZPPSA provide that the term “security interest” includes an interest created or provided for by a transfer of an account receivable whether or not it secures payment or performance of an obligation.⁵⁴ However, neither system applies the part of the legislation on enforcement and default to a security interest created or provided for by a transfer of an account receivable or chattel paper. In New Zealand this provision, unlike the case of commercial consignments and leases for more than one year, does not depend on whether the account receivable or chattel paper secures payment or performance of an obligation.⁵⁵
- 7.38 Drawing on the experience of the UCC and Canada, the Diamond report suggested that its system should include the assignment of debts as if they were security interests, and remarked that:

An attempt to distinguish between assignments with recourse and those without would probably not be profitable.⁵⁶

We agree, with the reservation (presumably intended in the Diamond report⁵⁷) that, as in the UCC and Commonwealth legislation, the rules on default remedies,

⁵¹ See above, paras 6.26-6.27.

⁵² See generally, F R Salinger, *Factoring: The Law and Practice of Invoice Finance* (3rd ed 1999).

⁵³ Section 9-102 and Section 9-109.

⁵⁴ See above, paras 7.15-7.16, and see the SPPSA, 2(1)(qq)(ii) and the NZPPSA, s 17(1)(b).

⁵⁵ See the SPPSA, ss 3(2) and 55(2), and the NZPPSA, s 105(b)(iii). The wording of the SPPSA seems to imply dependency on securing payment or performance of an obligation. See above, paras 7.28 and 7.33.

⁵⁶ Diamond report para 18.2.4.

⁵⁷ The Crowther report certainly intended this: “in one case the normal rules governing secured transactions require to be varied when applied to the sale of receivables. Since the sale is an outright sale the debtor should not be entitled to any surplus, or be liable for any deficiency, remaining after collection of the security unless the security agreement so provides.” Crowther report Appendix III, para 5.

accountability to the seller for a surplus, and so on would not apply to outright assignments of receivables.

BLOCK DISCOUNTING OR CHATTEL PAPER

- 7.39 The Diamond report referred to the concept of “chattel paper” in the UCC and the Canadian legislation, noting that it would apply to the block discounting of hire-purchase agreements.⁵⁸ It was not “clear ... whether there would be any desire for this” in the United Kingdom.⁵⁹ We are also unsure as to the extent to which the concept of chattel paper is in use in this jurisdiction. As we noted above, the SPPSA and the NZPPSA provide that the definition of security interest includes an interest created or provided for by a transfer of a chattel paper, although the rules on surplus will not apply to outright sales of chattel paper.⁶⁰

SECURITISATIONS

- 7.40 Whether transfers as part of a securitisation should be registrable involves difficult issues. In Part VI we explained that a standard securitisation arrangement involves the sale of the receivables by the owner (the ‘Originator’) to a purchaser, often a specially incorporated company or a specially established trust (the ‘Special Purpose Vehicle’ or ‘SPV’) that is structured so that it will not be affected should the originator become insolvent.⁶¹ The SPV will fund the purchase through the issue of debt securities, which are secured on the receivables by virtue of a security interest granted to a security trustee, who acts for the investors in the debt securities.⁶² It is important that the transfer to the SPV should not be recharacterisable as a disguised security agreement.⁶³ Registration of the assignment of the individual receivables under the current scheme would be impractical, even if it were desired, and it is also impractical for the SPV to give notice of assignment to each debtor.
- 7.41 The UCC Revised Article 9 provides that security interests over ‘accounts’ (which include most of the interests that we have termed ‘receivables’⁶⁴) are registrable.⁶⁵

⁵⁸ See above, para 6.28. UCC Revised Article 9 now has the concept of “electronic chattel paper” and “tangible chattel paper”: see Section 9-102(31) and Section 9-102(78).

⁵⁹ Diamond report para 18.2.5.

⁶⁰ See above, paras 7.14-7.16.

⁶¹ The SPV is structured so that it is not classified as a subsidiary of the Originator under companies legislation and its accounts are therefore not required to appear as part of group accounts.

⁶² See above, paras 6.30 ff.

⁶³ See above, paras 6.34-6.35.

⁶⁴ See J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) pp 732-734.

⁶⁵ This is the effect of UCC Revised Article 9, Section 9.310, which requires registration of security interests not exempted under other provisions. The provisions can be confusing, as Section 9-309(3) provides that security interests over ‘general intangibles’ are automatically perfected (and hence do not need to be perfected by filing). However, it seems that ‘payment intangibles’ refers to a limited range of interests and the effective exemption of payment intangibles from filing seems to reflect the interests of banks in loan participations and ‘mortgage warehousing’: see J J White and R S Summers, *Uniform Commercial Code* (5th ed 2000) p 766. Deposit accounts can be perfected only by control: see above, para 5.51.

However, as we noted earlier, UCC Revised Article 9 covers outright sales of accounts purely to attract the filing requirement; it is not intended to make the transaction a security transaction, which would have the effect of attracting restrictions on default remedies, such as accountability to the seller for a surplus. As we said earlier, these are viewed as inappropriate, since the buyer has become the full owner and has paid the price of the accounts.

- 7.42 Although in a securitisation the transfer of the receivables to the SPV is an outright sale, it can be argued that the case for requiring filing by the SPV is just as strong as for other assignees of receivables. It would also make it easier to discover any previous assignment as part of a securitisation and to preserve priority against any subsequent party to whom the Originator might assign the same receivables.

CONCLUSION

- 7.43 We think that receivables form such an important part of the assets of a business, and that debt factoring, block discounting and other transfers of receivables by way of assignment are so often closely akin to providing security for loans, that in principle these transactions should be registrable. In addition there is another reason for bringing assignment of receivables within the scheme. Under the present law, priority between competing assignments of receivables depends on the date of notice to the debtor. It is not practical for a factor, for example, to check with each debtor that the debt has not previously been assigned. Were the assignment to be registrable, priority would normally depend on the date of filing of the relevant financing statement. It would thus be easy for the factor or other assignee to see whether the debtor company has already made any arrangement to assign debts; and equally, if it has not, to file a financing statement itself and secure priority for the future. We would remind the reader that under the notice-filing system it would be possible for the factor or discount house to file a single financing statement for a series of transactions.⁶⁶
- 7.44 We are provisionally of the view that there should be an exception to the requirement to register when book debts are sold as part of a larger transaction (such as the overall sale of the business).⁶⁷ We also consider that there should be an exception in the case of negotiable instruments.⁶⁸
- 7.45 **We ask whether consultees agree with our provisional views:**

- (1) that sales of receivables, for example under a factoring or block discounting agreement or as part of a securitisation, should be registrable; but**
- (2) that there should be an exception to the requirement to register when book debts are sold as part of a larger transaction (such as the overall sale of the business), and**

⁶⁶ Subsequent purchasers, as well as creditors, would then be bound by the earlier security interests. The exception for purchasers in the ordinary course of business would be confined to purchases of 'inventory' and would not apply to factors or other purchasers of receivables.

⁶⁷ See, eg, the SPPSA, s 4(g).

⁶⁸ See above, para 5.16.

(3) that there should be an exception also in the case of negotiable instruments.

Declaration of trust by way of security

- 7.46 A person can in principle create an effective equitable charge over chattels by declaring that he holds them in trust for a creditor by way of security for the payment of a specified debt.⁶⁹ A declaration of trust by way of security will therefore be a registrable charge where it is given over registrable charge property⁷⁰ or in substance constitutes a floating charge.
- 7.47 The systems under the UCC, in Canada and in New Zealand all take a functional approach, generally expressly including interests created by trust deeds where they serve a security purpose.⁷¹ The Australian Law Reform Commission recommended that the question of whether an interest in property arising under a declaration of trust or under some other equitable assignment was a security should be decided by taking a functional approach, but that it was not necessary to have any other special provision in respect of this.⁷² It seems that this area is an example where our law already takes a functional approach.

ARE THERE ANY QUASI-SECURITIES THAT SHOULD NOT BE REGISTRABLE?

- 7.48 We provisionally proposed in Part V that a notice-filing system that applied only to charges should except some charges from registration.⁷³ While a notice-filing system taking a functional approach would obviously include more transactions than one simply applicable to charges, it should not include every transaction that falls within a broad definition of 'security interest'. (We also noted in Part IV our provisional view that possessory securities and those arising by operation of law should be excluded; this would be so whether the notice-filing system applied only to charges or took a wider, functional approach.⁷⁴)
- 7.49 There are several transactions that are expressly excluded from the scope of the overseas systems (either entirely or in respect of the notice-filing requirements). Some of these we have already noted in Part V, when we discussed charges that we consider should be exempt from registration. Examples include charges over shares and other investment securities, particularly in the light of the Draft Collateral Directive referred to in Part V.⁷⁵ In this Part we are discussing the functional

⁶⁹ *Re Bond Worth* [1980] Ch 228, 250.

⁷⁰ Or constitutes a registrable bill of sale if given by an individual.

⁷¹ See, eg, the SPPSA, ss 2(1)(qq) and 3(1)(b).

⁷² ALRC 64, *Personal Property Security* para 5.20.

⁷³ For a summary, see above, para 5.123.

⁷⁴ See above, paras 4.15-4.17. The overseas systems generally exclude such transactions either from the need to register (in the case of possessory securities) or from the overall legislative system itself: see the SPPSA, s 4(a) and the NZPPSA, s 23(b). The Australian Law Reform Commission recommended that securities arising from operation of law (with the exception of maritime liens) should be within the new system it proposed, for priority purposes, but accepted that it would be impracticable to require such securities to be registered in order to gain priority. See ALRC 64, *Personal Property Security* para 5.38.

⁷⁵ See above, para 5.25.

equivalents to traditional security devices. Our provisional view is that where a quasi-security is functionally equivalent to a charge that should be excluded from being registrable, it should also be exempted.

‘Repos’ of shares and investment securities

- 7.50 Thus in Part VI we described ‘repos’ (arrangements under which it is agreed that assets are sold for cash by one party to another, at a discounted price or at market price less a premium, with a provision for repurchase after a certain period of time or on demand) as frequently functionally equivalent to loans secured on a portfolio of shares that may continue to be traded. This might suggest that under a ‘functional’ approach to registration, ‘repos’ should be registrable. However, in Part V we proposed that even charges over shares and investment securities should not be registrable because in practice third parties will not have difficulty in finding out about them; either the share certificates will be deposited with the secured party or the secured party will be registered as legal owner. The same argument applies to ‘repos’; the shares will belong to the buyer (who functionally may be the secured party). There is thus no danger of third parties being misled and no need for registration of the ‘repo’.⁷⁶ **It is our provisional conclusion that transfers of shares and investment securities under a ‘repo’ should not be registrable.**

Contractual set-off arrangements

- 7.51 Rights of set-off are expressly excluded from UCC Article 9 and from the registration requirements in the New Zealand system.⁷⁷ Contractual set-offs do not purport to create proprietary rights and we would propose to follow these examples.⁷⁸
- 7.52 **We ask whether consultees agree with our provisional proposal that rights of set-off should be excluded from the need to register under a notice-filing system.**

Special purpose trusts

- 7.53 In *Barclays Bank Ltd v Quistclose Investments Ltd*⁷⁹ it was held that a loan to a company that was conditional on the sum being used for a particular purpose (in this case, the payment of a dividend) was held on a primary trust, and then on a secondary trust when that primary purpose failed. Whilst on a traditional trust analysis no question of security arises, it has been argued that from a functional point of view, a *Quistclose* payer is a secured creditor, if a *Quistclose* transaction is regarded as a two-step arrangement by which money is advanced outright,

⁷⁶ In principle repos may exist over other assets. Whether the repo should be registrable should depend on the nature of the asset. Thus a repo over land need not be registered as the buyer will be the legal owner (and with registered land, registered as such). With goods not covered by a specialist asset register it would be different.

⁷⁷ See the NZPPSA, s 23(c) (which also excludes ‘netting’ and ‘combination of accounts’). However, certain of the system’s priority rules do apply to such transactions.

⁷⁸ For similar reasons, liens over sub-freights should not be registrable either: see above, para 5.41.

⁷⁹ [1970] AC 567. See also *Re EVTR* [1987] BCLC 646, and *General Communications Ltd v Development Finance Corporation of New Zealand* [1990] 3 NZLR 406.

simultaneously coupled with a grant back by way of mortgage or charge.⁸⁰ However, even if this analysis is correct, we would regard this sort of transaction as one arising by operation of law, and hence outside the scope of our proposed system.⁸¹ In any event, the beneficiary is unlikely to know that there is a trust, and so will not know to register any charge.

- 7.54 **We ask whether consultees agree with our provisional view that special purpose trusts should be outside the requirement to register (either because no security arises, or alternatively any security arises through operation of law).**

Motor vehicles

- 7.55 Security interests over motor vehicles might cause difficulties in a notice-filing system that took a functional approach to what security interest should be registrable, but do so only in relation to companies. Vehicles sold on conditional sale, or bailed under a hire-purchase agreement or a finance lease, would be subject to registrable security interests, and the additional rules on priorities and purchasers that we outlined earlier in this Consultation Paper would apply unless the issue were expressly addressed in some other way.⁸²
- 7.56 At first sight, there seems to be no compelling reason why a hire-purchase agreement or conditional sale in respect of a motor vehicle should not create a registrable security interest and be generally subject to the rules of any new system. Both the Crowther and Diamond reports thought that this should be so.⁸³ If the scheme of notice-filing of quasi-securities is to be extended to quasi-securities created by all debtors, we would agree. However, introducing a functional system that applies initially only to companies causes complications.
- 7.57 The difficulties arise because of the way that questions of title for purchasers of vehicles that are subject to hire-purchase agreements or conditional sales are currently addressed by the law.
- 7.58 Normally a purchaser who buys goods from a party who has them on hire-purchase will not get good title.⁸⁴ A purchaser from a conditional buyer sometimes will obtain title,⁸⁵ but not if the agreement is regulated by the Consumer Credit

⁸⁰ M Bridge, "The Quistclose Trust in a World of Secured Transactions" (1992) 12 Ox JLS 333, 345-346.

⁸¹ See above, para 4.18.

⁸² See above, paras 4.118 ff.

⁸³ See the Crowther report para 5.7.42 and the Diamond report 13.5.6.

⁸⁴ *Helby v Matthews* [1895] AC 471; see above, para 6.13.

⁸⁵ If he can satisfy the rather exacting requirements of the Sale of Goods Act 1979, s 25, which provides that: "Where a person having bought or agreed to buy goods obtains, with the consent of the seller, possession of the goods or the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title, under any sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of any lien or other right of the original seller in respect of the goods, has the same effect as if the person making the delivery or transfer were a mercantile agent in possession of the goods or documents of title with the consent of the owner."

Act 1974.⁸⁶ However, under Part III of the Hire-Purchase Act 1964, provision is made for the passing of title on the sale of a motor vehicle that has been bailed under a hire-purchase agreement or sold on conditional sale, and which has been disposed of before the property has vested in the debtor.⁸⁷ A disposition to a private purchaser⁸⁸ without notice of the hire-purchase or conditional sale will pass good title to the purchaser.⁸⁹ Trade purchasers are not protected, the idea being that they can check in the HPI register to see if the vehicle is subject to an outstanding agreement.⁹⁰

7.59 Both the Crowther and Diamond reports suggested that such interests should be registrable, but that there should be particular rules in relation to purchasers of motor vehicles. The Crowther report suggested that rights of the type conferred by Part III of the Hire-Purchase Act 1964 should be restricted to the private buyer and should not apply to businesses.⁹¹ On this point, the Diamond report took a different view, preferring that all purchasers should be protected except for motor traders and finance houses (as in Part III).⁹²

7.60 We initially considered whether, if motor vehicles were to be brought within a notice-filing system that would apply to companies, the rules we had outlined earlier in respect of purchasers of assets that were subject to a security interest would apply in the same way,⁹³ or whether they would have to be modified to reflect the different situation existing under Part III of the Hire-Purchase Act 1964. However, we soon realised that there would be problems in trying to bring purchasers of motor vehicles within such a system at all.

7.61 A system that applied only to charges created by companies would result in confusion. Under the current system, protection is afforded to private purchasers

⁸⁶ See above, para 6.13.

⁸⁷ The issue of wrongfully disposed of vehicles is not a small one: a 1992 survey by the Finance and Leasing Association put the cumulative losses from wrongful dispositions of motor vehicles at £45.2 million. See I Davies, "Wrongful Dispositions of Motorvehicles - A Legal Quagmire" [1995] JBL 36, 36 n 3.

⁸⁸ A "private purchaser" is simply a person who does not carry on a business of purchasing motor vehicles for the purpose of sale, or of providing finance by purchasing motor vehicles for the purpose of bailing them under hire-purchase agreements or agreeing to sell them under conditional sale agreements: see the Hire-Purchase Act 1964, s 29(2). "Person" includes a body of persons corporate: Interpretation Act 1978, s 5 and Schedule 1.

⁸⁹ It will have effect "as if the creditor's title to the vehicle had been vested in the debtor immediately before that disposition": Hire-Purchase Act 1964, s 27(2). However, for a recent example of where title was not acquired by the innocent party, see *Shogun Finance v Hudson* [2002] 2 WLR 867.

⁹⁰ HPI provide a database containing details of motor vehicles in an attempt to ensure that vehicles bought and sold carry good title, by alerting searchers where the vehicle, eg, has been stolen, is subject to an outstanding financing agreement, or is an insurance 'write-off'. In recent years an on-line service has become available. A similar scheme operates for caravans and boats, and other assets that can be financed can also be recorded. For a discussion of the role of HPI, see I Davies, "Wrongful Dispositions of Motorvehicles - A Legal Quagmire" [1995] JBL 36, 43-47.

⁹¹ See the Crowther report paras 5.7.39-5.7.41 and 5.7.72.

⁹² Diamond report para 13.5.6.

⁹³ See above, para 4.173.

regardless of the legal personality of the 'rogue' seller - that is, the person who had possession of the vehicle under a conditional sale or hire-purchase agreement and who sold it wrongfully. Under a notice-filing system that applied only to companies, if the rogue seller were a company, there could be rules in respect of innocent purchasers that might be similar to the protection offered by the Hire-Purchase Act 1964.⁹⁴ However, if the vendor were an individual, such a sale would be outside the operation of the system, since it would apply only to security interests created by companies. Consequently, Part III of the Hire-Purchase Act 1964 would have to remain in existence at least in part, in order to protect purchasers from non-corporate vendors. Having two different systems in respect of motor vehicles would mean that the purchaser having to be aware of the seller's legal personality in order to know whether to conduct a search in the Company Charges Register or the HPI register.⁹⁵ This in turn might lead to problems if the legal personality was mistaken or misrepresented to the purchaser, who as a result did not search the relevant register.

7.62 The situation becomes even more complicated where there is a chain. What if the innocent purchaser (say, a partnership) of a vehicle from the rogue seller (a company) goes on to sell it on conditional sale to a trade purchaser (say, a sole trader)? This would be a non-company selling to a non-company, but concerning one security interest that was registrable in the Company Charges Register (the original one created by the company) and another that was not (the conditional sale between the partnership and the sole trader). If, as is possible, trade purchasers were exempted from any protection under a notice-filing system as well as the Hire-Purchase Act 1964,⁹⁶ would they be expected to search the HPI register, the Company Charges Register, or both? If the Company Charges Register, how would the second purchaser be alerted to this? In order to cover themselves, they would have to search the Company Charges Register in every case. Moreover, in case there was no entry in the Company Charges Register, they would also have to search the HPI register as well as a matter of course. Such a situation does not seem to be sensible.

7.63 In addition, we are not at all convinced that any provisional proposals we might suggest for the situation where the sale was by a company would often be applied: we suspect that the majority of sales that Part III of the Hire-Purchase Act 1964 was designed to catch are those where the rogue sale is undertaken by an individual or a small second-hand car dealership. If the latter is unincorporated, it will not come within the system, nor will individuals in any circumstances. Consequently, purchasers from sellers such as these will still have to be protected by the Hire-Purchase Act 1964.

⁹⁴ Indeed we asked in para 4.183 above whether this should apply to consumer purchasers of any goods that are subject to a registered charge and not stock-in-trade of the seller (in which case the purchase would be protected anyway).

⁹⁵ Under the Hire-Purchase Act 1964, trade and finance house purchasers cannot take advantage of the protection offered by the Act, and would be expected to search the HPI index. Under a notice-filing system, there would probably also be exceptions to any rule allowing innocent purchasers to take free of registered interests.

⁹⁶ The protection offered to purchasers under a notice-filing system might be different to that available under the Hire-Purchase Act 1964: see above, paras 4.173 ff.

- 7.64 Given the existence of specific statutory protection that would still have to apply in the case of purchases from unincorporated businesses and individuals, we do not think that having two systems is sensible. Instead, we provisionally propose to exclude certain quasi-security interests from the notice-filing system for so long as the scheme for companies is not extended to security interests created by other debtors.⁹⁷ A quasi-security interest over a motor vehicle that takes the form of a conditional sale (including, we provisionally think, a consignment) or a hire-purchase agreement should be excluded, such situations being dealt with by Part III of the Hire-Purchase Act 1964 in its current form.
- 7.65 We are uncertain as to whether the exception should be wider to cover other forms of vehicle financing by quasi-securities that are outside the protection offered by the Hire-Purchase Act 1964 (such as finance leasing). The finance lease may not fall within the protection offered by the Hire-Purchase Act 1964 for historic reasons, in that such a method of financing may not have been in common use for vehicle financing at that time. We suspect that the 1964 Act should be amended to bring finance leases and consignments with it, but we would welcome the views of consultees on this point.
- 7.66 A charge over a motor vehicle - as opposed to a quasi-security - would be registrable, however, and subject to the rules in relation to purchasers that we have outlined earlier.⁹⁸

FUNCTIONAL PRIORITY RULES

- 7.67 We noted in Part IV that all the overseas systems have a number of specific priority rules relating to particular situations which displace the residual 'first to file' rule.⁹⁹ We deferred consideration of some of those rules until this Part as they involve a change in approach from 'form' to 'function', and they apply particularly to quasi-securities. The rules relating to purchase-money security interests are of particular importance but there are also additional rules relating to accessions and commingled goods, as well as to purchasers of certain secured assets.

Purchase-money security interests

- 7.68 In Part IV we discussed the purchase-money interest from the point of view of its application to security. There,¹⁰⁰ and subsequently at the beginning of this Part,¹⁰¹ we noted that the treatment of purchase-money interests is of particular importance if quasi-securities are to be brought within a system of notice-filing.
- 7.69 We explained the rules of the overseas systems, insofar as they were relevant to security, in Part IV. All those rules will of course apply to quasi-securities, insofar as they meet the definition of a purchase-money security interest set out in the

⁹⁷ We return to this point when we discuss extending the system to cover all forms of debtor: see below, paras 10.8-10.13.

⁹⁸ See above, paras 4.173 ff.

⁹⁹ Eg, see above, para 4.158.

¹⁰⁰ See above, paras 4.55 ff.

¹⁰¹ See above, para 7.5.

relevant system.¹⁰² What we said in Part IV is equally applicable in this Part. There is an additional point, that not having such a concept under a functional system would make it more difficult for a company to obtain vendor credit. Both the SPPSA and the NZPPSA have additional rules that are applicable in such cases.

- 7.70 In Part IV we noted that, although the purchase-money interest would apply to security, the overseas systems have provisions that are more applicable to quasi-securities. More than one creditor may advance the funds that the debtor uses to purchase a single asset, and the debtor may grant each of them rights over it. As between competing purchase-money security holders, a seller, lessor or consignor¹⁰³ who takes a purchase-money security interest will gain priority over another holder if the seller, lessor or consignor perfects the interest at the time the debtor obtains possession (in the case of inventory) or not later than 15 days of the debtor obtaining possession (in the case of non-inventory collateral).¹⁰⁴ Priority of such interests not taken by a seller, lessor or consignor are determined by applying the residual rules set out in the overseas systems.¹⁰⁵

Other forms of super-priority

- 7.71 The priority given to purchase-money interests over earlier non-purchase-money interests is sometimes termed ‘super-priority’. As we noted earlier, it is justified in part by the argument that the secured party has enabled new assets to be brought into the company and that, without this priority scheme, it would be hard for companies to benefit from advantageous vendor-credit.
- 7.72 However, purchase-money interests are defined as security over the assets purchased with the financing secured on the asset. It may be asked whether any other forms of super-priority should be given. It may be argued that any creditor who has provided fresh value (such as cash) in exchange for the security (as opposed to taking it to secure an existing debt) should also be given priority. However, as we noted in Part IV, the purchase-money creditor has provided an additional asset which does not harm earlier secured creditors.¹⁰⁶
- 7.73 In New Zealand, special priority rules enable debtors to use their accounts receivable (the equivalent of the term ‘book debt’) as an independent source of credit. Financiers who inject new value into a debtor’s business against a security

¹⁰² Some of the overseas statutes give a wide definition, eg, s 16 of the NZPPSA: “‘Purchase money security interest’ (a) Means (i) A security interest taken in collateral by a seller to the extent that it secures the obligation to pay all or part of the collateral’s purchase price; or (ii) A security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire those rights; or (iii) The interest of a lessor of goods under a lease for a term of more than 1 year; or (iv) The interest of a consignor who delivers goods to a consignee under a commercial consignment; but (b) does not include a transaction of sale and lease back to the seller”.

¹⁰³ A seller, lessor or consignor is likely to be the holder of a security interest rather than a security.

¹⁰⁴ See the SPPSA, s 34(5) and the NZPPSA, s 76 (in which case 10 days is the given period).

¹⁰⁵ See above, para 4.122. The New Zealand system expressly deals with this point: see the NZPPSA, ss 77 and 66. In Saskatchewan, it is implicit.

¹⁰⁶ See above, para 4.159.

interest in receivables enjoy priority over the other creditors who claim the same receivables.¹⁰⁷

- 7.74 **We ask consultees whether secured parties who have given new value should, to the extent of that value, be given priority over existing perfected security interests.**

Purchasers of investment securities and of receivables

- 7.75 We have provisionally proposed that a purchaser of investment securities should take free of the security interest unless he knows of it and that sale would be in breach of the agreement.¹⁰⁸ For receivables we propose that a purchaser should be bound by a registered charge.¹⁰⁹ We suggest parallel rules should apply to the equivalent quasi-security interests ('repos'¹¹⁰ and purchases of receivables¹¹¹ respectively).

Summary

- 7.76 In Part V we discussed what charges should be registrable under a notice-filing system. We provisionally proposed that all charges should be registrable save those on a list of exceptions. At the end of that Part we provided a summary of the principal kinds of charge that should, in effect, be registrable. If the system were to extend to take a functional approach, we think that any transaction that has a security function should be registrable unless, again, the transaction was excepted. In effect the principal 'quasi-securities' that would fall to be registered would be:

- (1) retention of title clauses and conditional sale agreements,
- (4) hire-purchase agreements;
- (5) consignments that have a security purpose;
- (6) finance leases (either all leases for more than a certain period, or those that serve a security purpose), and
- (7) sales of receivables under transactions such as factoring or block discounting agreements and securitisations.

¹⁰⁷ NZPPSA, Schedule 1 (as substituted by the New Zealand Personal Property Securities Amendment Act 2001, s 13) amends legislation to this effect.

¹⁰⁸ See above, paras 4.192-4.193.

¹⁰⁹ See above, paras 4.194-4.196.

¹¹⁰ See above, para 7.50.

¹¹¹ See above, paras 7.35 ff.

OTHER ISSUES

Transitional issues for previously unregistrable charges and quasi-securities

- 7.77 There would need to be transitional provisions in respect of quasi-securities, were a functional approach to be adopted.¹¹² Should there be a requirement for previously unregistrable charges or security interests to be registered within a certain time (as with the New Zealand system¹¹³) or otherwise become unperfected (and hence at risk of invalidity against third parties and loss of priority)? The alternative would be to provide that quasi-securities existing before the introduction of a notice-filing system should continue to be valid without the need to register.
- 7.78 The difficulty with not having a requirement that such security interests be registered is that the notice-filing register will be inaccurate, and a person searching the register will not know whether there are existing security interests that might affect the company's assets. For example, a hire-purchase agreement entered into after the commencement of any new notice-filing system would have to be entered on the register (if the functional approach is adopted), but if there were no requirement to register pre-commencement hire-purchase agreements, the register would be incomplete. However, a requirement to register existing security interests that were not previously registrable would clearly be prejudicial to companies or creditors who had already complied with the law when they entered the relevant transaction.
- 7.79 We suspect that most of the security interests that would fall into the description of 'quasi-security' tend generally to be of relatively short duration (although there are always likely to be exceptions). If this be right, then the risk of the 'invisibility' of pre-existing unregistrable security interests will diminish within a reasonably short time following the introduction of a notice-filing system. It may therefore be necessary to accept that the introduction of a notice-filing system will be subject to the risk of invisible security interests for the early period of its existence, but that, over time, this risk will rapidly diminish (although previously unregistrable charges might last for a much longer period). As it is, under the current law such security interests (and currently unregistrable charges) will not be found on searching the Company Charges Register. It might be advisable for there to be a clear indication on the register that a charge or security interest that pre-dated the introduction of the system might be in existence, and that enquiry should be made of the debtor company. We think this approach might, on balance, be preferable to the prejudice caused by requiring all holders of unregistrable security interests to register them within a certain period, although we would welcome the views of consultees.
- 7.80 **We ask consultees whether they think that previous security interests (including quasi-security) that would be registrable under a notice-filing system, but which are currently not registrable ought to be registered**

¹¹² In Part IV we dealt with some of the transitional provisions that would probably be necessary if the move to notice-filing for company charges were made, and in Part V we deferred the question of transitional provisions for previously unregistrable charges.

¹¹³ See above, paras 4.222 ff.

within a certain period following the commencement of any new notice-filing system.

Quasi-securities and the company's own register of charges

- 7.81 We discussed in Part IV the question of whether the requirement under the Companies Act 1985 for a company to keep its own register of charges should be retained. We suggested that if the scope of the new register is widened to encompass more types of charge, as we have proposed, there is no clear case for continuing to require companies to keep their own registers.¹¹⁴ If these are to be retained, however, an additional point needs to be considered. Under the current law, the obligation to keep a register arises in respect of all charges a company creates. If a functional approach is taken, so as to include more than charges, should the requirements on the company in respect of its own register change to reflect this? In other words, should there be a requirement to keep a register not just of charges, but of all security and functionally-equivalent transactions, so that quasi-securities such as retention of title agreements, conditional sales and finance leases should also be recorded?
- 7.82 If the company's own register is to continue, but the register at Companies House becomes functionally-based, it seems only sensible to provide that the company's own register be on the same basis. The advantage would be to provide an additional source of information, given that the financing statement will contain little detail. The disadvantage of requiring this would be to increase the compliance workload on the part of the company involved (although it seems to us that such information would in all likelihood be kept in some form or other by a company in any event). **We would welcome the views of consultees on this point.**

Small transactions

- 7.83 If a system of notice-filing is to be introduced, should it apply to all transactions that come within its scope, regardless of size, or should there be a minimum threshold? The Crowther report suggested that security interests for small amounts should not be registrable, in order to avoid cluttering up the register,¹¹⁵ and the Halliday report also suggested such small transactions should be excluded.¹¹⁶ However, the Diamond report suggested that there should be no exclusion for small transactions from the scope of the filing arrangements. The argument that the register should not be burdened with recording small advances was not accepted as accurate, given that filing should be voluntary and given that many small scale creditors would not bother to file in respect of one-off transactions where only a small amount was concerned. The decision whether or not to file would be taken for commercial reasons.¹¹⁷

¹¹⁴ See above, paras 4.68-4.71.

¹¹⁵ Crowther report para 5.7.26. The sum recommended (in 1971) was £300.

¹¹⁶ Halliday report para 29. The sum recommended (in 1983) was £5000 (the exclusion would not apply to inventory).

¹¹⁷ See the Diamond report paras 11.5.15-11.5.17.

- 7.84 We have dealt with this topic in this Part, rather than Part IV, because with corporate debtors quasi-securities are much more likely to be small transactions than are charges. We are provisionally inclined to follow the suggestion of the Diamond report and not have an exclusion for small amounts. We are not convinced that there would be a clogging of the register with such financing statements, particularly given that the notice-filing system we are potentially considering would apply only to corporate debtors. It is unincorporated businesses and individuals whose debts, in very general terms, are likely to involve small transactions.
- 7.85 **We ask whether consultees agree with our provisional view that there should be no exclusion from the need to register in the case of small transactions.**

PART VIII

SECURITY INTERESTS CREATED BY NON-CORPORATE DEBTORS AND REGISTRATION

INTRODUCTION

- 8.1 In Parts I-VII of this Consultation Paper we considered a notice-filing system for corporate debtors. In Parts VIII-XI we move to consider the second aspect of our reference, and deal with security and security interests over property other than land created by non-corporate debtors.¹ As we noted in Part I, this Consultation Paper has divided the treatment of corporate and non-corporate debtors for two main reasons.
- 8.2 First, given that the Steering Group's primary concern was with company charges, it seems right, for consultation purposes, to separate security interests created by companies from those created by non-corporate debtors. Secondly, our understanding is that the DTI envisages that any new law governing company security interests will form part of, or be introduced by Regulations made under, a Companies Bill. To extend the system provisionally proposed for company security interests to security interests created by others would require separate legislation, either simultaneously with a Companies Bill or subsequently.
- 8.3 The purpose of this and the following Parts is therefore to consider whether the notice-filing system provisionally proposed for company security interests should be extended to cover the question of security interests over property other than land granted by non-corporate debtors. There is obviously a significant degree of overlap between this aspect and our discussion in respect of corporate debtors, and we will often refer back to earlier in this Consultation Paper. In this Part we discuss both security and quasi-security (rather than have separate Parts) as many of the latter forms have already been dealt with in detail earlier.
- 8.4 Non-corporate debtors include a wide range, from persons who borrow for private purposes not related at all to their business, trade or profession (we will refer to them as 'consumers') through sole traders and 'solo' professionals through to partnerships. In many cases partnerships are no longer limited by law to any particular size, and in some professions partnerships of several hundred partners are not unusual.
- 8.5 In contrast to our consideration of corporate debtors, for which our terms of reference were to consider charges of all types, the terms of reference for individuals and non-corporate debtors exclude security interests over land. This reflects similar limitations in the UCC and in the legislation of Saskatchewan and New Zealand² and also the fact that there already exist registration schemes for

¹ We noted in Part I that we use this phrase to cover both unincorporated businesses and individuals.

² Hence the Commonwealth Acts are usually entitled 'Personal Property Security Act'.

security over land.³ There has been no call for security over land to be brought within any system for registration of other security interests created by non-corporate debtors.⁴

SECURITY GRANTED BY NON-CORPORATE DEBTORS

Possessory security

- 8.6 We limit the detailed explanation in this Part to non-possessory security. A non-corporate debtor may pledge goods or documents of title just as can a company.⁵ We refer readers to the explanation given in Part II.⁶

Goods: bills of sale

Introduction

- 8.7 The rules of validity and registration of mortgages and charges over goods by non-corporate debtors are mainly governed by statute, principally the Bills of Sale Act 1878 (the '1878 Act') and the Bills of Sale Act (1878) Amendment Act 1882 (the '1882 Act').⁷ The statutory provisions are complex and have been the subject of much criticism.⁸ Curiously they apply to the document - the bill of sale - rather than the transaction itself, so a purely oral agreement for an equitable mortgage or charge over personal property is outside the scope of this legislation.⁹
- 8.8 The Bills of Sale Acts set out a scheme for the formal validity and the registration of certain bills of sale, and prescribe what can be severe consequences for failure to comply with the statutory requirements.¹⁰ The purposes behind the 1878 Act and the 1882 Act were different. The 1878 Act was designed to prevent the rights of creditors from being affected by secret dispositions of property by persons

³ See above, paras 2.51-2.52.

⁴ Company charges over land are at present registrable; but see above, paras 4.199 ff.

⁵ A pledge via a transfer of constructive possession by written attornment would be within the Bills of Sale Acts: see R Goode, *Commercial Law* (2nd ed 1995) p 1027 and Halsbury's Laws vol 4(1) para 621.

⁶ See above, paras 2.6-2.7.

⁷ Together cited as the Bills of Sale Acts 1878 and 1882: see the 1882 Act, s 1. The Bills of Sale Act 1890 and the Bills of Sale Act 1891 add minor provisions to these Acts. (We refer to these various statutes collectively as the 'Bills of Sale Acts'.) The Bills of Sale Acts operate against a background of the common law. The 1882 Act does not apply to securities created by companies, although we have noted earlier that a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale is, if created by a company, a registrable charge under the Companies Act 1985, s 396(1)(c). See above, para 2.26.

⁸ See below, Part IX.

⁹ A purely oral agreement would seem risky for the creditor because it might be hard to prove, though whether this risk is greater than the risk of invalidity through failure to comply with the complex requirements of the Bills of Sale Acts must be a moot point.

¹⁰ A registration requirement was introduced by the Bills of Sale Act 1854, which was subsequently replaced by the 1878 Act. For a detailed consideration of the law relating to bills of sale, see Halsbury's Laws vol 4(1).

remaining in possession of that property.¹¹ The purpose of the 1882 Act was to prevent people being entrapped into signing complicated documents which they might not understand, and so being subject to the enforcement of harsh and unreasonable provisions.¹² We will see that non-compliance with the requirements of each Act has different consequences: under the 1878 Act the bill is void as against the creditors or their representatives, under the 1882 Act the bill of sale is void also as between the parties.¹³

Application of the Bills of Sale Acts

- 8.9 The 1878 Act applies to every bill of sale whereby the holder or grantee has power¹⁴ to seize or take possession of any personal chattels comprised in or made subject to such a bill of sale.¹⁵ Although both the 1878 Act and the 1882 Act apply to bills of sale given by way of security for the payment of money (known as ‘security bills’¹⁶), the 1882 Act does not apply to bills given otherwise than by way of security for the payment of money (known as ‘absolute bills’¹⁷).¹⁸
- 8.10 The 1882 Act is to be construed as one with the 1878 Act so far as is consistent with the tenor of the 1882 Act, but enactments contained in the 1878 Act which are inconsistent with the 1882 Act are repealed.¹⁹

MEANING OF BILL OF SALE

- 8.11 Section 4 of the 1878 Act provides a detailed list of what the expression “bill of sale” covers, including assignments, transfers and declarations of trust without transfer. It also includes any agreement conferring a right in equity to, or a charge or security on, any personal chattels.²⁰ The 1878 Act also provides that certain instruments are deemed to be bills of sale of any personal chattels which may be seized or taken under powers of distress under powers given by the instrument.²¹ The 1882 Act states that “bill of sale” has the same meaning for the 1882 Act as it

¹¹ A similar purpose to the registration scheme introduced for company charges: see above, para 2.20.

¹² See *The Manchester, Sheffield, and Lincolnshire Railway v North Central Wagon Company* (1888) 13 App Cas 554, 559-560. See also *Thomas v Kelly and Baker* (1888) 13 App Cas 506, 513 and *Charlesworth v Mills* [1892] 231, 234. For a short explanation of why the earlier Bills of Sale legislation came about, see *Cookson v Swire and Lees* (1884) 9 App Cas 653, 664-666.

¹³ See below, paras 8.19 and 8.33.

¹⁴ With or without notice and either immediately or in the future.

¹⁵ 1878 Act, s 3.

¹⁶ Or sometimes ‘conditional bills’.

¹⁷ The 1882 Act has no application to debentures issued by a company and secured upon its capital stock, goods, chattels or effects. Cf the Companies Act 1985, s 396.

¹⁸ 1882 Act, s 3. Note that the 1882 Act applies to security for the payment of money: a security given to secure the performance of a non-monetary obligation would only be covered by the 1878 Act.

¹⁹ 1882 Act, s 15.

²⁰ For the meaning of “personal chattels” see below, para 8.14.

²¹ 1878 Act, s 6.

does for the 1878 Act (save that the 1882 Act does not apply to such bills given otherwise than by way of security for the payment of money).²²

8.12 However, section 4 of the 1878 Act also expressly excludes a number of transactions, including documents relating to assignments for the benefit of the creditors; transfers or assignments of any ship or vessel; transfers of goods in the ordinary course of business; bills of sale of goods in foreign parts or at sea; bills of lading; warrants or orders for the delivery of goods, and other documents used in the ordinary course of business as proof of the possession or control of goods.²³

8.13 Section 1 of the Bills of Sale Act 1890²⁴ additionally provides that:

An instrument charging or creating any security on or declaring trusts of imported goods given or executed at any time prior to their deposit in a warehouse, factory, or store, or to their being reshipped for export, or delivered to a purchaser not being the person giving or executing such instrument, shall not be deemed a bill of sale within the meaning of the Bills of Sale Acts 1878 and 1882.²⁵

MEANING OF “PERSONAL CHATTEL”

8.14 The phrase “personal chattel” is used several times in both the 1878 Act and the 1882 Act. Section 4 of the 1878 Act provides a definition that covers goods, furniture, and other articles that can be transferred completely by delivery, but does not include interests connected with land, shares or interests in the stock,

²² 1882 Act, s 3.

²³ The 1878 Act, s 4 provides that: “The expression ‘bill of sale’ shall include bills of sale, assignments, transfers, declarations of trust without transfer, inventories of goods with receipt thereto attached, or receipts for purchase moneys of goods, and other assurances of personal chattels, and also powers of attorney, authorities, or licenses to take possession of personal chattels as security for any debt, and also any agreement, whether intended or not to be followed by the execution of any other instrument, by which a right in equity to any personal chattels, or to any charge or security thereon, shall be conferred, but shall not include the following documents; that is to say, assignments for the benefit of the creditors of the person making or giving the same, marriage settlements, transfers or assignments of any ship or vessel or any share thereof, transfers of goods in the ordinary course of business of any trade or calling, bills of sale of goods in foreign parts or at sea, bills of lading, India warrants, warehouse-keepers’ certificates, warrants or orders for the delivery of goods, or any other documents used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by indorsement or by delivery, the possessor of such document to transfer or receive goods thereby represented.” India Warrants are now obsolete. For a detailed examination of all the above exceptions, see Halsbury’s Laws vol 4(1) paras 637-642.

²⁴ As substituted by the Bills of Sale Act 1891, s 1.

²⁵ We have noted that there should be similar exceptions from any new legislation: see above, para 5.40.

funds or securities of any government, or in the capital or property of companies, or choses in action.²⁶

SEIZURE OF PERSONAL CHATTELS UNDER A SECURITY BILL

- 8.15 Personal chattels assigned under a security bill are not liable to be seized or taken possession of by the grantee except in certain specified situations, including the grantor's default in payment or performance of any necessary covenant or agreement.²⁷ The other specified causes are the bankruptcy of the grantor, or her suffering the chattels to be distrained for rent, rates or taxes; the grantor fraudulently removing the goods (or suffering to be removed) from the premises; failure by the grantor, without reasonable excuse, to produce to the grantee (following written demand) her last receipts for rent, rates and taxes; or if execution has been levied against the grantor's chattels under any judgment at law.²⁸
- 8.16 Following seizure or possession on the above grounds, the grantor has five days to apply to the High Court, and if satisfied that by payment of money or otherwise the cause for the seizure or possession no longer exists, the judge can restrain the grantee from removing or selling the chattels, or may make such other order as may seem just.²⁹ In order to prevent circumvention of this provision by a grantee forcing an early sale, all personal chattels seized or taken possession of under any bill of sale must remain on the premises where they were seized or taken possession of, and are not to be removed or sold until after five clear days from the day of seizure or possession.³⁰

Formal requirements

- 8.17 Both absolute bills and security bills falling within section 3 of the 1878 Act are subject to certain requirements as to their form. The requirements are particularly stringent in respect of security bills.

²⁶ The 1878 Act, s 4 provides that it includes: "goods, furniture, and other articles capable of complete transfer by delivery, and (when separately assigned or charged) fixtures and growing crops, but shall not include chattel interests in real estate, nor fixtures (except trade machinery as hereinafter defined), when assigned together with a freehold or leasehold interest in any land or building to which they are affixed, nor growing crops when assigned together with any interest in the land on which they grow, nor shares or interests in the stock, funds or securities of any government, or in the capital or property of incorporated or joint stock companies, nor choses in action, nor any stock or produce upon any farm or lands which by virtue of any covenant or agreement or of the custom of the country ought not to be removed from any farm where the same are at the time of making or giving of such bill of sale."

²⁷ See the 1882 Act, s 7. This does not include a security bill where the bill is given for the payment of money under a regulated agreement under the Consumer Credit Act 1974, s 87(1) (unless the restriction under s 88(2) of that Act has ceased to apply to the bill, or, by virtue of s 89, the default is treated as not having occurred): see the 1882 Act, s 7A.

²⁸ See the 1882 Act, ss 7(1)-(5).

²⁹ 1882 Act, s 7.

³⁰ 1882 Act, s 13. See, eg, *Johnson v Diprose* [1893] 1 QB 512.

ABSOLUTE BILLS

- 8.18 The 1878 Act does not set out a detailed form for an absolute bill of sale. However, there are a number of requirements that must be complied with. In addition to the requirement of attestation and registration,³¹ section 8 of the 1878 Act requires that every absolute bill of sale³² must set out the consideration for which it was given. Failure to do this renders the bill void as against all trustees or assignees of the estate of the person whose chattels are comprised in the bill (in relation to bankruptcy or insolvency law), or under any assignment for the benefit of the creditors of that person. It is also rendered void as against any person executing a court-authorized seizure of any chattels comprised in the bill.³³ However, the absolute bill is not avoided as between grantor and grantee.

SECURITY BILLS

- 8.19 A security bill is subject to strict requirements as to its form. Such a bill must be made in accordance with³⁴ the form in the schedule to the 1882 Act,³⁵ and the execution of such bills must be attested by one or more credible witnesses (who are not party to the bill).³⁶ In summary, the form in the schedule requires that the bill of sale must state:

- (1) the date of the bill of sale,
- (2) the names of the grantor and grantee,
- (3) the consideration,³⁷ which must be at least £30 or the bill is void,³⁸
- (4) an acknowledgement of the receipt of that consideration,
- (5) an assignment by one party to the other (and her executors, administrators and assigns) of the chattels described in a schedule annexed to the bill of sale,³⁹
- (6) that the assignment be by way of security for the payment of a specified sum of money, together with interest at a specified agreed rate,
- (7) that the grantor agrees and declares that she will pay the grantee the principal sum together with interest at a stipulated time or times,

³¹ See below, para 8.24.

³² The section has been repealed so far as security bills are concerned by the 1882 Act, s 15.

³³ 1878 Act, s 8.

³⁴ It is sufficient if the bill of sale is “substantially in accordance with, and does not depart from, the prescribed form in any material respect”: see *Thomas v Kelly and Baker* (1888) 13 App Cas 506, 516, *per* Lord Fitzgerald.

³⁵ 1882 Act, s 9.

³⁶ 1882 Act, s 10.

³⁷ In addition to it being mentioned in the schedule, the 1882 Act, s 8 requires that the bill must “truly set forth the consideration” for which it was given.

³⁸ See the 1882 Act, s 12.

³⁹ See below, para 8.20.

- (8) any other terms as to “insurance, payment of rent or otherwise” that the parties may have agreed to for the maintenance or defeasance of the security, and
- (9) a provision that the chattels assigned by the bill are not liable to seizure or possession by the grantee for any cause other than those specified in section 7 of the 1882 Act.

Failure to comply with these requirements renders the bill void.⁴⁰ The security bill must be by deed signed by the grantor in the presence of a witness, whose name and address and description must be included.⁴¹

- 8.20 The schedule required to be annexed to, or written on, the bill of sale must contain an inventory of the personal chattels comprised in the bill. The bill will be effective only in respect of the personal chattels specifically described, and will be void, except as against the grantor, in respect of personal chattels not specifically described.⁴² In addition, the personal chattels described in the schedule must be ones of which the grantor was the true owner at the time of the execution of the bill, otherwise the bill will be void, except as against the grantor, in respect of such personal chattels.⁴³ This provision prevents ‘after-acquired’ property being covered by a security bill for personal chattels (and hence generally prevents floating charges being granted by non-corporate debtors).⁴⁴

Registration requirements

- 8.21 There are requirements set out in the Bills of Sale Acts to register bills of sale. The registration schemes differ slightly between absolute and security bills. It should be noted that a bill that is registered may still be void if it has failed to comply with the formal requirements for validity.⁴⁵

⁴⁰ This means void absolutely, and not just against all but the grantor: see *Thomas v Kelly and Baker* (1888) 13 App Cas 506, 509. Cf the 1882 Act, ss 4 and 5.

⁴¹ The original requirement that the bill also be sealed was abolished by the Law of Property (Miscellaneous Provisions) Act 1989, s 1.

⁴² See the 1882 Act, s 4. There are certain limited exceptions to this, including fixtures, plant and trade machinery substituted for like materials described in the schedule: see the 1882 Act, s 6.

⁴³ See the 1882 Act, s 4.

⁴⁴ See, eg, *Thomas v Kelly and Baker* (1888) 13 App Cas 506, where a purported assignment of future-acquired chattels resulted in the bill being held to be void. Cf *Tailby v The Official Receiver* (1888) 13 App Cas 523, where an assignment of future book debts, being a chose in action and therefore not registrable as a bill of sale, was effective. However, it seems that the effect of this section is not limited purely to ‘after-acquired’ property. In *Tuck v Southern Counties Deposit Bank* (1889) 42 Ch D 471 the Court of Appeal held by a majority that the wording of the section would cover after-acquired chattels, but also covered chattels that had been the subject to an earlier but unregistered absolute bill of sale. Though the earlier bill was invalid against third parties it was not void against the grantor, who therefore was no longer owner of the chattels at the time she granted the second, security bill. As a result the second bill was also void against all persons except the grantor.

⁴⁵ See above, paras 8.17-8.20.

THE REGISTER

- 8.22 The registrar⁴⁶ is required to keep a register and to enter the name, residence and occupation of the grantor, together with other particulars set out in Schedule 2 to the 1882 Act.⁴⁷ The registrar has certain duties concerning transmission of entries to county courts.⁴⁸
- 8.23 In respect of absolute bills, office copies or extracts of the bill and any affidavits can be obtained by any person, upon payment of a fee.⁴⁹ For security bills, a person is entitled to search the register and to inspect, examine and make extracts⁵⁰ from any such bill without having to make a written application or having to specify any particulars in reference thereto, on payment of a fee.⁵¹

REGISTRATION OF ABSOLUTE BILLS

- 8.24 For absolute bills, under the 1878 Act, the requirements for registration are set out in section 10.⁵² These are that:
- (1) the execution of every bill must be attested by a solicitor, and such attestation must state that before execution of the bill the effect of it has been explained to the grantor by that solicitor,⁵³
 - (2) certain documents are required to be presented to, and filed with,⁵⁴ the registrar within seven clear days after the making or giving of the bill. The documents concerned are:

⁴⁶ The 1878 Act, s 13 provides that the Masters of the Queen's Bench Division of the High Court shall be the registrar, with any one Master performing all or any of the registrar's duties. The register is kept at the Royal Courts of Justice in London.

⁴⁷ 1882 Act, s 12.

⁴⁸ In the case of security bills, where the affidavit of attestation (see below, para 8.28) describes the residence of the maker as being outside the London insolvency district, or where the chattels listed in the bill of sale are so described, the registrar is required, within three clear days after registration, to transmit an abstract of the contents of the bill of sale to the county court registrar where such places are situated: see the 1882 Act, s 11. Details on what must be sent to the County Court registrar and the filing requirements of that registrar can be found in the Bills of Sale (Local Registration) Rules, SI 1960 No 2326. The abstract is to be filed by that registrar, and the registered abstract can be examined and copied in the same way as the main register.

⁴⁹ 1878 Act, s 16.

⁵⁰ Extracts are limited to the dates of execution, registration, renewal of registration, and satisfaction; to the names, addresses and occupations of the parties, and to any further prescribed particulars. Given this restriction, it may be a point of argument as to whether the provisions of the 1882 Act, s 16 have repealed - for security bills - the entitlement under the 1878 Act, s 16 to have an (unrestricted) office copy or extract of any bill or affidavit. This may just be the result of infelicitous drafting, as may be the apparent effect that searching the register can only be done in respect of security bills (the 1882 Act not applying to absolute bills). However, this point is probably of limited academic interest only.

⁵¹ 1882 Act, s 16.

⁵² However, it is to be noted that there are differences when a security bill is concerned: see below, para 8.26.

⁵³ Cf below, para 8.28 for the attestation requirement in relation to security bills.

- (a) the bill, together with every schedule annexed or inventory referred to therein,
- (b) a true copy of the bill, schedule or inventory, and of the attestation of execution,
- (c) an affidavit of the time of such bill being made or given, and of its due execution and attestation, and a description of the residence and occupation of the person making or giving the bill⁵⁵ and of every attesting witness,⁵⁶
- (d) in the case of a bill made or given subject to any defeasance or condition, or declaration of trust not contained in the body thereof, the defeasance, condition or declaration is deemed to be part of the bill, and is required to be written on the same paper therewith before the registration, and is required to be set out in the copy filed. Failure to do this will render the registration void.⁵⁷

A transfer or assignment of a registered bill does not need to be registered.

- 8.25 The registration of a bill of sale has to be renewed once at least every five years, failing which the registration becomes void.⁵⁸

REGISTRATION OF SECURITY BILLS

- 8.26 Section 15 of the 1882 Act repeals enactments in the 1878 Act that are inconsistent with the 1882 Act. As a result, there are some differences in the registration requirements between absolute and security bills.
- 8.27 Every bill of sale must be duly attested and registered under the 1878 Act within seven clear days after the execution of the bill,⁵⁹ and it must “truly set forth the consideration for which it was given”.⁶⁰ Failure to do this renders the bill void in respect of the personal chattels comprised within it.

⁵⁴ According to the wording of the Act, “in like manner as a warrant of attorney in any personal action given by a trader is now by law required to be filed”. See also Rules of the Supreme Court, Order 95.

⁵⁵ Where the bill is made or given by any person under or in the execution of any process, then a description of the residence and occupation of the person against whom such process was issued must be given instead: 1878 Act, s 10(2).

⁵⁶ It is the copy of the bill, rather than the original, and the affidavit that are filed.

⁵⁷ See the 1878 Act, s 10(3).

⁵⁸ Renewal is effected by filing an affidavit in a form set out in Schedule A to the 1878 Act: see the 1878 Act, s 11.

⁵⁹ Or, if it is executed outside England, within seven clear days after the time at which it would in the ordinary course of post arrive in England if posted immediately after execution of the bill.

⁶⁰ 1882 Act, s 8.

8.28 The requirements for registration of a security bill⁶¹ are that:

- (1) the execution of every bill of sale by the grantor is to be attested by one or more credible witnesses, not being party to the bill,⁶²
- (2) the following documents must be presented to, and some filed with,⁶³ the registrar within seven clear days after the making or giving of the bill:⁶⁴
 - (a) the attested bill, together with every schedule annexed or inventory referred to,⁶⁵
 - (b) a true copy of the bill, schedule or inventory, and of the attestation,
 - (c) an affidavit of the time of the bill being made or given, and of its due execution and attestation, and a description of the residence and occupation of the person making or giving the bill⁶⁶ (and of every attesting witness),⁶⁷
 - (d) in the case of a bill made or given subject to any defeasance or condition, or declaration of trust not contained in the body thereof, the same requirements as for an absolute bill as noted above.⁶⁸

8.29 A transfer or assignment of a registered bill does not need to be registered, and the same renewal provisions relating to absolute bills apply to security bills.⁶⁹

RECTIFICATION OF THE REGISTER

8.30 A judge of the High Court may order (on such terms and conditions as thought fit) that the time for registration be extended or that there be rectification of an omission or mis-statement of the name, residence or occupation of any person. The omission to register or the omission or mis-statement of the name, residence or occupation must have been accidental or due to inadvertence.⁷⁰

⁶¹ Which must be made in accordance with the form in the Schedule annexed to the 1882 Act: see *ibid*, s 9.

⁶² Cf above, para 8.19.

⁶³ See above, para 8.24 n 54.

⁶⁴ For an example of an unsuccessful challenge to the validity of a bill based on allegedly defective particulars, see *Simmons, trading as the Discount Bank of London v Woodward and Heseltine* [1892] AC 100.

⁶⁵ See the 1882 Act, s 4 for the requirement to have a schedule containing an inventory of the personal chattels.

⁶⁶ See above, para 8.24 n 55.

⁶⁷ See above, para 8.24 n 56.

⁶⁸ See above, para 8.24.

⁶⁹ See above, para 8.25.

⁷⁰ See the 1878 Act, s 14. Cf the wider power to amend the register of company charges, where the power exists to rectify an omission or mis-statement of “any particular”, rather than just the name, residence or occupation of any person. See above, para 2.29.

ENTRIES OF SATISFACTION

- 8.31 Where the debt for which the bill was made or given has been discharged, the registrar may order a memorandum of satisfaction to be written upon any registered copy of a bill of sale.⁷¹

FAILURE TO REGISTER

Absolute bills

- 8.32 As we noted earlier, failure to attest and register an absolute bill does not avoid the bill as between grantor and grantee, although it does render it void as against all trustees or assignees of the estate of the person whose chattels are comprised in the bill (in relation to bankruptcy or insolvency law), or under any assignment for the benefit of the creditors of that person. In addition, it is rendered void against a person executing a court-authorized seizure of any chattels comprised in the bill.⁷²

Security bills

- 8.33 A failure to attest and register a security bill in accordance with the requirements of the 1878 Act and the 1882 Act renders the bill void in respect of the personal chattels comprised therein.⁷³

PRIORITY OF SECURITY BILLS

- 8.34 Section 10 of the 1878 Act (which appears to apply to security bills as well as to absolute ones) provides that priority between bills of sale comprising the same chattels is in the order of their date of registration.

Aircraft and ships

- 8.35 Security interests created by non-corporate debtors over aircraft and ships are exempt from the Bills of Sale Acts but must be registered in the appropriate specialist register.⁷⁴

Receivables

- 8.36 A non-corporate debtor may create security over intangible property such as book debts, including future book debts. Intangible property is not within the Bills of Sale Acts, so that assignment of particular debts or debts coming due under particular contracts need not be registered.⁷⁵ However, a general assignment by a person in business of existing or future book debts is registrable as if it were a bill

⁷¹ See the 1878 Act, s 15.

⁷² 1878 Act, s 8. See above, para 8.18.

⁷³ 1882 Act, s 8. As noted earlier, failure to comply with the other formal requirements will result in the bill being void.

⁷⁴ See the Mortgaging of Aircraft Order 1972, art 16(1), and for ships see the 1878 Act, s 4. For the specialist registers, see above, paras 2.49 ff.

⁷⁵ *Tailby v The Official Receiver* (1888) 13 App Cas 523.

of sale. If it is not registered the assignment is void against the trustee in bankruptcy as regards any debts not already paid.⁷⁶

- 8.37 The assignment is filed in a separate register of assignments of book debts. Assignment of debts by way of security is perfected by notice to the debtor, and priority will depend on the date of notice to the debtor save that a person who took her assignment with actual or constructive notice of an earlier assignment cannot gain priority by giving notice first.⁷⁷
- 8.38 We note that it is possible for a debtor to create a fixed charge over its book debts, provided that the chargee maintains control over the payments received as well as the debts before they are paid.⁷⁸ If the debtor assigns all its book debts in this way, then the assignment will be registrable as explained above. However if the assignment is limited in some way it fall outside the provisions of the Insolvency Act 1986, section 344. There will be no easy way for subsequent creditors to discover the existence of the charge. Nor, apparently, does registration of a general assignment of book debts secure priority.⁷⁹

Security over intellectual property rights

- 8.39 Security interests created by non-corporate debtors over intellectual property rights must be registered in the appropriate specialist register: the rules for registration and priority are the same as for corporate debtors.⁸⁰

Agricultural charges

- 8.40 The restrictive nature of the Bills of Sale Acts has been overcome by the provision of specific legislation in the case of farmers.⁸¹ Leaving aside legislation that relates more to charges over land (which are outside the scope of this aspect of our Consultation Paper), the Agricultural Credits Act 1928 (the '1928 Act') provides that a farmer can, by a written instrument, create a charge in favour of a bank on her farming stock and other agricultural assets.⁸² Such charges are known as "agricultural charges", and may be fixed, floating or both a fixed and a floating

⁷⁶ Insolvency Act 1986, s 344.

⁷⁷ Under the rule in *Dearle v Hall* (1828) 3 Russ 1.

⁷⁸ See above, para 2.18.

⁷⁹ The Insolvency Act 1986, s 344(4) provides that: "For the purposes of registration under the Act of 1878 an assignment of book debts is to be treated as if it were a bill of sale given otherwise than by way of security for the payment of a sum of money; and the provisions of that Act with respect to the registration of bills of sale apply accordingly with such necessary modifications as may be made by rules under that Act." That does not address the question of priority.

⁸⁰ See above, para 2.55.

⁸¹ Although bills of sale in respect of crops and fixtures can be granted: see the 1882 Act, s 6.

⁸² 1928 Act, s 5(1). The definition of "farmer" in the 1928 Act excludes incorporated companies or societies, and "farming stock" is widely defined to include crops (whether growing or severed from the land), livestock (including its produce and progeny) and agricultural vehicles and machinery: see *ibid*, s 5(7).

charge. Agricultural charges are not deemed to be bills of sale, and take effect notwithstanding anything in the Bills of Sale Acts.⁸³

8.41 The 1928 Act sets out certain rights and obligations in the case of fixed and floating charges. In the case of a fixed charge, the chargee bank has the right to seize the charged property upon the happening of any event specified in the charge as one that authorises the seizure, and has the right (where such possession is taken) to sell the property by auction after five clear days.⁸⁴ The bank also has the obligation to apply the proceeds of sale to discharge the secured liability and to pay any surplus to the farmer.⁸⁵ A fixed charge does not prevent the farmer selling the charged property, but she is obliged to pay the bank the proceeds in respect of any sale of the charged property or money received under certain insurance payments (except insofar as the charge or bank allows otherwise).⁸⁶

8.42 A floating charge:

shall have the like effect as if the charge had been created by a duly registered debenture issued by a company.⁸⁷

However, the charge will become a fixed one on the occurrence of certain events specified in the 1928 Act.⁸⁸ As with a fixed charge, the farmer is obliged to pay over sale or insurance money received (but not where the money received is used by the farmer to purchase farming stock which becomes subject to the charge).⁸⁹

8.43 Unlike a 'normal' floating charge, the 1928 Act provides that where the agricultural charge is a floating one, any subsequent fixed agricultural charge or a bill of sale comprising property in the floating charge that is purportedly created is void as respects that property, so long as the floating charge remains in force.⁹⁰

8.44 The 1928 Act provides that every agricultural charge must be registered within seven clear days after its execution, failing which it is void as against any person other than the farmer.⁹¹ The Land Registrar is required to keep a register of agricultural charges. Registration is deemed to constitute actual notice of the charge, except for the purposes of further advances being made, where the original

⁸³ 1928 Act, s 8(1).

⁸⁴ However, the sale can be by private treaty and earlier than five days where the charge provides for this.

⁸⁵ 1928 Act, s 6(1).

⁸⁶ 1928 Act, s 6(2).

⁸⁷ 1928 Act, s 7(1).

⁸⁸ These are the bankruptcy or death of the farmer, the dissolution of the partnership (where the charged property is partnership property), or a written notice by the bank on the happening of an event which by virtue of the charge allows the bank to give such notice: see the 1928 Act, s 7(1)(a).

⁸⁹ 1928 Act, s 7(1)(b). A farmer who, with intent to defraud the bank, fails to comply with the obligations for paying over the required money, or who removes from his or her holding any of the charged property commits a criminal offence: *ibid*, s 11(1).

⁹⁰ 1928 Act, s 8(3).

⁹¹ 1928 Act, s 9(1). The time can be extended by the High Court on proof that the omission to register was accidental or due to inadvertence.

charge is made for securing a current account or further advances and the other agricultural charge was not registered at the time the first charge was created or when the last search was made by the bank.⁹² The priority of agricultural charges is governed by the times at which they are registered under the 1928 Act.⁹³ However, specific priority is given in relation to an agricultural charge comprising growing crops as against an earlier mortgage of the land.⁹⁴

QUASI-SECURITY GRANTED BY NON-CORPORATE DEBTORS

- 8.45 Quasi-security interests are widely used as a way of providing secured purchase-money or loan finance to non-corporate debtors. Indeed the difficulty in complying with the technicalities of the Bills of Sale Acts is said to have contributed to the development of transactions such as hire-purchase, conditional sale, and sale and lease-back.
- 8.46 We discussed quasi-security transactions in some detail earlier, in Parts VI and VII of this Consultation Paper. The basic transactions used are available just as much to non-corporate debtors and their creditors as they are to companies, and no separate discussion is required save for one thing. This is that many such agreements entered into by debtors who are individuals (including partnerships and other non-corporate bodies⁹⁵) will be regulated by the Consumer Credit Act 1974. This Act, which was passed as a result of the recommendations of the Crowther report, has a major impact on contracts such as hire-purchase and conditional sale. However, the impact is mainly on the rights as between the parties; the Act has little to say about the effect of such contracts on third parties such as purchasers, other secured parties or creditors, which is the prime concern of most of this Consultation Paper. We may therefore deal with it very briefly at this stage. We will return to some of the provisions of the Consumer Credit Act 1974, notably those in Parts VII (Default and Termination) and VIII (Security), when we consider partial codification of the law of security in Part XI and Appendix B of this Consultation Paper.

The impact of the Consumer Credit Act 1974 on good faith purchasers

- 8.47 The one effect of the Consumer Credit Act 1974 that we need to consider at this stage is in fact contained not in that Act but in the Sale of Goods Act 1979. It concerns a purchaser of goods from a person who herself has agreed to buy them under a regulated conditional sale. In general a buyer who has obtained possession of goods under an agreement to sell but who is not yet owner of the goods has power to pass title to a person who takes the goods under a sale, pledge or other disposition in good faith and without notice of the rights of the original seller, provided that the sale is made in circumstances that, were the first buyer a mercantile agent, would be within her ordinary course of business.⁹⁶ In contrast, the hirer under a hire-purchase agreement cannot pass good title to a buyer.⁹⁷

⁹² 1928 Act, s 9(8).

⁹³ 1928 Act, s 8(2).

⁹⁴ 1928 Act, s 8(6).

⁹⁵ Consumer Credit Act 1974, s 189.

⁹⁶ Sale of Goods Act 1979, s 25(1). See *Newtons of Wembley Ltd v Williams* [1965] 1 QB 560, a decision that has been strongly criticised: see R Goode, *Commercial Law* (2nd ed 1995) p 475.

⁹⁷ *Helby v Matthews* [1895] AC 471.

However, if the conditional sale agreement is a “consumer credit agreement” within the meaning of the Consumer Credit Act 1974, the buyer does not have the power to pass title - in other words, the buyer is treated in the same way as a hirer.⁹⁸ A “consumer credit agreement” is a “personal credit agreement” (that is, a credit agreement between a creditor and an individual debtor) by which the creditor provides the debtor with credit not exceeding £25,000.⁹⁹

Factoring and block discounting

- 8.48 We have referred in Part VI to assignments of book debts and other receivables by corporate debtors by way of security. Equally, non-corporate debtors may dispose of receivables outright as a way of raising money, for example under a factoring or block discounting agreement. For reasons given in Part VI, there is a good case for treating such ‘sales’ as security devices. An outright assignment of book debts would require registration as a bill of sale were it ‘general’,¹⁰⁰ but we understand that factoring and block discounting agreements usually apply to only selected receivables and thus will not require registration.

Extended retention of title clauses

- 8.49 We saw in Part VI that contracts for the supply of goods frequently contain retention of title clauses that go further than allowing the supplier to retake the goods supplied if they have not been paid for. The clause may apply to ‘all monies due’ or may purport to give the supplier rights over new or mixed goods created from the goods supplied or to the proceeds of sale. An ‘all monies’ clause does not turn it into a charge and thus it will be valid against a company without registration.¹⁰¹ Extended clauses are in practice unlikely to be effective against a company: the courts have usually held clauses that give a right to new or mixed goods, or to proceeds, to be charges.¹⁰²
- 8.50 Whether such clauses are more likely to be more effective against an individual is unclear. This is because the debtor has express or implied authority to dispose of the goods. Thus the charges must be floating. It is very doubtful whether an individual can validly create such a charge. It is the prohibition on non-corporate debtors creating bills of sale over property they do not yet own that is normally thought to prevent them creating floating charges,¹⁰³ and in the case of new or mixed goods the goods are the debtor’s property by the relevant time. In any event, however, the charge would have to be registered as a bill of sale, which would not be practical.
- 8.51 A charge over the proceeds of goods supplied created by a non-corporate debtor in favour of the supplier might, it seems, be a valid assignment by way of security, providing it conforms with the statutory form.¹⁰⁴

⁹⁸ Sale of Goods Act 1979, s 25(2).

⁹⁹ Consumer Credit Act 1974, ss 8(1) and (2).

¹⁰⁰ See above, para 8.36.

¹⁰¹ See above, para 6.18.

¹⁰² See above, paras 6.19-6.20.

¹⁰³ See above, para 8.20.

¹⁰⁴ See Halsbury’s Laws vol 4(1) para 724.

PART IX

SECURITY INTERESTS CREATED BY NON-CORPORATE DEBTORS: THE NEED FOR REFORM

- 9.1 In Part III we considered the need for reform to the company charges registration scheme, and discussed a number of factors that we considered to be weaknesses, including the failure of the current scheme to fulfil efficiently the functions that are now attributed to it. This Part considers whether there is a need to reform the law relating to the creation and registration of security interests over property other than land by non-corporate debtors. It is our provisional conclusion that there is such a need. Although we are able to set out the problems quite shortly, we are of the view that they are significant ones. Some of them are similar to criticisms we made in the context of company charge registration (such as the ‘invisibility’ to third parties of the existence of certain transactions).

COMPLEXITY OF THE EXISTING LAW

- 9.2 We have noted that the granting of security by non-corporate debtors is in many cases covered by the Bills of Sale Acts. As can be seen from Part VIII, even a brief consideration of this legislation reveals it to contain a complex mass of technical requirements, failure to comply with which results in severe consequences for the creditor, who will find its security avoided. The problems may be exacerbated by the fact that the Bills of Sale Acts relate not just to registration (as with the scheme under the Companies Act 1985) but also to the form the bill is required to take.
- 9.3 There has been criticism of the way the Bills of Sale Acts operate for many years. Even within just a few years of the introduction of the 1882 Act the legislation was drawing adverse judicial comment:

to say that ‘the Bills of Sale Act (1878) Amendment Act (1882)’ is well-drawn, or that its meaning is reasonably clear, would be to affirm a proposition to which I think few lawyers would subscribe, and which seems to be contradicted by the mass of litigation which the Act has produced and is producing every day. For my own part, the more I have occasion to study the Act the more convinced I am that it is beset with difficulties which can only be removed by legislation.¹

- 9.4 Over 80 years later the Crowther report was equally critical:

¹ Per Lord McNaughton in *Thomas v Kelly and Baker* (1888) 13 App Cas 506, 517. Similar sentiments were hinted at by Kay J in *Tuck v Southern Counties Deposit Bank* (1889) 42 Ch D 471, 476: “It is necessary to tread very warily where one has anything to do with the law of bills of sale”.

It is difficult to imagine any legislation possessing more technical pitfalls than the Bills of Sale Acts, particularly in relation to security bills of sale.²

To have strict, detailed requirements as to form, and a registration system needing the presentation of attestations and affidavits, all upon pain of the avoidance of the bill in the case of error not only as between grantor and third parties but also grantor and grantee is, in our view, far too complicated an approach to be compatible with a modern economy. It is not necessary to achieve what we indicated in Part III should be the aims of a modern registration system.³ It is our clear provisional view that the criticisms outlined in the courts and in the Crowther report have much force, and would in themselves justify giving serious consideration to reform.

COMPATIBILITY WITH THE ECHR

- 9.5 We noted in Part III that one of the concerns the Steering Group expressed in its Final Report was whether the sanction of invalidity under the scheme of registration of company charges was compatible with the Convention rights given under the ECHR and applicable to the scheme of registration by virtue of the Human Rights Act 1998.⁴ We expressed doubts in that case as to whether such criticism was justified. However, a similar - but more serious - question mark hangs over the provisions of the Bills of Sale Acts that result in a security bill being void absolutely in the case of non-compliance with the statutory requirements. It is very hard to see how invalidating an incorrectly registered security agreement as against the debtor (and not just as against third parties) is proportionate to the risk that a third party might have been prejudiced by an incorrect registration, or even a complete failure to register. This is particularly so where the requirements of the registration process are complicated and detailed, and thus more easy to get wrong, as with the Bills of Sale Acts.

DIFFICULTY IN OBTAINING FINANCE FOR UNINCORPORATED BUSINESSES

- 9.6 Criticism of the existing law under the Bills of Sale Acts is not merely a question of inaccessibility. The complexity of the current law has more serious consequences. It is our understanding that bills of sale are seldom used:⁵ this is almost certainly the result of the technical difficulties that we have referred to.⁶ The result is that sole traders, partnerships and other unincorporated businesses are in practice unable to create fixed charges over goods they own.

² Crowther report para 4.2.12.

³ See above, paras 3.4-3.8.

⁴ See *Wilson v First County Trust Ltd (No 2)* [2002] QB 74, and see above, paras 3.41-3.43.

⁵ During the year 2001 only 2840 bills of sale were registered. It is not possible to obtain separate figures for absolute bills and security bills.

⁶ See Halsbury's Laws vol 4(1) para 611 n 3.

- 9.7 Moreover, the impossibility of taking a bill of sale over after-acquired property⁷ prevents any unincorporated business from creating a floating charge, which is an additional handicap to the raising of finance.
- 9.8 Thus it can be said that the need to comply with the rigid and complicated system set out by the Bills of Sale Acts, together with the draconian consequences (for the lender) of non-compliance, means that there are difficulties for sole traders or unincorporated businesses in obtaining finance.⁸ In New Zealand at least it has been suggested that the result of the old law was that lenders put pressure on businesses to incorporate:

many banks require sole traders to incorporate, so that the debtor is able to give the bank a debenture creating fixed and floating charges, which unnecessarily increases the number of companies on the register.⁹

- 9.9 In considering the question of whether the difficulty in raising finance facing non-corporate debtors is something that would justify reform, we need to separate the position of consumers from that of businesses.

Consumers

- 9.10 The 1882 Act, which is responsible for at least some of the technicalities in registration and for the ban on bills covering after-acquired property, was conceived as what would now be called a consumer protection measure.¹⁰ It was designed to prevent persons of modest means from improvident arrangements by, amongst other things, mortgaging goods they do not yet own. This restriction may well have contributed to the growth of other types of agreement such as hire-purchase, but these are considered to be less harmful to consumers, as the supplier's rights are normally in goods supplied on credit (that is, purchase-money credit)¹¹ and, secondly, are limited to those goods.¹²
- 9.11 Some of the protection given by the 1882 Act has been eroded by inflation: the ban on bills of sale for under £30 is now practically meaningless.¹³ However the ban on charging after-acquired property remains and, as far as consumers are concerned,

⁷ 1882 Act, s 5. See above, para 8.20.

⁸ See, eg, R Goode, *Commercial Law* (2nd ed 1995) p 749.

⁹ NZLC R8, *A Personal Property Securities Act for New Zealand* p 10.

¹⁰ See above, para 8.8; and P Atiyah, *The Rise and Fall of Freedom of Contract* (1979), pp 709-711.

¹¹ This does not preclude sale and hire-back contracts, which seem potentially as objectionable as bills of sale.

¹² Those familiar with the history of the unconscionability doctrine in the United States of America will know that one of the best-known early cases involved a cross-default clause, effectively allowing the creditor to repossess not only the goods on which the main default occurred but also goods previously supplied. This was possible because the agreements also permitted the supplier to allocate payments so that small sums remained outstanding on previous contracts. See *Williams v Walker-Thomas Furniture Co* 121 US App DC 315, 350 F 2d 445 (DC Civ, 1965).

¹³ See the 1882 Act, s 12.

probably should continue to do so. Some of the schemes adopted or proposed overseas either prevent consumers charging after-acquired personal property or prevent such security interests attaching without specific appropriation.¹⁴ We therefore do not regard the ban on charging after-acquired property to be unduly restrictive in the case of consumers. Whether the law should be even more restrictive and prevent consumers from creating security interests over existing personal property is a question to which we return in Part X.

Sole traders and partners

- 9.12 In contrast to consumers, we see no case for excluding sole traders, partners or other non-corporate borrowers from creating charges over either existing or after-acquired property, or from creating floating charges over their property. The Cork Committee¹⁵ recommended in 1982 that, if reforms to floating charges were made in the way advocated in its report, individuals should be able to create floating charges. However, it recommended that such a floating charge should not extend to the whole of the debtor's property and assets (so as to include even those that would be retained by the debtor on an insolvency): the power of an individual to create a floating charge should not be greater than that necessary to enable a trader to charge the whole of his business undertaking. Consequently, such a charge should not be capable of extending to any property or assets not used or acquired for use in connection with the debtor's business, trade or profession.¹⁶
- 9.13 It seems particularly anomalous that partnerships, which may now in some cases be of unlimited size,¹⁷ are unable to create floating charges and practically unable to create fixed charges over goods.¹⁸ It is true that partnerships of professionals will not hold goods as stock-in-trade, and that goods that they are using can effectively be made the subject of quasi-security interests by obtaining them under finance leases or on hire-purchase. However, it seems to us that there is no reason why other forms of business that do have capital locked up in goods should not be able to use the partnership form and yet use those goods as security. The law of security should be neutral as between business forms.¹⁹

¹⁴ See the UCC, Section 9-204(b) (which prevents attachment in the case of consumer goods other than certain accessions, or commercial tort claims); and the NZPPSA, s 44 (which prevents attachment without specific appropriation other than where there is an accession or replacement for existing collateral, or a purchase-money interest).

¹⁵ Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558.

¹⁶ Report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558 paras 1568-1569.

¹⁷ Moreover, we understand that the restriction on the maximum number of partners is likely soon to be removed entirely.

¹⁸ The law of partnerships is currently under review by the Law Commission and the Scottish Law Commission: see Partnership Law (2000) Consultation Paper No 159/Discussion Paper No 111. It is not currently anticipated that any recommendations from the review will affect questions discussed here.

¹⁹ See the Diamond report para 16.15.

INVISIBILITY OF CHARGES AND QUASI-SECURITY

- 9.14 We noted in Part III that one of the problems of the registration scheme for companies was that only those charges that were on the list set out in the Companies Act 1985 had to be registered. A security interest that was taken in a form not on the list did not have to be registered, which consequently meant that third parties might not be able to find out about the existence of that interest from a public source. Outside the scope of traditional securities, most quasi-securities are also not registrable, and thus risk being 'invisible' to other possible creditors or purchasers.
- 9.15 Similar criticisms can be made in the case of security interests created by non-corporate debtors. The Bills of Sale Acts apply in the case of goods and general assignments of book debts, and in theory should give public notice of the securities concerned,²⁰ but though a non-corporate debtor is able to create a fixed charge over receivables, the charge may not be registrable, and it is thus hard for subsequent creditors to discover its existence.
- 9.16 The criticisms that we made of the lack of a functional approach to registration of company charges also apply in the case of non-corporate debtors. Quasi-securities (with the exception of general assignments of book debts) are not registrable against a non-corporate debtor any more than they are against a company. We are not aware of complaints that this presents a misleading picture of the financial position of non-corporate debtors in particular. However, the information that certain apparent assets of an unincorporated business are subject to security interests in favour of third parties seems just as useful to potential creditors as it is in the case of a company. A charge over goods owned by a non-corporate debtor to secure an overdraft would need registration as a bill of sale, a sale and lease-back of the same goods would not. The secured nature of the latter transaction would again be invisible to someone searching the bills of sale register.
- 9.17 In some cases it is of course possible to discover whether a non-corporate debtor has created a security interest, in the broad sense, over some specified assets.²¹ Thus hire-purchase and conditional sale agreements over vehicles will normally be registered with HPI. A similar scheme now also covers caravans, motorhomes and boats.²² Security interests over ships and aircraft, however, are registrable only if they amount to charges.

CONCLUSION

- 9.18 It is our clear provisional view that the current law relating to security interests created by non-corporate debtors is in need of reform. The combination of a complicated and restrictive scheme of registration with the draconian consequences for non-compliance seems to us to be out of date and unfair. In

²⁰ A general assignment of book debts is registrable as if it were a bill of sale: see above, para 8.36.

²¹ We noted in Part IV how we envisaged the financing statement containing an indication of any unique serial number, which would allow searching by asset number in these cases: see above, paras 4.186-4.187.

²² See the HPI website <http://www.hpichk.com/>.

addition, the current law unnecessarily fetters the ability of unincorporated businesses to raise finance. Provided safeguards are put in place to protect consumers (which we discuss in Part X), there seems to be no reason why the ability of a partnership or a sole trader to raise secured finance should be significantly more restricted by the law than that of a company.

9.19 **We ask whether consultees agree that the existing law applying to the registration of security and quasi-security interests by individuals and unincorporated businesses is in need of reform because it:**

- (1) is unnecessarily complex;**
- (2) is potentially in compatible with the ECHR;**
- (3) makes it difficult for businesses and individuals to create fixed charges;**
- (4) makes it impossible for unincorporated businesses to create floating charges; and**
- (5) fails to give adequate public notice of security and quasi-security interests created by unincorporated debtors.**

Where they do not so agree, we ask them to explain why.

PART X

EXTENDING THE NOTICE-FILING SYSTEM

INTRODUCTION

- 10.1 In Part IV we provisionally proposed that a notice-filing system for charges created by companies be introduced to replace the current registration scheme. This would require that charges over most assets be registered by means of a financing statement in the Company Charges Register, and the priority of such registered charges would generally date from the time of registration, rather than of creation (except in the case of purchase-money interests). An exception would be for charges over land and other assets (such as ships and aircraft) that have to be registered in a specialist register anyway. In Part VII we considered - and were provisionally in favour of - extending that proposed system to make registrable not just charges but any transaction that fulfilled the function of a security (subject to a few exceptions). However, all of this was considered only in respect of corporate debtors.
- 10.2 As we have noted before, the systems proposed by the Crowther and Diamond reports, and the legislation in force in America, Canada and New Zealand, all apply the same system to security interests over personal property whether the debtor is corporate or non-corporate.
- 10.3 In this Part we consider whether the notice-filing system we provisionally proposed in respect of companies should be extended¹ to cover non-corporate debtors. However, in doing this, we think it is necessary to give separate consideration to the case of non-corporate business debtors - comprising sole traders, partnerships and other unincorporated businesses or associations - on the one hand, and consumers, on the other. Our provisional views on how the notice-filing scheme should apply differ in respect of the two groups.

NON-CORPORATE BUSINESS DEBTORS

Replacement of the Bills of Sale Acts

- 10.4 As we suggested in Part IX, there are strong reasons for replacing at least the old and very technical system of registration of charges over goods and general assignments of book debts under the Bills of Sale Acts with a system that is less technical and therefore easier to use. We see no reason why the new, simple system of notice-filing of financing statements provisionally proposed for company charges should not in general be applied to charges created by non-corporate business debtors, allowing repeal of the Bills of Sale Acts (at least as far as security bills are concerned).

¹ We have already noted our understanding that it is probable that the DTI will want to introduce specific legislation for companies rather than go straight to a single, unified system: see above, para 1.17.

Fixed charges

- 10.5 It would follow that an individual or partnership would be able to create a fixed charge over its assets and the creditor would be able to protect it from invalidity in the event of the debtor's insolvency, and to secure its priority, by filing a financing statement just as in the case of a corporate debtor.

Floating charges

- 10.6 It would follow naturally from the abolition of the restrictions contained in the Bills of Sale Acts that (unless the replacement legislation were also to contain restrictions on non-corporate business debtors from charging their after-acquired property²) sole traders and partnerships would be able to create floating charges. We think that there is a good case for permitting non-corporate business debtors to create floating charges. As we pointed out in Part IX, this was recommended by the Cork Committee (subject to certain safeguards relating to the debtor's personal possessions³). In Part IV we explained that under the notice-filing system floating charges as they are currently known would probably disappear over time, to be replaced by what we have provisionally called the 'floating lien'. The floating lien would operate in very much the same way as the old floating charge, save that priority would be determined by the date of filing.⁴ Equally we see no reason why non-corporate business debtors should not be allowed to use this kind of security interest. We think, however, that there should be a limit to the extent of such a charge, as was suggested by the Cork Committee.
- 10.7 **We ask consultees whether they agree with our provisional view that non-corporate business debtors (comprising sole traders, partnerships and other unincorporated bodies) should be able to create a floating charge or 'floating lien'. If they do agree with us, we ask them whether there are any safeguards that they would like to see in place (such as not permitting a floating charge to extend to property or assets not used or acquired for use in connection with the debtor's business, trade or profession).**

What should be registrable

Non-registrable charges

- 10.8 We have pointed out that under the current law certain charges created by non-corporate debtors are not registrable anywhere. This applies to assignments of receivables that do not amount to a general assignment of book debts. We do not know whether in practice this causes difficulty to third parties, but we see it as a possible advantage of applying the notice-filing system to non-corporate business debtors that it would be easy to require the filing of a financing statement for such

² We have explained already that we do not think that consumers should be able to charge their after-acquired property: see above, para 9.11. We later ask consultees whether consumers should be able to charge their existing goods: see below, paras 10.27 ff.

³ See above, para 9.12.

⁴ As we explain above, para 4.130, this is not very different to the effect that is at least intended when a floating charge includes a negative pledge clause (although whether the clause is effective to preserve the floating charge's priority over subsequent fixed charges depends on whether it comes to the notice of any subsequent secured creditor).

charges, which would then become a matter of public record.⁵ **We provisionally propose that the same types of charge should be registrable when created by unincorporated businesses as when created by companies.**

Quasi-securities

- 10.9 Equally, we have pointed out that both the functional approach to what amounts to a security interest, and the policy of avoiding the public being misled by the 'appearance of wealth' of a business, suggest that it would be advantageous to bring quasi-securities entered into by non-corporate business debtors within the system of notice-filing. As we discussed in relation to corporate debtors, it is also our view that priority of security interests should be determined not by their form as true security or quasi-security but according to the date of filing and whether the security interest was a purchase-money interest. **We provisionally propose that quasi-security interests created by unincorporated businesses should be registrable.**

Exceptions

- 10.10 In Part V we discussed which charges should be registrable (principally under a notice-filing system), and in Part VII we discussed which forms of quasi-security should be subject to notice-filing. The comments we made in those two Parts are relevant to our discussions at this stage. We provisionally proposed that a certain limited number of charges and quasi-securities should not be registrable, and, insofar as the proposed exceptions would be relevant to charges created by non-corporate business debtors, we would repeat them here. **We provisionally propose that charges and quasi-security interests that, under our earlier proposals, would not be registrable when created by companies should equally be exempt when created by an unincorporated business.**

Consequences of bringing quasi-securities into the notice-filing system

- 10.11 In Part VII we discussed extending the notice-filing system for security interests created by companies so that it would apply to quasi-securities, and we noted that the alteration to the rules of priority giving priority to purchase-money interests (as discussed in Part IV) would have more effect where a system included quasi-securities. We pointed out that the overseas systems subject quasi-securities (with some exceptions) to the rules generally applicable to security of the traditional kind. For example, any surplus obtained on realisation of the security is generally returnable to the debtor. This is achieved by subjecting security interests in general to a new, partial codification of the law of security.
- 10.12 We pointed out that for the purposes of security interests created by companies, such a codification is probably not necessary. Although we suggested that it would be possible simply to create a relatively short provision to the effect that all 'security interests' that come within the definition provisionally proposed in Part VII and that are created by companies should be treated as if they were securities

⁵ Registration would not be compulsory but an unregistered charge would be invalid against creditors in the event of bankruptcy: see above, paras 4.55 ff.

for a number of purposes, we did not recommend it for a system that applied simply to corporate debtors.

- 10.13 Were any new system to be widened to include non-corporate debtors, it might be better to include in the new legislation a partial codification of security law as in the Saskatchewan and New Zealand models. We return to this question in Part XI and Appendix B.

Agricultural charges

- 10.14 We noted in Part VIII that the restrictive nature of the Bills of Sale Acts has been overcome in the case of charges granted to banks by farmers, and that floating charges are permitted in certain cases under separate legislation.⁶
- 10.15 In his report Professor Diamond stated that:

My impression is that the fundamental reason for having separate registers under the Agricultural Credits Acts is that the legislation permitted farmers to grant charges that other individuals could not grant and ... to avoid the stigma of the Bills of Sale Acts.⁷

It was suggested that with the creation of the registers proposed in the Diamond report that there would be no need for separate registers against farmers, and that contact with what was then the Ministry of Agriculture, Fisheries and Food should be initiated to see if the policy of closing the separate agricultural credits register would be acceptable.

- 10.16 It seems to us that, as the Diamond report suggested, a notice-filing system that covered all forms of debtor would enable the separate legislation relating to agricultural charges to be repealed. However, we have not been able to investigate this area in as much depth as we would have liked in the time available for the preparation of this Consultation Paper, and we would therefore welcome the views of consultees on this point. Certainly the provisions of the 1928 Act are not identical to those that we are proposing,⁸ and there is a greater degree of overlap between personal and real property where this area is concerned (such as the priority given to growing crops over a mortgage over land); however, subject to receiving the views of interested consultees we provisionally think that it may be possible to repeal this legislation.
- 10.17 **We ask consultees whether they think a system of notice-filing that covers all forms of debtor should replace the current law in respect of agricultural charges.**

⁶ See above, paras 8.40 ff.

⁷ Diamond report para 12.4.3 (emphasis omitted).

⁸ We have not proposed, for example, that a subsequent fixed charge should be void against property covered by an earlier floating charge, as is the case with agricultural charges (see above, para 8.43). However, under notice-filing a subsequent fixed charge would be subordinate to an earlier floating charge (unless a purchase-money interest), and so the practical difference for the creditor may not be that great.

Priorities

- 10.18 We would envisage the system of priorities of a notice-filing system that we proposed in Part IV applying in the same way to non-corporate business debtors. This would include the favourable treatment given to purchase-money interests.

Purchasers

- 10.19 As with priorities, we would envisage the rules we outlined in Part IV relating to purchasers from companies applying to purchasers from non-corporate debtors.⁹ However, at this point we need to return to the question of the purchaser of a vehicle subject to a hire-purchase or conditional sale agreement, which raises an additional problem. The law relating to purchasers of such vehicles, and the operation of the HPI register, was described in Part VII.¹⁰ The Hire-Purchase Act 1964 applies whether the vehicle was sold by a company or by a non-corporate debtor.
- 10.20 When we discussed the position of purchasers of vehicles subject to hire-purchase or conditional sale agreements in respect of security interests granted by companies, we provisionally considered that such purchasers should be outside the system we proposed, given the difficulties we anticipated regarding the legal personality of the 'rogue' vendor of the vehicle.¹¹ However, there would still be a problem if the system were extended to cover security interests granted by all business debtors, but not to consumers, as the person selling the vehicle which was subject to the hire-purchase agreement or conditional sale might be an individual who was a consumer. If the system were to cover all forms of debtor, this difficulty would not apply. We therefore defer this issue again until we have considered whether consumers should be able to file financing statements. We then deal with the case of purchasers of vehicles as a separate issue.¹²

Conclusion

- 10.21 **We ask consultees whether they agree with our provisional view:**
- (1) that the notice-filing system that we proposed for companies should be extended to apply to security interests created by non-corporate business debtors such as sole traders, partnerships and other unincorporated businesses;**
 - (2) that, as is proposed for companies, the system should take a functional approach to what is registrable, so that quasi-securities are brought within it; and**
 - (3) the same rules on priority apply, with preference being given to purchase-money interests.**

⁹ See above, paras 4.173 ff.

¹⁰ See above, para 7.58 n 89.

¹¹ See above, para 7.64.

¹² See below, paras 10.51-10.54.

CONSUMERS

- 10.22 Whether security interests created by consumers should be registrable like security interests created by companies and non-corporate business debtors is a difficult question. We think it is best to consider it after we have considered the types of security interests that might be created by consumers.

Security interests over after-acquired property

In general

- 10.23 In Part VIII we pointed out that the restrictions on individuals creating bills of sale over after-acquired personal property under the 1882 Act were a consumer protection measure, and we note that many of the systems adopted or proposed overseas prevent consumers charging after-acquired personal property. We suggested that any new system for security interests over personal property should maintain this prohibition.¹³ We think that a power to create security interests over after-acquired property would be open to serious abuse as between lenders, not all of whom are scrupulous, and consumers, many of whom would not understand the significance of creating such a charge.¹⁴

Purchase-money interests

- 10.24 We have discussed above the concept of the purchase-money interest. Security interests falling into this class involve security over property acquired by the debtor with the funds provided by the secured party (as opposed to security granted over an existing item of the debtor's property). The whole purpose of the loan is to enable the secured property to be acquired.¹⁵ Consumer transactions involving quasi-security over the goods supplied (such as hire-purchase or conditional sale agreements) are very common. They constitute a valuable means of consumers being able to use their anticipated future income to cover present needs. We think it is important that there should be no undue hindrance to such transactions and no unwonted degree of risk to the creditor who employs this form of transaction.
- 10.25 Normally a consumer will obtain the goods at the same moment that the purchase-money-interest is created. However, on occasion the goods will be acquired shortly after the money is advanced and the advance would be for that purpose. We think that where consumers seek to create purchase-money interests in such after-acquired goods, such security interests should be permissible.¹⁶
- 10.26 **We ask whether consultees agree with our provisional view that consumers should not be permitted to grant security over their after-acquired**

¹³ See above, para 9.11.

¹⁴ Both the Crowther and Diamond reports opposed consumers granting security interests over after-acquired property (save, in the case of the Crowther report, where it amounted to a purchase-money interest: see para 5.6.6).

¹⁵ Although the taking of the security and the purchase of the asset may sometimes take place at the same time.

¹⁶ This was recommended by the Diamond report, para 18.1.9. The NZPPSA, s 45 allows a purchase-money security interest in a consumer's after-acquired goods.

property, except where the security is a purchase-money interest created shortly after the goods were acquired.

Security interests over existing property

- 10.27 It seems that the Crowther report would have gone further than simply preventing security interests over after-acquired consumer property. After discussing after-acquired consumer goods, it stated - without distinguishing between present and future goods - that it should not be permissible to take a security interest in consumer goods unless the loan secured was for the purpose of acquiring the goods (in other words, a purchase-money secured loan).¹⁷ The Diamond report was explicit on the point. It was noted that the Director-General of Fair Trading had expressed concern that consumers were already frequently over-committed in their borrowing, and it suggested that if it were possible simply to take security over even existing consumer goods, some less responsible lenders might do this as an alternative to making a careful evaluation of the consumer's prospects.¹⁸
- 10.28 We have stated our provisional view that consumers should not be able to create security interests in after-acquired goods save where they amount to purchase-money interests. However, we wonder whether it is necessary or right to prevent consumers from creating security interests over existing personal property, as the Diamond report recommended.
- 10.29 It seems right that creditors should not be able, by means of a simple clause in, say, a loan agreement, to take a security interests over all a consumer's existing assets. That might easily lead to consumers surrendering 'all they then own' to the creditor without realising the implications of their action (assuming the small print is even read), and might lead to abuse by less scrupulous creditors. On the other hand, to exclude the possibility of *any* security interest being created over existing personal property may be unduly restrictive.
- 10.30 It is probably the case that only a relatively small percentage of consumers have personal property of any great value (other than vehicles and boats, which we would treat separately in any event), but we suspect that the number who do is increasing. So many household items that once were merely 'old' are now treated as 'antiques', and have a considerable value (toys, books, and even kitchen tools, let alone the pictures, silver, china and jewellery long prized by wealthier families), which must mean that many people of quite modest means in fact have quite valuable personal property. However, those with such property may well wish to keep it for themselves or their children to enjoy if they can do so but may need cash for immediate expenses. Particularly if the expenses are unlikely to recur (for

¹⁷ Thus it would be possible to create a security interest in consumer goods only if the debtor acquires rights in the goods within 10 days after the secured party gives value (the delay is to cover the time between a purchase-money advance and the time when the asset actually becomes the property of the debtor): see the Crowther report para 5.6.6. Consumer goods cannot be defined solely by the nature of the goods (because in a manufacturer's or wholesaler's hands they will constitute inventory), therefore consumer goods would be defined in terms of goods "used or bought primarily for personal, family or household purposes": see *ibid*, para 5.7.24-25. Motor vehicles, other vehicles and the like would be subject to different rules: see below, paras 10.47-10.50.

¹⁸ Diamond report paras 18.1.1-18.1.12. It was proposed to exempt cases in which the consumer had acquired the goods within 30 days before the advance, which the consumer sought in order to pay for them: *ibid*, para 18.1.12.

example, university fees or the cost of a wedding) it may well make sense to borrow against the property now and to repay the money later rather than to sell the property outright. They are currently able to pawn the property; it is legally possible even for the consumer to enter a sale and lease-back transaction; should it become possible for them to create a non-possessory charge over the property, so that they can continue to enjoy it, if a lender was willing to take such a charge?

10.31 To permit consumers to pawn items of personal property may be seen as less 'risky' than to permit non-possessory charges over it. The need to hand the property over to the pawnbroker is likely to bring home to the consumer the significance of what she is doing and the risk that, if she defaults in payment, the property may be lost. We think this 'cautionary' function is important but we also think that it would be possible to build sufficient safeguards into any notice-filing system for non-possessory consumer security interests over existing property. In particular, we consider that it would be possible for consumers to be permitted to create security interests over their existing personal property if the items concerned are individually listed in the security agreement (and, in this context, a description along the lines of 'all existing property' should not be sufficient).¹⁹ It might be desirable also to require the secured party to use documents containing prescribed warning notices, rather as is done at present for some consumer credit agreements.²⁰ We certainly think that there should be some form of safeguard, for we expect that a credit lender operating against a simpler system than the Bills of Sale Acts will seek to take security from a consumer wherever possible.

10.32 **We ask consultees whether consumers should be able to create security interests over their existing personal property. If consultees do consider that consumers should be able to create such security interests, what safeguards (if any) would they wish to see?**

Consumer security interests and notice-filing

10.33 Whilst we think that consumers should be able to create purchase-money interests over personal property, and perhaps should be permitted to create security interests over individually-specified items of existing personal property,²¹ it does not necessarily follow that such interests would have to be registrable under a notice-filing system. The Crowther report recommended that security interests over consumer goods²² should not be registrable except for those over vehicles and the like.²³

¹⁹ This is the position under the NZPPSA, s 37.

²⁰ The security agreements would be "consumer credit agreements" within the Consumer Credit Act 1974. Under s 60 the Secretary of State has power to make regulations on the form and content of consumer credit agreements.

²¹ See above, para 10.31.

²² In the sense of goods bought for private use or consumption: see above, para 10.27 n 17.

²³ Both the Crowther and Diamond reports considered that security interests over consumer goods should be within the new schemes they envisaged: see in particular the Diamond report para 9.6.1-9.6.5, rejecting the contrary recommendation of the Halliday report. However what this seems to mean is that such security interests would be governed by the same general scheme of rules governing creation, remedies, and other matters. On these see below, Part XI.

10.34 The Crowther report stated that:

With the exception of motor and other vehicles, boats, light aircraft and fixtures to land²⁴ ... purchase of most types of consumer goods involves relatively small sums of money and the repossession value of such goods is small. Mandatory filing of security interests in consumer goods would thus involve expense and inconvenience disproportionate to the sums involved. Further, many consumer goods do not lend themselves to precise identification, so it would be difficult, if not impossible, to determine whether a particular article was the self-same article as that described in the security agreement. Moreover, most consumer goods [other than vehicles and the like] are of a household nature which are unlikely to be resold, and the necessity of giving notice of a security interest to third parties will therefore rarely arise. Finally, we doubt whether it is reasonable to expect the consumer to search a register before making a purchase, even where he is buying from another consumer rather than from a retail supplier.²⁵

In the Crowther Committee's view, the interest of the secured party should nonetheless be effective against the debtor's general creditors in a bankruptcy.²⁶

10.35 The Crowther report considered that in addition to not being mandatory,²⁷ filing of security interests over consumer goods should not be permissible. As purchasers could not be expected to search the register if filing were not obligatory, to permit it would risk clogging up the register to no good purpose. The Diamond report noted that the UCC does not require filing in the case of purchase-money security interests but does permit it, and that "this has some advantages for the secured creditor".²⁸ However it was also thought that to permit filing might lead to a vast number of entries in the register with no useful purpose being served, and concluded that, on balance, security interests over consumer goods should not be registrable.²⁹

10.36 Despite this unanimity, we think the question needs careful consideration, particularly as recent PPSAs do not exempt consumer security interests from the need to file a financing statement.

10.37 In our view the principal issue is actually not about whether the unfiled (and unfileable) consumer security interest should be valid in the event of the consumer's bankruptcy. The principal reason for making an unregistered company security invalid in the event of the company's insolvency is to protect unsecured creditors, who might otherwise be misled by seeing the company with apparently

²⁴ On these see below, paras 10.51-10.54. Footnote not in the original.

²⁵ Crowther report para 5.7.21.

²⁶ Crowther report para 5.7.27. This dealt also with purchasers of the goods: see below, paras 10.37 ff.

²⁷ We have already noted that we believe any system should be voluntary, with the sanction being loss of validity or priority against third parties.

²⁸ Filing is required to perfect non-purchase money security interests in consumer goods: UCC Revised Article 9, Section 9-309(1) and the Official Comment thereto.

²⁹ Diamond report paras 11.5.8-11.5.14.

unencumbered assets. We doubt whether creditors of consumers are likely to be misled by the consumer's appearance of having personal property that is unencumbered.³⁰ From that point of view we think it would not be necessary to require filing in order to protect the security interest (as the UCC puts it, a consumer security interest could be treated as perfected without filing). It is the position of innocent purchasers (including subsequent encumbrancers) of the goods subject to the security interest that seems more important.

- 10.38 Under the current law an innocent purchaser of consumer goods that are subject to a hire-purchase agreement, conditional sale or finance lease will not obtain title to the goods unless she falls within the protection provided by Part III of the Hire-Purchase Act 1964. The Diamond report considered that the rules about transfer of title by a non-owner were in need of radical reform, and proposed as part of a minimum set of proposals³¹ that a consumer buyer of goods from another consumer should take free of any security interest over the goods. The Diamond report does not state a view on trade buyers, but as the recommendation was made that consumer security interests should not be filed it may have been intended that a trade buyer would also take free unless it had actual knowledge of the security interest. This seems to have been the view of the Crowther Committee, which recommended that the secured party's interest would be subordinated to the rights of a bona fide buyer for value, as a buyer would take free of the security interest unless she knew of it. For this purpose, the Crowther report stated that "buyer" includes "subsequent encumbrancer".³²
- 10.39 Since the Diamond report was published a number of factors may have changed significantly. These may make a change to the law even more desirable but mean that it need not necessarily take the form that the Diamond report envisaged.
- 10.40 The first change is at this stage a matter of our impression rather than of evidence that we have received as yet. Still leaving on one side vehicles and boats, it is our belief that consumers are obtaining increasing numbers of high value items on hire-purchase or conditional sale. In particular, we have in mind electronic equipment and sports equipment of various kinds.
- 10.41 Associated with this is a second change that is again only a matter of impression: namely, that there is a developing second-hand market in such equipment. It seems that consumers frequently 'upgrade' their equipment well before it has reached the end of its working life. That may occur also before any hire-purchase or conditional sale agreement has been paid off. This creates risks for buyers who,

³⁰ Perhaps this is not true when the consumer has extensive intangible assets, but security interests over these will be easily discoverable from other sources, just as with investment securities owned by companies: see above, paras 5.18-5.28.

³¹ The Diamond report would have preferred a broader principle, to the effect that wherever the owner of goods has entrusted goods to, or acquiesced in their possession by, another person ('the possessor'), and the possessor then disposes of the goods in the ordinary course of business to an innocent purchaser, the latter should obtain a good title: see the Diamond report para 13.6.3.

³² Crowther report para 5.7.27; Diamond report para 11.5.12.

under the present law, would obtain no title to the goods even if they acted in complete good faith.³³

- 10.42 Thirdly, the very rapid development of computer technology means that registers can be much larger than before without becoming cumbersome 'cluttered'. Whereas in 1970 (the time of the Crowther report) it was clearly right to worry about registers being filled with data, this may no longer be a major concern. There may have been particular concern that the register might become cluttered with out-of-date financing statements. However, as consumer transactions of the kind in question are usually for a set initial period, it might be possible to provide that financing statements of consumer security interests must state the period and will be automatically removed from the register within a stated time after the expiry of that period unless renewed by the secured party (for instance, if the consumer is in arrears so that the security interest is still effective).
- 10.43 Fourthly, the Crowther report considered that filing would be of little value if it were optional, because purchasers could not be treated as having constructive notice of filed interests. Whilst the point on constructive notice may be true, in our view it does not necessarily follow from it that filing would be of little value. Even if buyers of consumer goods subject to a security interest will obtain a good title, knowledgeable buyers would prefer not to take any chances, particularly if they in turn may wish to resell.³⁴ If the relevant information is easy to look up, potential buyers may well check it. We suspect that even consumer buyers are becoming more sophisticated and thus more likely to wish to check. At the same time they are better able to do so now that registers can be searched on-line and access to the Internet is so widespread.
- 10.44 Fifthly, one of the changes in the way that expensive electronic items, at least, are produced is that each manufacturer seems to use unique serial numbers for items of any size or value.³⁵ This makes it far easier to identify consumer goods and it can make any register more useful. When goods are readily exchanged second-hand, the question is not just whether the immediate seller has created a security interest over the goods but whether that has been done by a previous owner. Previous owners' names may not be known to the potential buyer, so a search by name of debtor may not produce the relevant information. If the unique serial number is entered on the register, a quick and simple search will quickly reveal if there is a registered security interest. We suggested in Part IV that such a detail be one of the required particulars for a financing statement. We suspect that most buyers would prefer to check (particularly if this can be done cheaply and easily). They may discover that what looks like a good deal is not necessarily a safe deal.

³³ And whether the quasi-security was a hire-purchase agreement or a conditional sale: see above, para 6.13 n 25.

³⁴ Compare the point made in the Crowther report in relation to the Hire-Purchase Act 1964, Part III: private buyers who take a valid, statutory title may find that a dealer to whom they try to resell will check the HPI register, discover the previous hire-purchase agreement and refuse to deal with them. See the Crowther report para 5.7.32. A valid title is not the same as a marketable title.

³⁵ This may originally have been a device to discourage theft.

- 10.45 Lastly, we suggested earlier that perhaps consumers should be enabled to create security over individual items of their existing property.³⁶ Whereas hire-purchase agreements and the like are usually confined to fairly new items, we envisage security being created over valuable artefacts that may be far from new (such as antiques). That might make it all the more desirable to have such interests filed. First, filing would enable third parties to discover that the debtor does not have full rights over all that is in her possession (the original purpose of the Bills of Sale Acts). Secondly, it would give the secured party more protection against subsequent buyers or other parties taking security interests in the same item. Such items are unlikely to be identifiable by serial number, but filing should offer the hope that at least the first potential purchaser will discover the security interest.
- 10.46 We think that these factors combined mean that reform is needed but that it could either take the form recommended by the Crowther and Diamond reports - leaving consumer security interests outside the filing system - or it could give parties holding security interests over consumer goods the right to file if they so wish. The filed interest would then be protected against subsequent buyers, who would be expected to search the register. This is obviously different to the approach of the earlier reports, which thought that this would be an unreasonable burden, but it may be justified by advances in technology and the sophistication of buyers.
- 10.47 There is a third possibility, which is to provide that a filed security interest will be protected against a trade buyer but not against a private purchaser. That is more-or-less the pattern used by the Hire-Purchase Act 1964, Part III, for motor vehicles.
- 10.48 We noted that the other statutory systems do not exempt consumer security interests from filing. Under the New Zealand and Saskatchewan legislation, for example, security interests over consumer goods are not effective against creditors unless a financing statement is filed, just as for security interests over other goods. There are, however, a number of special rules for consumer goods. In the NZPPSA:
- (1) consumers may not create security interests over their after-acquired property except where the security interest is a purchase-money interest or the goods are replacements for goods under an earlier, valid security interest;³⁷
 - (2) a security agreement that specifies merely that the security interest is over 'consumer goods' will not be effective as against third parties;³⁸
 - (3) a buyer or lessor of consumer goods takes free of even a registered security interest if the goods are worth less than \$2000 and the buyer or lessee (a)

³⁶ See above, para 10.32.

³⁷ NZPPSA, s 44.

³⁸ NZPPSA, s 37. This rule is perhaps not accurately categorised as one of consumer protection as the same applies to an agreement that specifies merely 'equipment'. On the other hand, it is possible to exclude consumer goods from a security interests merely by using that phrase.

gave value and (b) bought or leased the goods without knowledge of the security interest,³⁹ and

- (4) if the obligations under a security interest relating to consumer goods are performed, the registration must be discharged by the secured party within 15 days.⁴⁰

10.49 The net effect of these rules appears to be that security interests over consumer goods can be created and notice must be filed to protect them in the event of bankruptcy; but

- (1) the interest must be over specified, existing goods or goods bought with the loan secured; and
- (2) buyers of such goods take free of the security interest if they give new value, the goods are worth less than \$2000 and the buyer does not know of the security interest.

10.50 **We ask consultees whether they think it better that:**

- (1) security interests over consumer goods should be treated as valid in the event of the consumer's insolvency without filing, which would not be possible, with a concomitant rule that a purchaser would be bound by the security interest only if she had actual knowledge of it**

or

- (2) security interests over consumer goods should be fileable, so that**
 - (a) an unfiled interest should not be valid in the event of the consumer's insolvency;**
 - (b) an unfiled interest should not be binding on a subsequent purchaser unless she knew of it; and**
 - (c) a filed interest should bind any purchaser.**

We also ask whether, under (2) above, private purchasers (as opposed to purchasers who are in the relevant trade) who do not know of the security interest should take free of it even if it has been filed.

We have a preference for permitting filing and treating a filed interest as good against trade purchasers but not private purchasers (that is, a similar rule to that used for motor vehicles).

³⁹ NZPPSA, s 54. Where the goods are sold in the ordinary course of business the buyer takes free unless the buyer or lessee also knows that the sale or lease constitutes a breach of the security agreement under which the security interest was created: NZPPSA, s 53(1).

⁴⁰ NZPPSA, s 161.

Motor vehicles

- 10.51 The reason for our preference for permitting filing and treating a filed interest as good against trade purchasers but not private purchasers is that, as against purchasers, this in effect replicates the system already used as far as motor vehicles are concerned.⁴¹ In other words, security interests in vehicles, whoever the debtor, could also be fileable on the register of security interests; and, following our earlier proposal, the security interest would be fileable (and searchable) against the vehicle by its unique serial number as well as against the debtor. The filed interest would then be binding on a trade purchaser but a private buyer would take free of the interest unless she knew of it.
- 10.52 This system has, so far as we are aware, worked reasonably well. The Crowther report did note that private purchasers who bought without knowing of the hire-purchase or conditional sale agreement over the vehicle, and who thus in law take free of it, may nonetheless find that their 'statutory title' is not fully marketable.⁴² However, there would be nothing to prevent a private purchaser from searching the register and, we suggested earlier that, even if private buyers are not to be affected by filed interests of which they do not know, we think that more sophisticated buyers will do a search in order to avoid trouble.
- 10.53 In Part IV we asked whether all consumers who buy goods that are not the seller's stock-in-trade should take free of the security interest unless they know of it. If that rule were adopted, then private purchasers of motor vehicles would be treated no differently to private purchasers of other goods. If, however, it is thought that private purchasers of other capital goods should be expected to check the register, and should be bound by registered security interests, private purchasers of vehicles would be treated more favourably. We think this could be justified on the basis that vehicles are traded so regularly by both companies and consumers that special rules are needed. The special rules could if necessary be expanded to cater for other goods that are regularly purchased and sold by consumers and that have unique serial numbers, such as caravans and small boats.⁴³
- 10.54 **We provisionally propose that:**
- (1) security interests over motor vehicles be registrable in the same way as other security interests, whether the debtor is a company, unincorporated business or a consumer;**
 - (2) an unfiled interest should not be valid in the event of the debtor's insolvency;**
 - (3) an unfiled interest should not be binding on any purchaser, whether or not she knew of it;**

⁴¹ See above, paras 7.55 - 7.66.

⁴² See above, para 10.43 n 34.

⁴³ Larger vessels and aircraft would remain subject to the specialist registers that apply to them.

- (4) a filed interest should be binding on a trade purchaser (or subsequent secured creditor, who will take subject to it); but**
- (5) a filed interest should not be binding on a person who buys the vehicle for private use unless she knows of the security interest.⁴⁴**

SMALL TRANSACTIONS

- 10.55 It will be apparent that one feature of the New Zealand legislation is that goods worth less than \$2000 are treated differently from those over that value. The Crowther report suggested that filing should not be available for any security interest unless the sum secured exceeds or may exceed £300, or no secured sum is stated.⁴⁵ The reason given was again to avoid burdening the register with small items. In contrast, the Diamond report rejected a complete exemption for small transactions, on the ground that there was no justification for exempting security interests created by businesses, and thus rendering them enforceable even if the business becomes insolvent, just because the amounts were small. Further, there might be several transactions between the same parties, each one small but of a significant amount in aggregate.⁴⁶ In the context of a notice-filing system that would apply only to companies we provisionally proposed that there should be no exclusions for small transactions, because we are of the view that a company's secured debt is unlikely to be of the amount that would qualify as small.⁴⁷ However, even for individuals and unincorporated businesses, we agree that it is not necessary or desirable to exempt all small transactions. As the Diamond report pointed out, the creditor may choose not to file but in such a case the consequences in the event of the debtor's bankruptcy are the result of the creditor's own decision.⁴⁸
- 10.56 We have suggested that there is a case (contrary to the recommendations of the Crowther and Diamond reports) for permitting filing of consumer security interests; and we have asked whether filing should normally be compulsory. It does not necessarily follow that all consumer security interests should be fileable no matter how small. We do not expect the cost of filing a financing statement to be high but it is a burden that business does not carry at the moment (there are voluntary filing schemes relating to the HPI register but applicable only to vehicles, caravans and boats) in order to preserve its rights. We think that it may be the case that even notice-filing would be disproportionately burdensome for transactions of less than, say, £1000.
- 10.57 If this is correct, we see two possibilities. One is to prevent filing of small consumer transactions. This would mean that the secured party's interest would be effective against the debtor's general creditors in bankruptcy but would be subordinated to the rights of a bona fide buyer for value, as a buyer would take free of the security

⁴⁴ In addition, a purchaser of stock-in-trade will take free of the security interest unless she knows that the sale is in breach of the security agreement: see above, para 4.181.

⁴⁵ Crowther report para 5.7.26.

⁴⁶ Diamond report paras 11.5.15-11.5.17.

⁴⁷ See above, para 7.85.

⁴⁸ Diamond report para 11.5.17.

interest unless she knew of it. The other is to follow the approach of the NZPPSA: in the event of the consumer's insolvency the security interest will not be valid unless filed, but purchasers of goods worth less than the limit will take free of the security interest unless they knew of it.

- 10.58 **We invite consultees' views on whether the filing of small consumer transactions should be prevented. Alternatively, if consumer security interests should be filed, should the system provide that in the event of the consumer's insolvency purchasers of goods worth less than a certain limit will take free of the security interest unless they knew of it?**

THE SECURITY REGISTER

- 10.59 When we discussed notice-filing in the context of corporate debtors, we suggested that Companies House could still administer such a system using the Company Charges Register. The relevant registers in the 'unified' systems in Saskatchewan and New Zealand are, for obvious reasons, referred to as the Personal Property Register (or a similar title), but essentially they operate in the same way as we envisage that the Company Charges Register would operate under a notice-filing system: a financing statement is filed against the name of the debtor for existing or future security interests. If the system were to be expanded to cover all forms of debtor, the implication would be that the Company Charges Register would be replaced by a register of security interests in property other than land (such a register might also refer to security interests over land, though neither the validity nor the priority of such interests would be governed by registration.⁴⁹) Presumably there would still have to be a separate Companies Register for purposes other than the recording of security interests.

CONCLUSION

- 10.60 We noted in Part I that we had split the treatment of this Consultation Paper into two, dealing first with companies, and secondly with non-corporate debtors. We noted that we did this because it seemed likely that the DTI would implement reform by way of secondary legislation under any forthcoming Companies Bill. However, our provisional view is that a unified system of security interests relating to debtors of all forms of legal personality would be more logical than to leave the law relating to security granted by non-corporate debtors unreformed.
- 10.61 **Our provisional conclusion is therefore that the notice-filing system we provisionally proposed for security interests granted by companies should be extended to cover security interests granted by non-corporate debtors, although there should be appropriate protection for consumers.**
- 10.62 We also think that it would be sensible to combine such an extended system with a codification of the rules of security, to incorporate security interests, although this is a point we go on to develop in the next Part.

⁴⁹ See above, para 4.211.

PART XI

RESTATING THE LAW OF SECURITY

INTRODUCTION

- 11.1 In Part VII we provisionally proposed that traditional securities and their functional equivalents (quasi-securities) should be treated identically for the purposes of perfection by notice-filing, as with the overseas systems. However, the decision to introduce a similar system for England and Wales may have implications beyond simply requiring a financing statement to be filed in respect of a wider range of transactions than are currently registrable under the Companies Act 1985. In this Part we consider the implications for the general rules applying to security interests, and in particular the remedies available to either party if the security interest is enforced.¹
- 11.2 If charges and their functional equivalents are to be treated identically in that both types of security interest need to be perfected by notice-filing, it seems logical to treat them in the same way for other purposes also. For instance, in the UCC, the SPPSA and the NZPPSA it is provided that, with exceptions we will mention in a moment, if a security interest is realised and the amount produced by the sale of the asset exceeds the amount due to the creditor, the balance should be payable to the debtor. This applies whether the security interest was by way of charge or was a hire-purchase or other retention of title device.² Similarly, the Crowther report recommended that a secured party exercising its power to sell property subject to any type of security interest should be deemed to sell for the account of the debtor, and should be under an obligation to hand over any surplus remaining after discharge of expenses.³ The Diamond report suggested that the provisions of the Crowther report dealing with the rights of the debtor and the rights of the secured party on default:

to be among the most important in the new scheme and a significant justification for adopting it.⁴

It recommended that the Crowther report proposals should be implemented.⁵

- 11.3 The exception from the rules as to surpluses or deficiencies to which we referred in the previous paragraph relates to outright sales of receivables. We have proposed that outright sales of receivables should be registrable, and that this should affect the priority of competing claims over receivables. However we proposed that outright sales of receivables should be excluded from the application of the surplus

¹ We develop the points we consider here in more detail in Appendix B. See below, para 11.12.

² For discussion of this point see above, para 6.4.

³ Crowther report para 5.6.13.

⁴ Diamond report para 14.3. For additional recommendations made by the Crowther report, see below, para 11.4.

⁵ Diamond report para 14.1.

and deficiency rules. Exceptions to this effect are found in the UCC and Commonwealth legislation, and were recommended also by the Crowther report.⁶

- 11.4 The overseas legislation referred to goes further than dealing with the question of surplus. It sets out a scheme of remedies and other provisions applying to security interests in general, amounting to a partial restatement or codification of the law of security over moveable property. The Crowther report recommended a similar approach, and the Diamond report, without discussing the provisions in detail, agreed that there should be a scheme based on Part 5 of the UCC and Part V (“Default – Rights and Remedies”) of the Canadian Model PPSA.⁷ One of the questions to be addressed in this Part is whether the new legislation we are provisionally proposing should do the same.
- 11.5 The UCC, the SPPSA and the NZPPSA, like the systems envisaged by the Crowther and Diamond reports, apply to security interests in personal property created by any debtor, corporate or not. We have provisionally proposed that a similar scheme be adopted in England and Wales; but for reasons we have explained,⁸ we think that it is likely that any notice-filing scheme will be applied in the first instance to security interests created by companies and only later be extended to security interests created by other debtors.
- 11.6 There are therefore two separate issues. One is whether a restatement of the law of security along the lines indicated should form part of a complete scheme applying to security interests created by debtors generally. The other is whether it should form part of the more limited scheme, applying only to security interests created by companies. It is possible that consultees will think that if there were to be reform of the law applying to the granting of security over property other than land by all debtors, it would be appropriate to include such provisions in any legislation, but also consider that, in the context of reform affecting only security interests created by companies, it is unnecessary or even undesirable to set out a scheme of general provisions applying only to security interests created by companies.
- 11.7 As will be seen below,⁹ it is our provisional view that a complete scheme applying to security interests created by any debtor should include a restatement of the kind envisaged.
- 11.8 As far as concerns security interests created by companies, what alternatives are there to restating the law of security? There seem to be two. One is for the new legislation to require that quasi-securities created by companies should be registered, and be subject to the same rules of priority as traditional security interests, yet not provide any further rules, for example on the entitlement to any surplus value the asset has over the outstanding debt or remedies for enforcement.
- 11.9 The other alternative is to include in the proposed legislation on company charges a short provision stating that for certain purposes, quasi-security devices such as

⁶ See above, para 7.37.

⁷ Diamond report para 14.4.

⁸ See above, para 1.17.

⁹ See below, para 11.46.

hire-purchase should be treated 'as if' they were security devices in the traditional sense. Thus the parties would have the same rights and remedies as if the devices were securities, but without setting out those rights and remedies in the legislation.

11.10 Thus our questions to consultees in this Part are:

- (1) whether a notice-filing scheme for securities and quasi-securities created by debtors generally should contain a restatement of at least the principal rules on creation and enforcement of securities and quasi-securities; and
- (2) whether the notice-filing scheme for securities and quasi-securities created by companies that we envisage in the first instance should also contain such a restatement; or whether it might have:
 - (a) no provisions dealing with the creation or enforcement of security interests; or
 - (b) a short provision to the effect that quasi-security devices within the scheme should be treated 'as if' they were securities for the purposes of enforcement.

11.11 Before we ask consultees to decide these issues, however, we think it would be useful to describe in outline what might be contained in a restatement of the principal rules on creation and enforcement of securities and quasi-securities. At this stage we have not produced a draft restatement even as part of the scheme for extending the notice-filing scheme to all debtors. This is partly because of the short time in which this Consultation Paper has had to be prepared, and partly because it does not seem sensible to do the work unless consultees take the view that it would be desirable, either as part of the company charges aspect or as part of the wider exercise. Instead we merely describe in outline the main provisions that have been adopted in the NZPPSA (Part 9) and the SPPSA on creation of the security interest, the rights of the parties and remedies for default.¹⁰ These Acts have been selected as the law in Canada and New Zealand is closer to the law in England and Wales than the codification contained in the UCC. We then return to the questions set out above.

11.12 For those who are interested, the provisions of the SPPSA and NZPPSA are described in more detail in Appendix B, together with relevant recommendations of the Crowther and Diamond Reports. In the Appendix we give brief accounts of the existing law, comment on the need for particular provisions and ask for consultees' views both on the provisions described and on whether there are others that should be included.

A RESTATEMENT OF THE LAW OF SECURITY

Scope of application

11.13 The schemes for notice-filing that we have described in earlier parts of this Consultation Paper do not apply to possessory securities (principally the pledge).

¹⁰ The provisions outlined below apply in both jurisdictions except where specific reference is made to differences in the provisions.

These are perfected by the creditor taking possession of the goods or document that forms the collateral. In addition we have provisionally proposed that security interests over some assets should be capable of perfection by 'control' rather than by filing.

- 11.14 If the legislation were to contain a partial codification of the law of security, one point that would need to be considered is whether security interests that are not perfectable by filing, such as possessory security interests, should be brought within the system. Both the Crowther and Diamond reports suggested that although it should not be necessary to register such interests, they should come within the general schemes proposed in those reports.¹¹
- 11.15 The SPPSA and NZPPSA schemes apply to all security interests and indeed contain some provisions that apply only to possessory security.¹²

Effectiveness of the security agreement¹³

Creation¹⁴

- 11.16 The SPPSA and NZPPSA each provide that a security agreement is effective according to its terms.¹⁵ However the agreement is only enforceable against third parties where either the collateral is in the possession of the secured party or the debtor has signed a security agreement which contains the specifications of the collateral or the form the collateral takes.¹⁶ The NZPPSA specifically states that a security agreement may be enforceable against a third party in respect of particular collateral even though the security agreement is not enforceable against a third party in respect of other collateral to which the security agreement relates.¹⁷
- 11.17 The Diamond Report suggested that it would be useful to create model forms for security agreements, though it stressed that use of the form would be entirely optional.¹⁸

Attachment⁹

- 11.18 The SPPSA, section 12 provides that a security interest attaches when:

¹¹ See the Crowther report para 5.3.1 and the Diamond report paras 9.5.6-9.5.7 and 11.5.2-11.5.7. The Halliday Report appears to have disagreed: para 25(2) (see the Diamond report para 9.5.2).

¹² See, eg, the SPPSA, s 17 (care of collateral; expenses and risk; use of collateral).

¹³ This section deals with creation and attachment only, because perfection and priority would necessarily be covered by the notice-filing scheme. See above, paras 4.55 ff and 4.118 ff.

¹⁴ Cf para 2.5 above.

¹⁵ NZPPSA, s 35(1); SPPSA, s 9(1).

¹⁶ NZPPSA, s 36(1); SPPSA, s 10(1). This is a separate question from whether the security interest must also be perfected in order to preserve its priority or to be valid as against purchasers or unsecured creditors in the event of the debtor's insolvency.

¹⁷ NZPPSA, s 36(2).

¹⁸ Diamond Report paras 10.5.1-10.5.4.

¹⁹ Cf para 2.5 above.

- (a) value is given;
- (b) the debtor has rights in the collateral (where the debtor is a lessee or consignee, this is when it obtains possession); and
- (c) except for the purpose of enforcing rights between the parties to the security agreement, the security agreement becomes enforceable (within section 10, as explained above),

unless the parties have agreed to postpone attachment. There are also rules for crops, the young of animals, minerals and trees.²⁰

Rights and remedies on default

Secured party may require payment of money

- 11.19 Where collateral is a debt or chattel paper, and there has been a default by the debtor under the security agreement, the secured party may require the party liable to pay the debt or the person liable under the chattel paper to pay the debt to him regardless of whether collections on the collateral were made prior to the notification.²¹ The secured party is also entitled to 'take control of' the proceeds of any collateral to which the secured party is entitled.²² In either of the above cases, the secured party must give notice to the debtor no later than 15 days after enforcing the security interest.²³ There are also provisions on the steps a secured party may take when the collateral is a licence.²⁴

Taking possession

- 11.20 The SPPSA provides that where the debtor has defaulted under the security agreement the secured party has the right to take possession of the collateral.²⁵ There are provisions dealing with property that cannot readily be moved from the debtor's premises or of a kind for which adequate storage facilities are not readily available.²⁶ Under the NZPPSA a secured party with priority over all other secured parties may take possession of and sell the collateral where the debtor is in default under the terms of the security agreement or where the collateral is at risk.²⁷

Powers and duties of receivers

- 11.21 Under the SPPSA a security agreement may provide for the appointment of a receiver and it may also set out the rights and duties of that receiver subject to any

²⁰ NZPPSA, s 40 is in broadly similar terms.

²¹ SPPSA, s 57(2)(a).

²² SPPSA, s 57(2)(b).

²³ SPPSA, s 57(5).

²⁴ SPPSA, s 57(3).

²⁵ SPPSA, s 58(2)(a). The secured party may also enforce the security agreement by any other method permitted by law.

²⁶ SPPSA, ss 58(2)(b)-(c).

²⁷ NZPPSA, ss 109(1)(a) and (b).

provisions in that Act or other Acts.²⁸ The SPPSA then sets out the role of a receiver, which includes taking custody and control of the collateral²⁹ and keeping records.³⁰

- 11.22 In contrast the NZPPSA does not outline the function of the receiver as this is dealt with in the Receiverships Act 1993, which details the duties³¹ and powers³² of receivers. Where a provision of the NZPPSA Part 9 is inconsistent with the Receiverships Act 1993 the latter Act prevails.³³

Sale of collateral

- 11.23 The secured creditor has a power of sale or disposal of the collateral that has been seized or repossessed.³⁴ It must give notice to the debtor or other relevant persons prior to sale of the collateral.³⁵ There are exceptions to the notice requirement for situations in which notice would be impracticable.³⁶ The sale must be made in a commercially reasonable manner;³⁷ under the NZPPSA there is a duty to sell for the best price reasonably obtainable.³⁸ It is provided that a good faith purchaser is not affected by any failure to follow the statutory requirements as to sale,³⁹ and that the sale will extinguish all security interests in the collateral and its proceeds that are subordinate to that of the secured party.⁴⁰ There are provisions as to the application of the proceeds.⁴¹

Surplus or deficiency

- 11.24 Where a surplus has arisen following sale of collateral by the secured party the payment of that surplus has to be made in a specific order.⁴² The SPPSA provides that the debtor is placed last to receive any surplus.⁴³ The legislation then deals with deficiency. The debtor is liable to pay any deficiency to the secured party

²⁸ SPPSA, s 64(2).

²⁹ SPPSA, s 64(3)(a).

³⁰ SPPSA, s 64(3)(a).

³¹ Receiverships Act 1993, ss 18, 19 and 21.

³² Receiverships Act 1993, ss 14, 15 and 31.

³³ NZPPSA, s 106(2).

³⁴ SPPSA, s 59(2); NZPPSA, s 109(1).

³⁵ NZPPSA, s 120(2) which refers to s 114(1); SPPSA, s 59(6).

³⁶ NZPPSA, s 114(2); SPPSA, s 59(16).

³⁷ SPPSA s 65(3), NZPPSA 25(1).

³⁸ NZPPSA, s 110.

³⁹ SPPSA, s 59(14); NZPPSA s 124.

⁴⁰ NZPPSA, s 115.

⁴¹ SPPSA, s 59(2).

⁴² NZPPSA, s 117(1).

⁴³ SPPSA, s 60(2).

except where a prior agreement contrary to this provision has been made or where another provision of the SPPSA or another Act applies.⁴⁴

Retention of collateral (foreclosure) by the secured party

- 11.25 Following a default by the debtor a secured party may make a proposal to take the collateral in satisfaction of the obligation secured by it.⁴⁵ Notice of the proposal must be given to those with a relevant interest⁴⁶ and objections by those persons must be received within the relevant period of notice.⁴⁷

Right to redeem collateral

- 11.26 Before the secured party or receiver has disposed of the collateral, or before the secured party has irrevocably elected to retain the collateral, it may be redeemed.⁴⁸ The redemption may be made by those entitled to notice of the disposition.⁴⁹ A person entitled to redeem may do so by “tendering fulfilment of the obligations secured by the collateral”⁵⁰ or paying a sum equal to the reasonable expenses of enforcing the security agreement.⁵¹

Reinstatement of security agreement

- 11.27 The debtor may reinstate the security agreement prior to the secured party disposing of the collateral or being deemed to have taken the collateral in satisfaction of the obligation secured by it.⁵² Reinstatement may occur where the debtor pays the sums in arrears “exclusive of the operation of an acceleration clause in the security agreement”;⁵³ remedies any default “by reason of which the secured party intends to sell the collateral”⁵⁴ and pays reasonable expenses incurred by the secured party in enforcing the security agreement.⁵⁵

Applications to court

- 11.28 The SPPSA provides that where an application is made by an ‘interested person’ the court may make an order which determines questions of priority or entitlement

⁴⁴ SPPSA, s 60(5).

⁴⁵ NZPPSA, s 61(1); SPPSA, s 120(1).

⁴⁶ See the NZPPSA, s 120(2) and the SPPSA, s 61(1).

⁴⁷ 15 days after notice by the secured creditor under the SPPSA, s 61(2) and 10 days after notice under the NZPPSA, s 121.

⁴⁸ NZPPSA, s 132; SPPSA, s 62(1).

⁴⁹ NZPPSA, s 114; SPPSA, s 59(6) or s 59(10).

⁵⁰ NZPPSA, s 132(1)(a); SPPSA, s 62(1)(a)(i).

⁵¹ NZPPSA, s 132(1)(b); SPPSA, s 62(1)(a)(ii).

⁵² See, eg, the NZPPSA, s 133.

⁵³ NZPPSA, s 133(a); SPPSA, s 62(1)(b)(i).

⁵⁴ NZPPSA, s 133(b); SPPSA, s 62(1)(b)(ii).

⁵⁵ NZPPSA, s 133(c); SPPSA, s 62(1)(b)(iii).

to collateral⁵⁶ or the court may direct that an action be brought or an issue is to be tried.⁵⁷

Remedies of secured party when collateral is seized by a third party

- 11.29 Under a notice-filing system, if a security interest has not been perfected, third parties such as judgment creditors or liquidators are entitled to seize the property that is subject to the security interest. Where the underlying security agreement is a loan, the debtor will still be liable for the outstanding balance and can recover the sums due from the debtor or prove in the insolvency. If the underlying agreement was a lease or a consignment, the SPPSA, section 21 provides that the measure of damages is the value of the leased or consigned goods at the date of seizure plus any further loss suffered as a result of the termination of the lease or consignment.

Fixtures, crops, accession and processed or commingled goods

- 11.30 The SPPSA contains provisions on security interests over fixtures and growing crops, in particular dealing with the question of priority as against interests in the land.⁵⁸ It also deals with accessions to goods⁵⁹ and processed and commingled goods.⁶⁰

General provisions

- 11.31 The SPPSA and NZPPSA contain some general provisions. Thus the SPPSA provides that (unless otherwise provided in that Act), a provision in a security agreement or any other agreement purporting to exclude any duty or onus imposed by that Act, or purporting to limit either the liability of, or amount of damages recoverable from, a person who has failed to discharge any duty or obligation imposed by that Act, is void.⁶¹ The SPPSA deals also with the debtor's right to transfer goods;⁶² and contains rules on such matters as the service of documents.⁶³

Tracing

- 11.32 In the event of an unauthorised disposition of the collateral, should a security interest continue to exist over the asset? This involves the question of tracing. The Diamond report said:

it would be desirable for the new legislation to spell out the details with some precision, and in my view it should be made clear that ...

⁵⁶ SPPSA, s 66(1)(a).

⁵⁷ SPPSA, s 66(1)(b).

⁵⁸ SPPSA, ss 36-37.

⁵⁹ SPPSA, s 38.

⁶⁰ SPPSA, s 39.

⁶¹ SPPSA, s 65(10).

⁶² SPPSA, s 33.

⁶³ SPPSA, s 68.

the right to trace does not depend on the presence of a fiduciary relationship.⁶⁴

IS A RESTATEMENT NEEDED?

- 11.33 We now turn back to the questions posed earlier. To repeat: should a notice-filing scheme for securities and quasi-securities created by debtors of all types contain a restatement of at least the principal rules on creation and enforcement of securities and quasi-securities? If in the first instance the scheme applies only to companies, is a restatement necessary? Alternatively, should the scheme for companies have no provisions on these issues? Or should it contain a short provision to the effect that for the purposes of enforcement, quasi-security devices within the scheme should be treated 'as if' they were securities?

Scheme applying to all types of debtor

- 11.34 We think that to subject quasi-securities generally to notice-filing and the associated priority rules, without providing that they are to be treated like traditional securities, is possible. However it would produce less than satisfactory results.
- 11.35 First, the result would be to perpetuate the distinctions for which the earlier reports so roundly criticised the current law. It will be recalled that the Crowther report saw two points as fundamental:

Recognition that the extension of credit in a sale or hire-purchase transaction is in reality a purchase-money loan and that the reservation of title under a hire-purchase or conditional sale agreement or finance lease is in reality a chattel mortgage securing a loan.

In addition:

Replacement of what are at present distinct sets of rules for different security devices by a legal structure applicable uniformly to all forms of security interest.⁶⁵

- 11.36 Secondly, simply to make quasi-securities registrable but to do no more might produce unattractive results. Take the question of surplus value. If there were no rule that surplus value obtained on the sale of a 'title-retention' transaction like a hire-purchase agreement, it would mean that no creditor could have a security interest in the same asset subordinate to the quasi-security, even if the asset were worth much more than the sum outstanding. The holder of the quasi-security would simply be able to take back the asset concerned without being accountable to anyone else for the surplus value. This of course is the position under the present law; however, in a notice-filing system applying to quasi-securities it might

⁶⁴ Diamond report para 15.2.3.

⁶⁵ Crowther report para 5.2.8. The Crowther report went on to note that: "The assimilation of the various security devices does not, of course, mean that all forms of security will be treated in the same way, but simply that distinctions will be drawn on a functional basis, according to the nature and purpose of the security itself rather than according to the form of the security instrument." *Ibid*, para 5.5.9.

cause difficulties. It would mean that the register, in order to give adequate information to third parties, might have to indicate whether the security interest claimed was a quasi-security or a 'true' security; or at least it would mean that third parties would have to enquire into the nature of the security interest. This would make the law more - rather than less - complicated and it seems unnecessary.

11.37 We have suggested that for security interests granted by companies it might be possible to achieve the desired result, in the first instance, by a short 'as if' provision. The difficulty we see with this, and why we do not propose it as a long-term solution, is that it may be difficult to decide which parts of the law of security should be treated as applicable to quasi-security devices - or to which quasi-security devices. As we pointed out earlier, we would wish to follow other schemes in exempting from the 'surplus and deficiency rules' either all outright sales of receivables (as in New Zealand) or at least those that do not have 'a security purpose' (as in the SPPSA).⁶⁶

11.38 Moreover, the law governing the creation of and remedies relating to traditional security devices is far from perfect. As our brief survey above suggests - and as is demonstrated further in Appendix B - it is complex, sometimes drawing distinctions that seem outmoded and unnecessary; it is, as we have discovered to our cost, not easy to find; and it does not deal with many practical issues that concern creditors and debtors in the modern world. The case for revision would be even stronger were it to apply to security interests created by non-corporate debtors, since then the provisions of the Consumer Credit Act 1974 apply, usually improving the law but adding to its complexity. The law on security is ripe for restatement in the form of a simple statutory code, and preferably one that does its best to make the law accessible to the businesspeople and consumer advisers who have to apply it. Restatement should aim, in the words of the Tax Law Rewrite Project:

To make any replacement legislation clearer and more accessible to the reader, so far as is possible without making the law significantly less certain, by using language which is non-technical with simple sentences, by setting out the law in a simple structure following a clear logic and by using a presentation which is easy to follow.⁶⁷

11.39 The New Zealand Law Commission did not make any recommendations on restating the law of security, but merely proposed that remedies could be dealt with separately.⁶⁸ Likewise, the Australian Law Reform Commission suggested that it was unnecessary to extend the scope of its report to consider the law governing remedies on default.⁶⁹ However this latter Commission reported that one of the architects of the New Zealand Law Commission report now considered that

⁶⁶ See above, para 7.38.

⁶⁷ See Inland Revenue Report: *The Path to Tax Simplification* (December 1995) and *The Path to Tax Simplification: A Background Paper*.

⁶⁸ See NZLC R8, *A Personal Property Securities Act for New Zealand* p 3.

⁶⁹ ALRC 64, *Personal Property Security* para 10.18.

remedies should have been covered,⁷⁰ and the NZPPSA does incorporate a scheme of remedies.⁷¹ Thus Commonwealth experience suggests that in the long run a restatement of the rules is desirable.

- 11.40 Our provisional conclusion is that a system of notice-filing that takes a functional approach, so as to apply to both securities and quasi-securities created by a debtor of any type, should contain a restatement of at least the principal rules on creation and enforcement of securities and quasi-securities. In general the same rules should apply to both kinds of interest. Thus it should operate so as to ensure that there was no difference in the treatment of surplus arising from resale as between security devices in the traditional sense and functionally-equivalent devices that involve the creditor retaining title.⁷² The creditor who ‘enforces’ the security device by taking possession of the asset should be placed under similar obligations to obtain a good price for the asset and to account for the surplus to the debtor or junior creditors.⁷³

The initial scheme for companies only

- 11.41 We have explained that any notice-filing scheme is likely to be applied in the first instance only to security interests created by companies.⁷⁴ Even here there would be advantages in having a restatement. We do not think that the fact that the scheme would be confined to company security interests really affects the substance. The point of stating the relevant rules in the legislation is to clarify them and in particular to make it clear when the particular rules are applicable. The fact that the debtor is a company does not make the rules significantly easier to understand or to apply. Those issues are much the same whoever the debtor is.
- 11.42 If there are advantages in having a restatement ‘sooner or later’, the issues become ones of timing and the means of implementation. That poses two problems. The first is time. To draft a restatement of the law on creation of security interests and the rights of the parties and enforcement would take some time. Even if there were no questions of policy, it would require at least that an ‘exposure draft’ be circulated for consultation. In practice there are likely to be issues of policy (even beyond those flagged up in Appendix B) on which we would need to consult. The second is the means of implementation. It would no doubt be possible to include a restatement of the law of security in Regulations which would be made under any forthcoming Companies Bill and which would apply only to security interests created by companies, but it would produce unjustified distinctions between securities created by companies and those created by non-corporate debtors.

⁷⁰ See ALRC 64, *Personal Property Security* para 10.16, n 37.

⁷¹ See the NZPPSA, Part 9: Enforcement of Security Interests, contained in ss 104–134.

⁷² We have noted that these rules would not apply to the purchaser of receivables, even though the purchase would be registrable: see above, para 11.3.

⁷³ See above, para 11.23.

⁷⁴ It is currently envisaged that any reform of the law governing the registration of company charges, including the possible extension of notice-filing to quasi-securities, would be implemented by Regulations made under a new Companies Act. See above, para 1.17.

11.43 Thus though in an ideal world we would prefer to enact a statutory statement of the rules on the creation of security interests, the rights of the parties and enforcement at the same time as a notice-filing system covering quasi-securities created by companies, it seems likely that lack of legislative time, if nothing else, will mean that this cannot be done.

11.44 Earlier we suggested as one solution a short ‘as if’ provision, to the effect that quasi-securities might be treated ‘as if’ they were securities in the true sense. The difficulty might be to know which rules of ‘security’ should apply to quasi-securities. It would be possible to give an indication - for instance, the provision might include a statement that this would apply when the property is repossessed because of the debtor’s default and would include:

- (1) the secured party’s rights and obligations in relation to sale or other disposal of the property, including the means of sale and the duties to act in good faith and to take reasonable care to obtain a proper price;
- (2) the secured party’s obligation to account for the proceeds to junior creditors and the debtor; and
- (3) the secured party’s right to retain the collateral (that is, foreclosure).

It would not necessarily be easy to find a statutory formula that would accomplish this but we think that it would not be impossible.

11.45 However, we think such an approach is likely to be unsatisfactory. Either the legislation would have to limit very severely the ‘security’ rules that should apply to quasi-securities, in which case the limits will seem arbitrary; or, if it is in broader terms, it is likely to cause considerable uncertainty. In our view it would be better to apply none of the security rules other than the requirement of notice-filing and, where relevant, those of priority, until a full restatement can be prepared setting out which rules apply in what circumstances.

11.46 We therefore propose that, as a temporary measure only, the scheme for replacing registration of company charges by notice-filing of both charges and the quasi-security devices we have indicated should not contain provisions dealing with the creation and enforcement of security interests. It could then be brought into force by Regulations made under any proposed Companies Act. However, a restatement of relevant rules, setting out clearly what these are and the extent to which they apply to each kind of security interest should be prepared for subsequent enactment, preferably with the extension of the notice-filing scheme to non-corporate debtors that we proposed in Part X.⁷⁵

11.47 **We ask consultees whether they agree with our provisional conclusions that:**

- (1) it is very desirable that there be a restatement of the law on the creation of security interests, the rights of the parties and enforcement of security interests, that would set out the extent to**

⁷⁵ See above, para 10.58.

which such rules should apply to each kind of security interest (including quasi-securities); but that

- (2) as an interim measure, the notice-filing scheme proposed earlier for security interests (including quasi-securities) created by companies should be introduced without any provision that quasi-securities are to be subjected to the rules governing traditional security instruments.**

Alternatively, do consultees consider either that the Regulations for company charges should include such a restatement, or that they should include (for title-retention transactions only) a clause stating that such transactions should be treated 'as if' they were true securities?

PART XII

LIST OF PROVISIONAL PROPOSALS AND CONSULTATION QUESTIONS

- 12.1 We set out below a summary of our provisional proposals and questions on which we invite the views of consultees. We would be grateful for comments not only on the matters specifically listed below, but also on any other points raised by this Consultation Paper. It would be very helpful if, when responding, consultees could indicate either the paragraph of the summary that follows to which their remarks relate, or the paragraph of this Consultation Paper in which the issue was originally raised.

PART III - THE NEED FOR REFORM OF THE COMPANY CHARGES REGISTRATION SCHEME

- 12.2 We ask whether consultees agree with the criticisms we have made of the current registration scheme, and, where they do not so agree, we ask them to explain why. (Paragraph 3.48.)

PART IV - NOTICE-FILING FOR COMPANY CHARGES

Scope of the notice-filing scheme

- 12.3 We provisionally propose leaving possessory securities out of the scope of the notice-filing system, save where the creditor's possession is constructive and results from the debtor attorning to the creditor. We invite views on whether a pledge of goods that subsequently are delivered to the debtor under a trust receipt should cease to be perfected if the debtor remains in possession of the goods for more than 15 days. (Paragraph 4.17.)
- 12.4 We propose that notice-filing should not apply to security created by operation of the law. (Paragraph 4.18.)

The financing statement

- 12.5 We provisionally propose that under a notice-filing system for company charges a financing statement should contain at least:
- (1) the names of the debtor and secured party (although we ask consultees for their views on whether the creditor should be identified at all);
 - (2) the Companies House registration number of the debtor and, where appropriate, the secured party;
 - (3) a brief description of the secured property, including, where appropriate, an indication that the proceeds of the secured property are included (we ask consultees for their views regarding the level of detail to be given in order to identify the secured property). (Paragraph 4.29.)
- 12.6 We would be grateful for the views of consultees (particularly from those who have experience of using notice-filing systems in other jurisdictions) on any matters which they think should be included in the required particulars in addition to those we have discussed. (Paragraph 4.28.)

- 12.7 We provisionally recommend that any register under a notice-filing system should be operated on an electronic basis. We would welcome the views of consultees as to the practical and economic impact that operating an electronic system would have. (Paragraph 4.34.)
- 12.8 We would welcome consultees' views on our provisional proposals to allow for estoppel in relation to seriously misleading (whether intentionally or not) and/or spuriously filed financing statements. We also ask whether consultees think that there should be a provision to allow the awarding of damages where loss has been caused by the provision of false information. (Paragraph 4.46.)
- 12.9 We would welcome consultees' views on whether there should be criminal sanctions relating to the provision of false particulars or other information. (Paragraph 4.47.)
- 12.10 We welcome the views of consultees on whether a person must actually have been misled in order for an error to be seriously misleading, and whether that person should actually have been prejudiced by such an error. (Paragraph 4.49.)
- 12.11 We provisionally consider that the absence of a conclusive certificate is unlikely to deter lenders. (Paragraph 4.50.)

The consequences of not filing

- 12.12 We ask consultees whether they agree with our provisional view that there should not be a criminal sanction for failing to file a financing statement (in other words, that participation in the system should be voluntary). (Paragraph 4.54.)
- 12.13 We are provisionally of the view that the effect of a failure to file should be invalidity against an administrator and liquidator, and a loss of priority against a subsequent secured creditor who files first. We would welcome consultees' views. (Paragraph 4.58.)

Supply of information to other parties

- 12.14 We are provisionally of the view that the debtor company, and anyone else with an existing interest in the company's property, should be entitled to obtain further information about the security agreement. We have no view as to whether this should include a copy of the agreement itself, or just a more detailed summary of the information it contains, and we would welcome the views of consultees on the question. (Paragraph 4.63.)
- 12.15 We welcome consultees' views on whether an error made in the details by a person who is responding to a request for information should give rise to an estoppel. (Paragraph 4.65.)
- 12.16 We welcome consultees' views on whether the requirement to register all charges on the company's own register should be abolished. (Paragraph 4.71.)
- 12.17 We provisionally propose that there should not be a general requirement to provide further information or a copy of the security agreement to a member of the public upon request, but we would welcome consultees' views. (Paragraph 4.73.)

Time allowed for filing

- 12.18 We provisionally propose that a creditor should not be required to file within a certain time after creation of the security interest. (Paragraph 4.75.)
- 12.19 We provisionally propose that there be no time limit for filing a financing statement, although we invite consultees' views on whether 'last-minute filing' by creditors or connected persons should be permitted, and if so what cut-off period is appropriate. (Paragraph 4.80.)

Duration of filing

- 12.20 We provisionally propose that a registration be effective for the period indicated on the financing statement. (Paragraph 4.86.)

Changes to the information filed

- 12.21 We provisionally propose provisions allowing the debtor to demand that a change in an inaccurate financing statement be made, or an outdated financing statement be removed, by the secured party within a certain period, failing which the debtor may make the change. (Paragraph 4.92.)
- 12.22 We ask whether consultees agree with us that there should be provision for the original financing statement to be amended following the transfer of a creditor's interest over a registrable security interest. (Paragraph 4.96.)
- 12.23 We would welcome the views of consultees as to whether they think that, on a transfer by the debtor of its interest, the creditor should be given a short period from the transfer (or, if it had not consented to the transfer, from when it knows the facts) in which to file against the transferee. (Paragraph 4.100.)

Should the financing statement be signed?

- 12.24 We ask whether consultees agree with our provisional proposal that the signature of both the chargor and chargee on the financing statement should not be required but that:
- (1) the person filing should be required to confirm that the filing is being made with the consent of the chargor;
 - (2) there should be a mechanism to ensure that the chargor is aware of the filing after it has been made; and
 - (3) there should be a criminal sanction on a party who deliberately (or possibly recklessly) provides false or inaccurate information.

We also ask consultees whether damages should be available for a party that has suffered as a result of this (and, if so, whether this should depend on proof of negligence). (Paragraph 4.108.)

Advance filing and multiple transactions

- 12.25 We provisionally propose that it should be possible to file a financing statement before or after a security agreement is made. (Paragraph 4.110.)

- 12.26 We provisionally propose that, where no security agreement exists, the debtor, or any person with an interest in the charged property, should be able to give a written demand to the secured creditor to change a filed financing statement, failing which the person making the demand can make the change itself. (Paragraph 4.113.)
- 12.27 We provisionally propose not to require an indication of whether the charge has actually been created at the time of filing, but we would welcome the views of consultees on this point. (Paragraph 4.115.)
- 12.28 We ask consultees whether they agree that an important advantage of notice-filing would be that it would permit a single filing to cover a series of security transactions between the same parties. (Paragraph 4.117.)

Floating charges

- 12.29 Do consultees agree with our provisional views that a floating charge should no longer give a company authority to create subsequent fixed charges that automatically get priority over an earlier floating charge; and that the financing statement should indicate whether the charge is fixed or floating (or both)? (Paragraph 4.142.)
- 12.30 We ask consultees whether they agree with our provisional recommendation:
- (1) not to require inclusion of the nature of the charge and/or whether there is an automatic crystallisation clause in the financing statement, and
 - (2) to register the fact that a floating charge has crystallised pursuant to an automatic crystallisation clause. (Paragraph 4.144.)

Priorities

- 12.31 We ask consultees whether they agree that, if our provisional proposal that charges over assets such as shares and other investment securities that are 'controlled' by the secured party (or in the case of certificated shares, if the certificates are in the secured party's possession) should be treated as perfected without the need for registration, priority between registrable and unregistrable charges should depend on the date of perfection. (Paragraph 4.148.)
- 12.32 We provisionally propose that priority as between competing charges, each of which is registrable but neither of which has been registered, should be determined by the date of attachment. (Paragraph 4.149.)
- 12.33 We provisionally propose not to make the registration of a subordination agreement necessary for the agreement to be effective, and ask whether registration of a subordination agreement should be made possible. (Paragraph 4.150.)
- 12.34 Where the security agreement has been changed but the changes not yet recorded in the financing statement we provisionally think that the priority position of the security interest should not be altered. (Paragraph 4.151.)
- 12.35 We provisionally propose to allow the tacking of further advances where these are contemplated by the security agreement and are covered by the financing statement. (Paragraph 4.154.)

- 12.36 We provisionally propose that a purchase-money interest should have priority over an already registered non-purchase-money security. (Paragraph 4.160.)
- 12.37 We invite views as to whether in the case of inventory the holder of the purchase-money interest should have to give notice to other secured parties who have filed in order to preserve the priority of the purchase-money interest. (Paragraph 4.162.)

Proceeds

- 12.38 We ask whether consultees agree with our provisional views that:
- (1) where an asset subject to a security is dealt with or otherwise gives rise to proceeds, the security should extend to the proceeds;
 - (2) the proceeds should be treated as continuously perfected (and therefore having the priority of the original financing statement) where there was a financing statement covering the original secured asset and either
 - (a) the proceeds are money or similar property (and we ask consultees whether they have views as to the extent of this provision); or
 - (b) the proceeds would either come within the description of the property originally subject to the security, or the financing statement covers proceeds of the original property;
- and
- (3) where the proceeds are not continuously perfected, they should be temporarily perfected for a short period, allowing a new financing statement to be filed in respect of the proceeds, in which case, priority will be that of the original financing statement. (Paragraph 4.172.)

Purchasers

- 12.39 We provisionally recommend that such an unregistered charge should be ineffective against any person who for value acquires an interest in or right over property subject to the charge and we consider that questions of actual knowledge should be as irrelevant for this purpose as they are for purposes of priority. (Paragraph 4.177.)
- 12.40 We invite comment from consultees on whether a buyer of capital equipment should be expected to search the register. (Paragraph 4.182.)
- 12.41 We invite views on whether a consumer who buys goods (other than stock-in-trade, which is covered above) that are subject to a registered charge should take free of the charge unless she knows of the charge. (Paragraph 4.183.)
- 12.42 We provisionally propose that a buyer should not be bound by security interests in goods (other than those that are uniquely identifiable) created by prior owners. (Paragraph 4.185.)
- 12.43 Where a financing statement identified an asset by serial number or other identifying mark, we would provisionally propose an exception to our previous proposal that the purchaser should not be bound by security interests created by prior owners. We invite consultees' views. (Paragraph 4.188.)

- 12.44 We provisionally propose that persons acquiring ownership or possession of goods in the ordinary course of business under a hire-purchase agreement, lease, contract for work and materials or contract of barter should take free from a security interest in the same circumstances as buyers. (Paragraph 4.189.)
- 12.45 We ask whether consultees agree with our provisional view that the validity of charges that should be registrable in specialist registers should be determined by the rules of that register. (Paragraph 4.191.)
- 12.46 We ask whether consultees agree with our provisional view that a purchaser of investment securities should take free of the security unless she knows of it and that sale would be in breach of the agreement. (Paragraph 4.193.)
- 12.47 We ask whether consultees agree with our provisional view that a factor or other person purchasing book debts should be expected to check the register and should not be protected merely because it does not know that the subsequent sale is in breach of the agreement. (Paragraph 4.196.)
- 12.48 We ask whether consultees agree with our provisional view that the priority rules of a notice-filing system should not disturb the protection currently given to a holder in due course. (Paragraph 4.198.)

Charges registrable in specialist registers

- 12.49 We invite views from consultees on our provisional proposal to exclude all charges registrable in a specialist register from the notice-filing system. We would welcome views on whether the specialist registry should forward information about charges created by a company to the Company Charges Register for public notice. (Paragraph 4.211.)

Other issues raised by a new system

- 12.50 We ask whether consultees agree with our provisional view that a printed search result should be receivable in evidence as prima facie proof of its contents, including the date of registration and the order of registration as indicated by the registration number. (Paragraph 4.214.)
- 12.51 We ask consultees whether the registrar should be liable in damages for breach of any duty or obligation imposed by the notice-filing system, to the extent of reasonably foreseeable loss or damage caused to those who can reasonably be expected to rely on performance of the duty or obligation. (Paragraph 4.219.)
- 12.52 We ask consultees for their views on whether there should be a provision to the effect that a person failing to discharge any duty or obligation imposed by the notice-filing system should be liable for reasonably foreseeable loss or damage caused to those who can reasonably be expected to rely on performance of the duty or obligation. (Paragraph 4.221.)
- 12.53 We welcome consultees' views on whether to transfer all existing registrations to a new Company Charges Register or whether to keep the existing information on the present register. We ask whether consultees agree that there is no need to re-register previously registered charges. (Paragraph 4.232.)

Conclusion on notice-filing

- 12.54 We ask consultees whether they agree with our provisional proposal that a system of notice-filing should replace the current registration scheme for company charges. It would be particularly helpful if consultees could explain the practical and economic impact they envisage our provisional proposals having. We also ask consultees whether there are any additional matters that they consider should be dealt with as part of a notice-filing system applicable to company charges. (Paragraph 4.236.)

PART V - REGISTRABLE CHARGES

- 12.55 Our provisional view is that a notice-filing system applicable to charges should make all charges registrable unless excluded, rather than identifying only those charges that are to be registrable. (Paragraph 5.6.)

Proposed exceptions

- 12.56 We provisionally propose that the question of whether a retention of title clause creates a registrable charge should be left to the courts. (Paragraph 5.12.)
- 12.57 We ask consultees whether they agree with our provisional view that charges given to secure the issue of debentures should not be specifically excluded from being registrable, even if in practice this method of raising capital is rarely used. (Paragraph 5.15.)
- 12.58 We provisionally propose that the deposit of a negotiable instrument by way of security to secure the payment of a book debt should continue to be exempt from registration. (Paragraph 5.17.)
- 12.59 We provisionally propose that all charges over shares, and charges over rights to dividends when this forms part of a charge over the shares concerned, should be treated as perfected if the secured party has possession of the certificate or has control by being registered as owner. (Paragraph 5.28.)
- 12.60 We invite the views of consultees on whether, under a notice-filing system, it should be possible to perfect a charge over shares by filing a financing statement as an alternative to either taking possession of the certificates or taking control. If so, should a charge protected by possession or control have priority over one protected by even an earlier filing? (Paragraph 5.35.)
- 12.61 We provisionally propose that charges over insurance policies should in general be registrable. (Paragraph 5.39.)
- 12.62 We provisionally propose that neither charges on goods nor on insurance policies on goods should be registrable where the goods are abroad or at sea, or are imported goods before they are delivered to a buyer or deposited in a warehouse, factory or store. (Paragraph 5.40.)
- 12.63 We would therefore propose to make it clear that contractual liens over sub-freights are not charges and therefore are not registrable. (Paragraph 5.42.)
- 12.64 We provisionally propose that a charge over a bank account in favour of the bank itself should be possible only if the bank takes 'control' of the account; and that it should be exempt from registration. (Paragraph 5.51.)

- 12.65 We provisionally propose that a charge over a bank account in favour of a party other than the bank itself should also be possible only if the third party takes 'control' of the account; and that it too should be exempt from registration. (Paragraph 5.52.)
- 12.66 We ask consultees whether they agree that:
- (1) charges over money obligations, including contingent obligations, ought to be made registrable; but that
 - (2) 'charge-backs' and charges over bank accounts should be possible only if the account is under the control of the secured party. The charge should then be treated as perfected without filing. (Paragraph 5.53.)

Charges created by trustee companies and 'market charges'

- 12.67 It is our provisional view that charges created by a trustee company over trust property should be registrable against the trustee company unless the charge is on the list of charges that are exempt from filing. (Paragraph 5.65.)
- 12.68 We provisionally propose that if the chargor company is acting as a trustee, that should be entered on the financing statement. We invite views on whether, if the trustee company is charging the assets at the direction of a corporate beneficiary, the beneficiary should be identified on the financing statement. (Paragraph 5.75.)
- 12.69 It is our provisional view that it is not necessary to state in the financing statement whether a charge is a "market charge" but we would welcome the views of consultees. (Paragraph 5.77.)
- 12.70 We provisionally propose that if (contrary to our main provisional recommendation) Lloyds' trust deeds are to be brought within the notice-filing system, each corporate member should be obliged only to file a financing statement listing the members' and premium trusts that it has created; and, for the third class of trust, describing (in the general terms required for any financing statement) the assets that the standard form trust deeds require to be held in trust for each class of business, and the names of the trustees. It should state that the trust is for the purposes of insurance at Lloyds. We invite consultees' views. (Paragraph 5.86.)

Charges by overseas companies and charges over assets in other jurisdictions

- 12.71 We would therefore provisionally propose that any notice-filing system should apply to those overseas companies that have registered their place of business, whether they ought to have done so or not. (Paragraph 5.93.)
- 12.72 We provisionally propose that a charge that has been created by an overseas company on property that was then outside the United Kingdom, but which is subsequently brought into the United Kingdom, should also be registrable. (Paragraph 5.94.)
- 12.73 It is our tentative view that a charge created by a company registered in England and Wales over assets in Scotland should be registrable in England and Wales if the same charge would be registrable were the assets in England. However we invite views. Before commenting on this point, consultees may want to consider the

reciprocal question of charges created by companies registered in Scotland over property in England and Wales. (Paragraph 5.113.)

- 12.74 We tentatively propose that charges created by Scots companies over assets in England and Wales should continue not to be registrable in England and Wales, but we invite views. (Paragraph 5.120.)

Unregistered companies

- 12.75 We provisionally propose that charges created by unregistered companies should be within the notice-filing scheme we have proposed. (Paragraph 5.122.)

PART VII - A FUNCTIONAL APPROACH TO SECURITY

- 12.76 We ask consultees whether they agree with our provisional view that if there is to be a functionally-based notice-filing system, the approach taken by the overseas systems as to the meaning of 'security interest' should be followed, so as to apply, in general, to transactions that secure payment or performance of an obligation. (Paragraph 7.20.)

Common forms of quasi-security

- 12.77 We ask whether consultees agree with our provisional proposal that transactions of hire-purchase and conditional sale should be registrable against the hirer or buyer company. (Paragraph 7.23.)
- 12.78 We provisionally agree that retention of title clauses should be registrable. (Paragraph 7.24.)
- 12.79 We provisionally agree that the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller should not be regarded as a security interest, unless the parties have evidenced an intention otherwise. (Paragraph 7.26.)
- 12.80 We ask consultees for their views on whether a consignment should be registrable under a functional system only if it secures payment or performance of an obligation, or whether it should be registrable whatever its purpose. Should a consignment be expressly stated to be a purchase-money security interest? (Paragraph 7.29.)
- 12.81 We ask consultees for their views on whether all leases should be registrable (if over a certain minimum period) or whether only those leases that perform a security function should be registrable. (Paragraph 7.34.)
- 12.82 We ask whether consultees agree with our provisional views:
- (1) that sales of receivables, for example under a factoring or block discounting agreement or as part of a securitisation, should be registrable; but
 - (2) that there should be an exception to the requirement to register when book debts are sold as part of a larger transaction (such as the overall sale of the business), and

- (3) that there should be an exception also in the case of negotiable instruments. (Paragraph 7.45.)

Quasi-securities that should not be registrable

- 12.83 It is our provisional conclusion that transfers of shares and investment securities under a 'repo' should not be registrable. (Paragraph 7.50.)
- 12.84 We ask whether consultees agree with our provisional proposal that rights of set-off should be excluded from the need to register under a notice-filing system. (Paragraph 7.52.)
- 12.85 We ask whether consultees agree with our provisional view that special purpose trusts should be outside the requirement to register (either because no security arises, or alternatively any security arises through operation of law). (Paragraph 7.54.)

Purchase-money security interests

- 12.86 We ask consultees whether secured parties who have given new value should, to the extent of that value, be given priority over existing perfected security interests. (Paragraph 7.74.)

Other issues

- 12.87 We ask consultees whether they think that previous security interests (including quasi-security) that would be registrable under a notice-filing system, but which are currently not registrable ought to be registered within a certain period following the commencement of any new notice-filing system. (Paragraph 7.80.)
- 12.88 We would welcome the views of consultees on whether, if the company's own register of charges is to be kept, it should include registrable quasi-security interests. (Paragraph 7.82.)
- 12.89 We ask whether consultees agree with our provisional view that there should be no exclusion from the need to register in the case of small transactions. (Paragraph 7.85.)

PART IX - SECURITY INTERESTS CREATED BY NON-CORPORATE DEBTORS: THE NEED FOR REFORM

- 12.90 We ask whether consultees agree that the existing law applying to the registration of security and quasi-security interests by individuals and unincorporated businesses is in need of reform because it:
 - (1) is unnecessarily complex;
 - (2) is potentially incompatible with the ECHR;
 - (3) makes it difficult for businesses and individuals to create fixed charges;
 - (4) makes it impossible for unincorporated businesses to create floating charges; and

- (5) fails to give adequate public notice of security and quasi-security interests created by unincorporated debtors.

Where they do not so agree, we ask them to explain why. (Paragraph 9.19.)

PART X - EXTENDING THE NOTICE-FILING SYSTEM

NON-CORPORATE BUSINESS DEBTORS

Floating charges

- 12.91 We ask consultees whether they agree with our provisional view that non-corporate business debtors (comprising sole traders, partnerships and other unincorporated bodies) should be able to create a floating charge or 'floating lien'. If they do agree with us, we ask them whether there are any safeguards that they would like to see in place (such as not permitting a floating charge to extend to property or assets not used or acquired for use in connection with the debtor's business, trade or profession). (Paragraph 10.7.)

Types of security interest that should be registrable

- 12.92 We provisionally propose that the same types of charge should be registrable when created by unincorporated businesses as when created by companies. (Paragraph 10.8.)
- 12.93 We provisionally propose that quasi-security interests created by unincorporated businesses should be registrable. (Paragraph 10.9.)
- 12.94 We provisionally propose that charges and quasi-security interests that, under our earlier proposals, would not be registrable when created by companies should equally be exempt when created by an unincorporated business. (Paragraph 10.10.)
- 12.95 We ask consultees whether they think a system of notice-filing that covers all forms of debtor should replace the current law in respect of agricultural charges. (Paragraph 10.17.)

Conclusion

- 12.96 We ask consultees whether they agree with our provisional view:
 - (1) that the notice-filing system that we proposed for companies should be extended to apply to security interests created by non-corporate business debtors such as sole traders, partnerships and other unincorporated businesses;
 - (2) that, as is proposed for companies, the system should take a functional approach to what is registrable, so that quasi-securities are brought within it; and
 - (3) the same rules on priority apply, with preference being given to purchase-money interests. (Paragraph 10.21.)

CONSUMERS

Security interests over after-acquired property

- 12.97 We ask whether consultees agree with our provisional view that consumers should not be permitted to grant security over their after-acquired property, except where the security is a purchase-money interest created shortly after the goods were acquired. (Paragraph 10.26.)

Security interests over existing property

- 12.98 We ask consultees whether consumers should be able to create security interests over their existing personal property. If consultees do consider that consumers should be able to create such security interests, what safeguards (if any) would they wish to see? (Paragraph 10.32.)

Consumer security interests and notice-filing

- 12.99 We ask consultees whether they think it better that:
- (1) security interests over consumer goods should be treated as valid in the event of the consumer's insolvency without filing, which would not be possible, with concomitant rules that a purchaser would be bound by the security interest only if he had actual knowledge of it

or

 - (2) security interests over consumer goods should be fileable, so that
 - (a) an unfiled interest should not be valid in the event of the consumer's insolvency;
 - (b) an unfiled interest should not be binding on a subsequent purchaser unless she knew of it; and
 - (c) a filed interest should bind any purchaser.

We also ask whether, under (2) above, private purchasers (as opposed to purchasers who are in the relevant trade) who do not know of the security interest should take free of it even if it has been filed.

We have a preference for permitting filing and treating a filed interest as good against trade purchasers but not private purchasers (that is, a similar rule to that used for motor vehicles). (Paragraph 10.50.)

- 12.100 We provisionally propose that:
- (1) security interests over motor vehicles be registrable in the same way as other security interests, whether the debtor is a company, unincorporated business or a consumer;
 - (2) an unfiled interest should not be valid in the event of the debtor's insolvency;
 - (3) an unfiled interest should not be binding on any purchaser, whether or not she knew of it;

- (4) a filed interest should be binding on a trade purchaser (or subsequent secured creditor, who will take subject to it); but
- (5) a filed interest should not be binding on a person who buys the vehicle for private use unless she knows of the security interest. (Paragraph 10.54.)

Small transactions

- 12.101 We invite consultees' views on whether the filing of small consumer transactions should be prevented. Alternatively, if consumer security interests should be filed, should the system provide that in the event of the consumer's insolvency purchasers of goods worth less than a certain limit will take free of the security interest unless they knew of it? (Paragraph 10.58.)

Conclusion on security interests created by non-corporate debtors

- 12.102 Our provisional conclusion is therefore that the notice-filing system we provisionally proposed for security interests granted by companies should be extended to cover security interests granted by non-corporate debtors, although there should be appropriate protection for consumers. (Paragraph 10.61.)

PART XI - RESTATING THE LAW OF SECURITY

- 12.103 We ask consultees whether they agree with our provisional conclusions that:
- (1) it is very desirable that there be a restatement of the law on the creation of security interests, the rights of the parties and enforcement of security interests, that would set out the extent to which such rules should apply to each kind of security interest (including quasi-securities); but that
 - (2) as an interim measure, the notice-filing scheme proposed earlier for security interests (including quasi-securities) created by companies should be introduced without any provision that quasi-securities are to be subjected to the rules governing traditional security instruments.

Alternatively, do consultees consider either that the Regulations for company charges should include such a restatement, or that they should include (for title-retention transactions only) a clause stating that such transactions should be treated 'as if' they were true securities? (Paragraph 11.47.)

APPENDIX A - AMENDING THE CURRENT REGISTRATION SCHEME FOR COMPANY CHARGES

Please note that the provisional proposals made in this Appendix are only intended to apply if our main proposal for a notice-filing system is rejected.

The particulars to be delivered to the registrar

- 12.104 We provisionally propose that the particulars required should not include:
- (1) whether the charge is in respect of a monetary obligation (together with the amount secured) or other variable obligation; or
 - (2) whether a floating charge includes an automatic crystallisation clause.

We consider that there should be provision for the registration of a crystallisation that has occurred as the result of an 'automatic' clause. We ask for views on the inclusion of statements as to whether a charge is a market charge. We propose that if the chargor is acting as a trustee, that should be indicated as one of the required particulars. (Paragraph A.11.)

- 12.105 We provisionally propose that a negative pledge clause be listed as a registrable particular. (Paragraph A.12.)
- 12.106 We would welcome views on whether registration of a negative pledge clause should be voluntary or compulsory. (Paragraph A.13.)
- 12.107 We provisionally think that it would not be essential to have details of commission allowance or discount. (Paragraph A.14.)
- 12.108 It is our provisional proposal that the particulars need not be signed. (Paragraph A.15.)

Defects in particulars, the registrar's certificate and submission of the charge instrument

- 12.109 We ask whether consultees agree with our provisional proposal that, if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing:
- (1) defects in the particulars submitted would not render the registration invalid;
 - (2) it should not be necessary to submit either the original or a copy of the charge document with the particulars;
 - (3) the charge would only be valid for the property or classes of property included in both the particulars and the charging instrument; and
 - (4) there should be civil liability on the applicant for loss suffered as a result of any inaccuracy in the particulars. (Paragraph A.27.)

The period for registration and late registration

- 12.110 Do consultees agree with our provisional view that if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing:
- (1) registration after the 21-day period should be possible without a court order, provided that at the time of registration there had been neither the presentation of a winding up petition nor the convening of a meeting to pass a resolution for a creditors' voluntary winding up petition;
 - (2) a late registered charge should be void against the liquidator, administrator and other creditors where it is registered following the onset of insolvency; and
 - (3) that there should be a provision to prevent 'last-minute registration' by connected persons? (Paragraph A.34.)

The effect of non-registration and the sanctions for failure to register

- 12.111 We provisionally propose that the criminal sanction for failure to register a charge created by the company should be abolished; that the sanction of the secured sum being repayable on demand in the event of a failure to correctly register the charge should also be abolished; but that chargees should be free to contract that the money should be repayable in the event of non-registration. (Paragraph A.36.)

Alterations, satisfaction or release and assignment of charge

- 12.112 We provisionally propose that there should be no obligation to file particulars of alterations; but there should be provision for the chargor to require registration of a memorandum of satisfaction, or of a note that certain assets have been released from the charge. (Paragraph A.38.)
- 12.113 We provisionally propose that there should be a mechanism to ensure that the debtor can identify a person to whom the creditor has assigned its interest, but that there should be no criminal penalty for failure to provide details. (Paragraph A.39.)

Priorities and provisional registration

- 12.114 We ask consultees whether they agree that, even if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing, a priority scheme should be introduced based on the time of receipt for registration by the registrar. (Paragraph A.42.)
- 12.115 We consider that if there are to be changes to move to a system of priority by date of registration and to permit advance filing, this should be done by adopting a system of notice-filing. (Paragraph A.45.)

The position of purchasers of property subject to a charge

- 12.116 We provisionally propose that an unregistered charge should be void against a purchaser unless the purchaser had actual knowledge of the charge. (Paragraph A.48.)
- 12.117 In relation to the position of purchasers of property that is subject to a charge, we provisionally propose that amendments to the current scheme should be on the same lines as we proposed earlier for notice filing, and we ask the same question, as in paragraphs 4.173-4.198. (Paragraph A.49.)

The company's own register

- 12.118 We provisionally propose that the company's own register of charges be abolished. (Paragraph A.50.)

The register of company charges

- 12.119 We provisionally propose that any improvement to the existing scheme should give the registrar discretion as to the form of the Companies Register. (Paragraph A.52.)

Conclusions

- 12.120 It is our provisional but firm view that the current scheme for registration of company charges should be replaced by the scheme of notice-filing described in Part IV rather than being amended in the ways that we have outlined in Appendix A. (Paragraph A.53.)

APPENDIX B - A RESTATEMENT OF THE LAW OF SECURITY

Effectiveness of the security agreement

- 12.121 We provisionally think that it would be sensible to require a written agreement signed by the debtor for all non-possessory security interests. (Paragraph B.6.)
- 12.122 We think that a statement that a sufficient description of the property is required should be included in any restatement. (Paragraph B.8)
- 12.123 We think that attachment is so central to the notion of security that it would be worth including such a restatement of the rules on attachment. We ask whether, if under the security interest the debtor remains free to dispose of assets in the ordinary course of business, judgment creditors should be able (as at present) to seize goods before the charge has 'crystallised'. (Paragraph B.11.)

Rights and remedies on default

- 12.124 We ask whether it would be useful to include rules on when the secured party can require payment. (Paragraph B.15.)
- 12.125 We provisionally propose that there should be a provision to enable the secured party to take possession of collateral that is 'at risk'. (Paragraph B.18.)
- 12.126 The provisions as to possession or enforcement seem to state an obvious principle but one that should be included in a restatement. The provisions as to seizure and disposal may be useful. We would welcome the views of consultees. (Paragraph B.24.)
- 12.127 We ask consultees whether a restatement should set out the powers and duties of receivers, and the powers of the court, more fully than does the present legislation. (Paragraph B.33.)
- 12.128 We think that the provisions relating to the power of sale set out above are so central to the remedies of the secured party that they should be included in a restatement, and suggest that each of the points described above should be covered. (Paragraph B.46.)
- 12.129 Any restatement forming part of a system that included quasi-securities should clearly set out the rights and duties in respect of surplus. (Paragraph B.50.)
- 12.130 We think that provisions on statement of account and the payment of surplus into court would be useful. (Paragraph B.53.)
- 12.131 We think that foreclosure is such a central topic that it should be covered in a restatement. (Paragraph B.57.)
- 12.132 We agree that the right of redemption should be included in any restatement. (Paragraph B.60.)

- 12.133 We invite views on whether a restatement should include a right for the debtor to reinstate the security. (Paragraph B.63.)
- 12.134 We ask consultees whether it is desirable to set out the powers of the court along the lines of the provisions in the Saskatchewan and New Zealand PPSAs. (Paragraph B.67.)
- 12.135 We ask whether provisions setting out the measure of the secured party's damages when collateral is seized by a third party would be useful in a restatement. (Paragraph B.68.)

Fixtures, crops, accessions, processed and commingled goods

- 12.136 We ask whether a restatement of the law of security (which would be largely concerned with personal property) should set out rules on fixtures, accessions and processed or commingled goods. (Paragraph B.77.)

General and miscellaneous provisions

- 12.137 We ask whether the right to transfer ownership of the collateral should be included in a restatement. (Paragraph B.81.)
- 12.138 We ask whether a provision preventing exclusion or limitation of liability is needed. (Paragraph B.83.)
- 12.139 We ask whether consultees share our view that special rules on service of documents would not be necessary in a restatement. (Paragraph B.85.)

GENERAL CONSULTATION QUESTION

- 12.140 What practical and economic impact, in financial and non-financial terms, do consultees think our provisional proposals would have?

APPENDIX A

AMENDING THE CURRENT REGISTRATION SCHEME FOR COMPANY CHARGES

INTRODUCTION

- A.1 In Part IV we briefly listed a number of recommendations that the Steering Group made as an alternative to a notice-filing system. As we, like the Steering Group, are provisionally in favour of a notice-filing system, we did not consider amendments to the current scheme in any detail.
- A.2 Amendment of the current scheme was the initial approach of the Steering Group. Its Final Report refers to this approach as an alternative should its (by then) preferred option of notice-filing be rejected.¹ The Diamond report also made a number of proposals for improving the existing scheme, in this case intended as a temporary measure pending implementation of the wider proposed notice-filing system.² Some of the proposals found their way into the unimplemented provisions of the Companies Act 1989.
- A.3 In this Part we consider the amendments proposed by the Steering Group and some proposed in the Diamond report that were not referred to by the Steering Group. We consider whether the aims of a system of registration of company charges, and the criticisms of the current system that we made in Part III can be met by this less radical alternative. At the end we explain our conclusion that to introduce the various amendments would be a less satisfactory approach than the notice-filing system we discussed in Part IV. The final decision involves considering the desirability of the changes that the more radical system would bring but that would not result from simply 'improving' the present scheme.
- A.4 The Steering Group's consultation document asked a considerable number of questions on possible improvements and received a very full response. We have been able to draw on its work, and the responses, to a very helpful extent. They enable us, where a clear consensus emerged, to be rather more certain about some of the improvements to the present scheme proposed than we might otherwise have been. Nonetheless we have decided that it would only be right to give consultees (who may include persons and organisations that did not respond to the Steering Group's consultation document) the chance to tell us their views on all the questions, not just on those on which no consensus emerged or where we believe that there is reason to consider the matter further.

¹ Although a majority of those who responded to the question agreed that further work should be commissioned to examine notice-filing, the substantive responses were made in respect of the proposals contained in the consultation document. Some of the points are considered in Final Report paras 12.70-12.82, and para 12.83 states: "In all other respects ... our proposals apply whether it is decided to improve the present system or to replace it with notice-filing."

² See the Diamond report ch 20.

- A.5 Some of the proposals for improvement made by the Steering Group and in the Diamond report we can deal with briefly because we have already discussed the relevant topic in the context of notice-filing, and little adjustment needs to be made to apply the points made to amendment of the current scheme.

THE PARTICULARS TO BE DELIVERED TO THE REGISTRAR

- A.6 As we noted earlier, the particulars that have to be supplied to the registrar under the Companies Act 1985 are set out in secondary legislation.³ We saw that for registering a mortgage or charge, the requirements included the name and number of the company; the date of the creation of the charge; a description of the instrument (if any) creating or evidencing the charge; the amount secured by the charge; the names and addresses of the persons entitled to the charge; short particulars of all the property charged; details of the presenter; particulars as to any commission allowance or discount, and a signature of the company or the chargee.

- A.7 The Steering Group proposed a mandatory list of particulars to be sent to the registrar that was largely identical to the list it suggested for its proposed notice-filing system.⁴ The proposed list has much in common with the current list.⁵ The suggested additions are:

- (1) whether the chargor is acting as trustee of the property;
- (2) whether the charge is in respect of a monetary obligation and, if so, the amount secured, for example, whether 'all monies' or a specific figure or other variable obligation (although it should be noted that the amount secured is a current requirement); and
- (3) whether there is an automatic crystallisation clause.

- A.8 In addition, the Steering Group suggested that there should be provision voluntarily to include whether the charge is subject to a negative pledge, and whether the charge is a market charge within section 173 of the Companies Act 1989.

³ See the Companies (Forms) Regulations 1985, SI 1985 No 854 (which provides for the use of a series of forms) and see above, para 2.27.

⁴ Final Report para 12.79. The Steering Group proposed the particulars should comprise the chargor's name and Companies House registration number; whether the chargor is acting as a trustee; the chargee's name and, if a registered company, its Companies House registration number; the date of creation of the charge; the property or classes of property charged; the nature of the charge (ie, whether it is a fixed or floating charge); whether the charge is in respect of a monetary obligation, and, if so, the amount secured; and whether there is an automatic crystallisation clause. Cf *ibid*, para 12.28. The date of the creation of the charge was not on the list for notice-filing, since it is not of particular importance under that system. Conversely, the list above does not include whether the charge had already been created or who was registering the charge. The latter two are omitted because, under the current scheme (as opposed to the notice-filing system), there is no provision for registration to take place before a charge has been created (although see further below, para 4.43).

⁵ Common points are: the chargor's name and Companies House registration number; the chargee's name; the date of creation of the charge; the property or classes of property charged, and the amount secured.

- A.9 Particulars that are required currently but that are omitted from the Steering Group's list of proposals are those relating to any commission allowance or discount, details of the presentor and a signature of the company or the chargee.
- A.10 We will discuss here only the additions and omissions. We discussed most of the proposed listed particulars when we considered the contents of a financing statement in Part IV,⁶ and insofar as they apply to a registration scheme, we would make the same points here. Thus we do not think it useful to state whether the charge is in respect of a monetary obligation (together with the amount secured) or other variable obligation. That information is, in the case of an 'all monies' clause, incomplete and in other cases likely to be out of date.⁷ Nor do we think it useful to include notice of an automatic crystallisation clause; instead, we think there should be provision for the registration of a crystallisation that has occurred only as the result of an 'automatic' clause.⁸ One respondent to the Steering Group's consultation document suggested adding whether the charge was a market charge, and this was something that would have been allowed under the proposed amendments of the Companies Act 1989.⁹ We discussed this issue in Part V and asked for views on whether the particulars should be required to state whether a charge is a market charge.¹⁰ We also discussed the question of chargors who are acting as trustees and concluded that the financing statement should indicate whether the chargor is acting as trustee.¹¹
- A.11 **We therefore provisionally propose that the particulars required should not include:**

- (1) whether the charge is in respect of a monetary obligation (together with the amount secured) or other variable obligation; or**
- (2) whether a floating charge includes an automatic crystallisation clause.**

We consider that there should be provision for the registration of a crystallisation that has occurred as the result of an 'automatic' clause. We ask for views on the inclusion of statements as to whether a charge is a market charge. We propose that if the chargor is acting as a trustee, that should be indicated as one of the required particulars.

- A.12 The Steering Group suggested that there should be provision to allow voluntary registration of negative pledge clauses. When we considered notice-filing and floating charges we provisionally proposed that the new legislation should provide that a floating charge does not give the company authority to create subsequent

⁶ See above, paras 4.19-4.29.

⁷ See above, para 4.26.

⁸ See above, para 4.144.

⁹ The unimplemented Companies Act 1989, s 103 would have substituted a new Companies Act 1985, s 415(2)(b), allowing a market charge to be one of the prescribed particulars.

¹⁰ See above, para 5.77.

¹¹ See above, para 5.75.

security interests having priority to the floating charge.¹² This would preserve the floating charge's priority as from the date of filing. Under a scheme of amendment to the current system of registration, priority would not, of course, be from the date of filing; and to retain priority over subsequent fixed charges the floating charge-holder would need to include a negative pledge clause. We pointed out in Part II that this is not an infallible method. If subsequent creditors do not have actual knowledge of the negative pledge they will probably take free of it, as they will not be treated as having constructive notice of it even if it has been included among the particulars of the charge that are registered. This is because it seems that they will be fixed with constructive notice only of those matters that must be shown. It seems sensible to avoid this and therefore **we provisionally propose that a negative pledge clause be listed as a registrable particular.**

- A.13 We do not think it needs to be made compulsory to register such a clause (it is a matter for the floating charge-holder whether it wishes to make sure it will retain priority) provided that it is made clear that a voluntary registration will constitute constructive notice to other creditors.¹³ **However we would welcome views on whether registration of a negative pledge clause should be voluntary or compulsory.**
- A.14 As to the omissions, we are uncertain as to whether details of commission allowance or discount are regarded as important in practice, or whether it is essential to have the name, address and reference of the presenter. **We provisionally think that it would not be essential to have details of commission allowance or discount, but we have no strong view.**
- A.15 Should the particulars be signed? To require a signature, when what is required is only the signature of either the chargor or the chargee, seems to us to create an additional burden but to provide little benefit. If there is a question of whether the particulars were indeed filed by one of those parties or a person authorised to act on their behalf, the matter can be resolved as a question of fact and we suspect that the apparent signature will add little by way of evidence. It was thought in the Diamond report that a signature would be regarded as a formality, and it was not thought necessary to introduce any new rules as to signatures (accuracy being ensured by the effect of mistakes on a party's rights¹⁴).¹⁵ **It is our provisional proposal that the particulars need not be signed.**

DEFECTS IN PARTICULARS, THE REGISTRAR'S CERTIFICATE AND SUBMISSION OF THE CHARGE INSTRUMENT

- A.16 We have already noted the criticisms that the Steering Group, like the Jenkins report¹⁶ and the Diamond report before it, made of the present requirements that

¹² Or perhaps that a provision to this effect will be invalid. See above, para 4.136.

¹³ The Diamond report recommended that it should be mandatory to mention the existence of a negative pledge: *ibid*, para 22.4.7.

¹⁴ See below, para A.18.

¹⁵ Diamond report paras 22.3.2-22.3.4.

¹⁶ See above, para 4.216 n 325.

the chargor, or some other interested party (normally the chargee), lodge particulars of the charge and the charge instrument itself with the registrar of companies; and of the unrealistic expectation that the registrar must check the accuracy of the particulars against the charge document.¹⁷

- A.17 In its consultation document the Steering Group considered a number of possible simplifications designed to take from the registrar the responsibility for the accuracy of the particulars and to place this responsibility on the person submitting the form, a general aim with which we provisionally agree.

Defects in the particulars

- A.18 The Steering Group proposed that provided that some particulars had been delivered, the charge would not be invalidated by defects in the particulars.¹⁸ There would be a sanction against failing to describe the reach of the charge accurately in that the charge would be valid only for the property or classes of property included in both the particulars and the charging instrument. The Steering Group did not see the need for an additional sanction against the chargor who included in the particulars assets not in fact covered by the charge;¹⁹ the charge should be valid for the assets rightly included. The chargor would be able to have the registration cancelled in part. Similar recommendations had been made in the Diamond report, although this had also recommended that a person delivering incorrect particulars should be under a civil liability to any person who suffered loss as a result of the inaccuracy.²⁰

The role of Companies House and the registrar's certificate

- A.19 The Steering Group then turned to the role Companies House should play:

Companies House would merely check that the form was complete, that the particulars showed the same date as the instrument in respect of the date on which the charge had been created, and that the form and instrument creating the charge had been delivered within 21 days of its creation. ... The conclusive certificate would then only validate those facts: it would be conclusive only as to the timeliness²¹

¹⁷ See above, para 3.16.

¹⁸ Final Report para 12.80. In the Final Report this is discussed principally in relation to notice-filing, but it appears to be one of those matters of which the Steering Group said that "our proposals apply whether it is decided to improve the present system or to replace it with notice-filing": *ibid*, para 12.83.

¹⁹ Although there should be an offence of knowingly or recklessly delivering false information to the registrar: Final Report para 12.29.

²⁰ Diamond report para 22.3.3.

²¹ See Registration of Company Charges para 3.21. The Diamond report seems to have reached a similar conclusion: "In my view we should preserve the rule that that it is not open to a receiver, liquidator or administrator to allege that because of a mistake in the particulars the charge has never been registered On the other hand, I have already indicated that in the case of divergences between the contents of the charge and the particulars registered the person entitled to the charge should be restricted to the lesser or narrower of the two." *Ibid*, para 22.3.5.

Submitting the charge instrument

- A.20 The Steering Group next considered what information should have to be delivered for registration. One possible simplification would be to allow delivery of a copy of the charge instrument in place of the original:

this would remove the timing problem that arises when the documents have also to be delivered to a specialist registry.²²

Another would be to dispense entirely with delivery of the charge instrument or a copy: only the particulars would have to be submitted, and Companies House would simply certify that the particulars had been received within 21 days of the date of creation as stated in the particulars.

- A.21 It is hard to see how Companies House could usefully certify that the charge had been filed in time without checking the date of registration as against the date of creation stated in the charge instrument itself (or a copy). In effect any certificate could be conclusive of no more than the date of registration. This would be evident from the Companies Register itself, although it would be possible for receipts to be issued and possibly even confirmation of registrations sent to the parties listed.²³

Conclusions

- A.22 In its Final Report the Steering Group recommended that defective particulars should not invalidate the charge and reported that:

A clear majority of consultees considered that evidence of registration on the Companies House register should only be conclusive as to the date on which the charge was registered, and in this case, presentation of the instrument (or a copy) would serve little purpose.²⁴

- A.23 The proposal made by the Steering Group that the registrar's certificate should be conclusive only as to the date of delivery of the particulars for registration seems at first sight very similar to the change that the Companies Act 1989 would have introduced, that the registrar's certificate would be conclusive evidence only as to the date of delivery of the particulars for registration.²⁵ That change was said to be one of the reasons why the 1989 provisions have not been implemented: limiting the effect of the certificate in that way "while leaving the sanction of invalidity operative in respect of **any** breach of the registration requirements"²⁶ would have caused grave difficulties for the Land Registry, which requires that an application to register be accompanied by a conclusive certificate that the charge has been

²² Registration of Company Charges para 3.23.

²³ Registration of Company Charges paras 3.26-3.28.

²⁴ Final Report para 12.82. See also para 12.80. However, when answering another question (question 15 in the consultation document), a sizeable majority of consultees were in favour of a copy (at least) of the instrument being delivered to the registrar.

²⁵ The Companies Act 1989, s 94 would have introduced a new Companies Act 1985, s 397(5).

²⁶ Registration of Company Charges para 3.14.

registered at Companies House.²⁷ However, the context of the Steering Group proposal was very different. The Steering Group had, as we have just seen, recommended that defects in the particulars would not invalidate a registration.²⁸

A.24 We have considered the Steering Group's proposal, and it seems to us to be a sensible way of reducing the burdens on those responsible for registering charges and on Companies House. In the light of the recommendation of the Jenkins report that the registrar should merely have to provide an accurate copy of the particulars lodged and that the charge document itself (or a copy) should not be required; the Diamond report's endorsement of the Jenkins report's proposal, and the views of respondents to the Steering Group's consultation document, we provisionally propose that, if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing, the Steering Group's proposals should be followed.²⁹

A.25 In order to encourage accurate submission of particulars, it might be sensible to have a provision making the person submitting the particulars liable in damages for loss arising out of their inaccuracy, a recommendation that was made in the Diamond report.³⁰ This would move the obligation for ensuring that the accuracy of the information about the charge from the registrar to the supplier of that information, which seems to us to be a fairer approach.

A.26 The Steering Group pointed out that, as under its proposals the registrar would not see the charge instrument, there might be a danger of confusion between similar charges. It therefore proposed that the particulars should include a unique company reference number that cross-refers to each instrument.³¹ However, this proposal did not feature in the list of particulars proposed in the Final Report: several consultees were unsure as to what was meant by this, and others thought it unnecessary. Provisionally, we would not propose to adopt this suggestion.

A.27 **We ask whether consultees agree with our provisional proposal that, if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing:**

- (1) defects in the particulars submitted would not render the registration invalid;**
- (2) it should not be necessary to submit either the original or a copy of the charge document with the particulars;**

²⁷ See above, para 2.51.

²⁸ It had already recommended that where the charge is over land, the validity of the charge should not be affected by a defect in the particulars registered (and similarly with charges over other assets for which there is a specialist register): Final Report para 12.31. This recommendation seems to be overtaken by the more general one referred to in the text.

²⁹ NB the Diamond report paras 22.1.3-22.1.7: the Jenkins report pointed out that the registrar may be liable for mistakes. The Diamond report rejected calls that the document should be filed: see *ibid*, paras 22.1.9-22.1.11. Cf above, para 4.11.

³⁰ Diamond report para 22.3.3.

³¹ Registration of Company Charges para 3.25.

- (3) the charge would only be valid for the property or classes of property included in both the particulars and the charging instrument, and**
- (4) there should be civil liability on the applicant for loss suffered as a result of any inaccuracy in the particulars.**

THE PERIOD FOR REGISTRATION AND LATE REGISTRATION

The period for registration

A.28 As we shall see below, the Diamond report recommended (even in the context of improvements to the existing system of registration),³² a change to the rules of priority so that priority between competing charges would depend in part on the date of registration.³³ It then considered whether it would still be necessary to maintain a fixed period for registration, and doubted whether the sanction of the loss of priority would be enough by itself because the creation of more than one charge over a single piece of property “is not all that common”.³⁴ The main sanction against delay in registration was and should remain that the charge would be invalid against the liquidator, administrator or other creditors in the event of insolvency. There should be a period for registration after which a charge could not be registered if the company had in the meanwhile become insolvent. Thus it was recommended that the present 21-day rule be maintained.³⁵ The Steering Group, which in the context of reforming the present system did not consider changing the rules of priority, also considered that the charge should be registered within 21 days.³⁶

Late registration

- A.29 The Diamond report recommended that it should no longer be necessary to obtain a court order in order to register a charge outside the 21-day period. Provided that the applicant made certain declarations, the charge would be registered without prejudice to the rights of other parties acquired before the date of registration.³⁷ The amendments made by the Companies Act 1989 would have implemented such a scheme but these have not been brought into force.³⁸
- A.30 The Steering Group similarly proposed that late registration should be possible without making application to the court, provided that at the time of registration there had been neither the presentation of a winding up petition nor the convening

³² Cf under notice-filing: see above, paras 4.118 ff.

³³ See below, para A.40. It would also depend on the nature of the prior charge.

³⁴ Diamond report para 24.1.2. It was pointed out that voidness as against a creditor was less important than the fact that a receiver or judgment creditor can ignore an unregistered charge: *ibid*, para 24.1.3.

³⁵ Diamond report para 25.1. A longer period for property outside the United Kingdom was proposed: *ibid*, para 25.2.

³⁶ Final Report para 12.73.

³⁷ See the Diamond report para 25.3.

³⁸ The Companies Act 1989, s 95 would have inserted a new Companies Act 1985, s 400.

of a meeting to pass a resolution for a creditors' voluntary winding up petition.³⁹ In the event of late registration, the charge would be treated as if it were registered in time, although it would rank behind any prior registered charges. This would not retrospectively validate the late registered charge where either a liquidator had been appointed or enforcement action had been commenced by a creditor before the charge had been registered.⁴⁰ Allowing late registration in this way would save the cost of either an application to the court or executing a new charge.⁴¹

- A.31 The Diamond report had recommended that the applicant should have to declare that the omission to register in time was accidental or due to inadvertence. As the Steering Group also suggested that registration should no longer be compulsory,⁴² it did not recommend that such a declaration be required.
- A.32 The Steering Group's recommendation was supported by a clear majority of those who commented on the issue.⁴³ We provisionally propose that registration after the 21-day period should be possible without a court order, subject to the same points as made by the Steering Group.
- A.33 The 1989 amendments to the Companies Act 1985 would have provided that the late-registered charge would also become void against a liquidator or administrator if the company became insolvent within stated periods of the date of registration.⁴⁴ The Steering Group considered that this would be an "unnecessary and undesirable complication in insolvency law", which would benefit only those creditors whose claim arose after registration and were therefore deemed to be aware of it. "It is not clear why such creditors should receive this benefit merely as a result of the delay."⁴⁵ A possible answer is that earlier creditors might have left their debts uncollected for longer on the assumption that the company's assets were unencumbered,⁴⁶ but the Steering Group reported that most respondents considered the appropriate deadline to be the onset of insolvency.⁴⁷ We explained when we considered this point in relation to notice-filing⁴⁸ that we see no reason to differ from the Steering Group's view in general. However we pointed out that under a system of notice-filing in which filing can be made at any time before insolvency, special provisions might be needed to prevent last-minute filing by connected persons. The same issue would arise under the current scheme if it were

³⁹ Final Report para 12.76.

⁴⁰ Final Report para 12.76.

⁴¹ Registration of Company Charges para 3.8.

⁴² See below, para A.35.

⁴³ Final Report para 12.76 n 226.

⁴⁴ The Companies Act 1989, s 95 amended the Companies Act 1985, ss 400(2) and (3). The periods differed according to the nature of the charge and to whom it had been granted. This had not been proposed by the Diamond report in this context but may have reflected its views in relation to notice-filing: see above, para 4.77. The periods reflect the Insolvency Act 1986, ss 239-240 and 245.

⁴⁵ Registration of Company Charges para 3.9.

⁴⁶ See above, para 4.79.

⁴⁷ Final Report para 12.46.

⁴⁸ See above, para 4.78.

to be amended in the way we proposed above, to permit late filing without a court order at any time before insolvency or winding up.

A.34 Do consultees agree with our provisional view that if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing:

- (1) registration after the 21-day period should be possible without a court order, provided that at the time of registration there had been neither the presentation of a winding up petition nor the convening of a meeting to pass a resolution for a creditors' voluntary winding up petition;**
- (2) a late registered charge should be void against the liquidator, administrator and other creditors where it is registered following the onset of insolvency; and**
- (3) that there should be a provision to prevent 'last-minute registration' by connected persons?**

THE EFFECT OF NON-REGISTRATION AND THE SANCTIONS FOR FAILURE TO REGISTER

A.35 In its consultation document the Steering Group agreed with the Diamond report that the most potent sanction against non-registration is that the charge will be invalid on insolvency. It questioned the need for a criminal sanction currently set out in section 399(2) of the Companies Act 1985. In its consultation document the Steering Group suggested that a criminal sanction might be needed first, to ensure that the proper details of the charge, rather than its mere existence,⁴⁹ were registered; and secondly, in the case in which the company has acquired property already subject to a charge.⁵⁰ In its Final Report, however, it stated that the majority of consultees considered that the criminal sanction should be abolished and that it agreed.⁵¹ Further, on the assumption that its proposals in respect of late registration were adopted,⁵² it proposed that the sanction of the secured sum being repayable on demand in the event of a failure to correctly register the charge⁵³ should also be abolished. The Steering Group did make it clear that chargees should be free to contract that the money should be repayable in the event of non-registration.⁵⁴ We see no reason to differ from the Steering Group's view on the effect of non-registration and the sanctions for failure to register.

⁴⁹ Cf above, para 4.52.

⁵⁰ Registration of Company Charges para 3.22. In the latter case the validity of the charge does not depend on registration see above, para 2.23.

⁵¹ Final Report para 12.73.

⁵² Final Report para 12.77. See above, para A.32.

⁵³ Companies Act 1985, s 395(2). The Companies Act 1989 would have preserved this: the Companies Act 1989, s 99 would have amended the Companies Act 1985, s 407.

⁵⁴ Final Report para 12.77.

A.36 **We provisionally propose that the criminal sanction for failure to register a charge created by the company⁵⁵ should be abolished; that the sanction of the secured sum being repayable on demand in the event of a failure to correctly register the charge should also be abolished; but that chargees should be free to contract that the money should be repayable in the event of non-registration.**

A.37 There has been some doubt as to the position if there are two registrable charges over an asset and neither is registered within the 21-day period,⁵⁶ the point at which an unregistered charge becomes invalid as against a second, properly registered charge⁵⁷ and also over the effect if an unregistered charge is in fact enforced: must the chargeholder account for the proceeds to the holder of a second, properly registered charge?⁵⁸ These issues would have been resolved by the Companies Act 1989.⁵⁹ Broadly speaking, the first charge would not be void against the second unless the second charge was registered within 21 days (or before the first was registered).⁶⁰ If the first charge was void against the second, any proceeds of sale obtained by the first chargeholder would be held by that chargee in trust according to a statutory scheme of distribution under which the first person entitled would be the holder of the second charge.⁶¹

ALTERATIONS, SATISFACTION OR RELEASE AND ASSIGNMENT OF CHARGE

Alterations, satisfaction or release

A.38 The Diamond report recommended that alterations to charges⁶² and information about satisfaction of the debt secured, or release of any of the assets from the charge, should be registered.⁶³ The unimplemented provisions of the Companies Act 1989 would have made registration of further additional or varied particulars⁶⁴ possible but not compulsory. There is already provision for registration of a memorandum that a charge has ceased to affect a company's property.⁶⁵ It is

⁵⁵ It might need to be retained for failure to register a charge that exists already over property acquired by the company.

⁵⁶ The different views are summarised by de Lacy, p 364.

⁵⁷ See Registration of Company Charges para 3.4 and W J Gough, *Company Charges* (2nd ed) pp 744-746.

⁵⁸ *Ibid.*

⁵⁹ The Companies Act 1989, s 99 amended the Companies Act 1985, ss 404-407.

⁶⁰ See the amended Companies Act 1985, s 404(1).

⁶¹ See the amended Companies Act 1985, s 406(2). After the prior encumbrancer the money would go to the chargeholder and subsequent chargeholders. The scheme would not apply if the charge is void against an administrator or liquidator because the company has become insolvent (*semble* at the date of distribution): *ibid*, s 406(3)(b). Cf Final Report para 12.53.

⁶² Currently there is no provision for registering alterations or variations to existing charges, though a purported alteration might amount to a new charge that would require registration.

⁶³ Diamond report paras 28.1-28.2. It would not be necessary to register the fact that a revolving credit like an overdraft was temporarily in credit: *ibid*, para 28.2.2.

⁶⁴ The unimplemented Companies Act 1989, s 96 amended the Companies Act 1985, s 401.

⁶⁵ Companies Act 1985, s 403. The unimplemented Companies Act 1989, s 98 amended the Companies Act 1985, s 403 and would have preserved this. Unlike the old version, the new

consistent with our provisional approach that registration should be, in effect, voluntary⁶⁶ that there should be no obligation to file particulars of alterations; but there should be provision for the chargor to require registration of a memorandum of satisfaction, or of a note that certain assets have been released from the charge. **We provisionally propose that there should be no obligation to file particulars of alterations; but there should be provision for the chargor to require registration of a memorandum of satisfaction, or of a note that certain assets have been released from the charge.**

Assignment of charge

- A.39 The case of the charge that has been assigned by the creditor raises somewhat different issues. The debtor and third parties need to be able to discover the identity of the chargeholder. The Steering Group reported that it had been put to them that assignments should be registrable, but it considered that to make it a criminal offence not to provide details of the assignment would be inappropriate and to invalidate the assigned charge would be disproportionate.⁶⁷ Provided that there is a mechanism whereby the debtor who wishes to secure registration of a memorandum of satisfaction or a note of release can discover who is the assignee,⁶⁸ we agree. **We provisionally propose that there should be a mechanism to ensure that the debtor can identify a person to whom the creditor has assigned its interest, but that there should be no criminal penalty for failure to provide details.**

PRIORITIES AND PROVISIONAL REGISTRATION

Priorities

- A.40 In Part II we pointed out that although the current scheme of registration was not intended to govern questions of priority, the fact that a charge that has not been registered within 21 days may be invalid against subsequent creditors and that registration is treated as giving third persons constructive notice of the existence of the charge means that the scheme does affect priorities. The Diamond report noted that the provisions of the Companies Act 1985 applying to Scotland do set out a scheme of priorities, and so does the Companies Act 1981 (Australia).⁶⁹ As one of the suggested improvements to the current scheme, the Diamond report recommended a statutory scheme based on the Scottish model or, preferably, a more far-reaching scheme based in part on the Australian model.⁷⁰ The proposed

s 403 did not refer to part of the property being released from the charge. It may have been intended to deal with this in Regulations to be made under the new s 413 to be added by the Companies Act 1989, s 102.

⁶⁶ See above, para A.36.

⁶⁷ Final Report para 12.38 (in relation to notice-filing, but see above, para A.2 n 1). The NZPPSA, s 155 makes registration of a transfer possible but not mandatory.

⁶⁸ See Final Report para 12.38.

⁶⁹ Diamond report paras 24.2.2 and 24.2.5.

⁷⁰ Diamond report para 24.2.6.

scheme is set out in some detail in the report.⁷¹ Its essential features are that, unless the chargees had agreed otherwise between themselves:

- (1) a fixed charge would take priority over an earlier floating charge unless the floating charge contained a negative pledge clause and the registered particulars stated that fact;
- (2) otherwise, charges would rank with one another in accordance with the date of receipt for registration.

A.41 This scheme would not apply to questions of priority as between a registrable and an unregistrable charge, nor would it affect property covered by a specialist asset register.⁷² It is our provisional view that a similar scheme should be introduced.

A.42 **We ask consultees whether they agree that, even if reform is to take the form of amendments to the current scheme rather than the adoption of notice-filing, a priority scheme should be introduced based on the time of receipt for registration by the registrar.**

Provisional registration

A.43 The Diamond report noted that even if the scheme dated priority from the time of receipt for registration, there could still be problems regarding the accuracy of the register because of postal or administrative reasons which would still result in 'invisibility' problems. Consequently, it was recommended that, if the present scheme were altered so that priority would depend on the nature of the charge and the date of registration, a scheme of provisional registration should also be introduced. This would require submission of a form of particulars similar to that to be required for a charge that had been created but without the date of creation. Registration of this would give priority for a period of 21 days thereafter; if the charge were created and duly registered, the date of registration for priority purposes would be the date of the provisional registration.⁷³

A.44 If the suggested changes to the priority rules were not introduced, the Diamond report suggested an alternative system. An official search would be made and if no relevant charge was found a certificate would be issued and its issue recorded. That would give priority to applications made pursuant to it within a specified period. However, it was noted that this would impose additional burdens on the registrar.⁷⁴

A.45 Neither recommendation was adopted by Government. In Parliament it was said that the problem was "best dealt with by chargees ensuring that they leave as little time as possible between their search and the creation of the charge."⁷⁵ The

⁷¹ Diamond report para 24.2.9.

⁷² Diamond report paras 24.2.7-24.2.8.

⁷³ Diamond report para 26.6.

⁷⁴ Diamond report paras 26.4 and 26.7.

⁷⁵ 504 Deb (HL) 135 (February 14, 1989), quoted in G McCormack, *Registration of Company Charges* (1994) p 136.

possibility of either appears not to have been explored in the Steering Group's consultation document. In sum, the Diamond report's proposals on these points come very close to a proposal for a system of notice-filing, but without the full advantages offered by that system. It is true that under its scheme deciding issues of priority might be simpler and the 21-day problem would be overcome. However we have already said that the 21-day problem is a relatively rare one. The principal advantage of 'advance notice-filing' is to permit a single filing for a series of future transactions. The Diamond report's proposals for improvements to the present scheme, as was pointed out, would not have achieved that.⁷⁶ **We consider that if there are to be changes to move to a system of priority by date of registration and to permit advance filing, this should be done by adopting a system of notice-filing.**

The position of purchasers of property subject to a charge

- A.46 In Part II we noted that a charge that is not properly registered under the Companies Act 1985 will be invalid only as against the administrator, liquidator or creditors; it will be valid against a purchaser. Whether the purchaser takes free of the charge will depend on the nature of the charge and the general rules of priority.⁷⁷
- A.47 In its proposals for 'interim' improvements to the current scheme of registration, the Diamond report noted that:

It would surely be right that a purchaser of an asset subject to an unregistered (but registrable) charge should take free of it unless he actually knew of the charge. Even if the charge were registered, my own view would be that a purchaser should not be taken to know of the charge by reason of its registration alone, unless he could reasonably be expected to have inspected the register, and that if not he should take free from it if he had no knowledge of it from any other source.⁷⁸

- A.48 The Companies Act 1989 would have implemented the first of these recommendations, that an unregistered charge should be void against a purchaser,⁷⁹ with an exception not for the case in which the purchaser knew of the charge but if the acquisition were expressly subject to the charge.⁸⁰ The Steering Group endorsed those provisions.⁸¹ We think the test of '*knowledge*' will be easier to apply than that of 'acquisition expressly subject to the charge.' **We provisionally propose that an unregistered charge should be void against a purchaser unless the purchaser had actual knowledge of the charge.**

⁷⁶ Diamond report para 26.5. It was thought that a system of full advance registration was too radical to recommend in the context of amendments to the current system.

⁷⁷ See above, paras 2.58 ff.

⁷⁸ Diamond report para 24.3.5.

⁷⁹ The unimplemented Companies Act 1989, s 95 amended the Companies Act 1985, s 399(1).

⁸⁰ The unimplemented Companies Act 1989, s 99 amended the Companies Act 1985, s 405(1).

- A.49 On the question of whether purchasers should be bound by a registered charge, the Steering Group reported “widely differing views”.⁸² In the part of its Final Report dealing with notice-filing it recommended “that those not themselves taking registrable charges should not be deemed to have notice of charges that have been registered.”⁸³ In our provisional proposals on notice-filing we have taken a different approach. We agreed that a person who buys goods supplied by the seller in the ordinary course of its business (in the sense of sale of stock-in-trade, as opposed to sales of capital assets such as used equipment) should take free of even a registered security interest unless the buyer knows that the disposition to him is in breach of the agreement.⁸⁴ If the floating charge has crystallised or if, unusually, the stock-in-trade was subject to a fixed charge, we thought the buyer should take free of it unless he knows that the sale to him would be a breach of the agreement; but we asked whether the same protection should be given to a buyer who is buying capital equipment, as he can be expected to check the register.⁸⁵ We suggested that purchasers of investment securities should, in effect, be treated in the same way as purchasers of inventory, but purchasers of receivables should take subject to registered charges. **In relation to the position of purchasers of property that is subject to a charge, we provisionally propose that amendments to the current scheme should be on the same lines as we proposed earlier for notice filing, and we ask the same question, as in paragraphs 4.173-4.198.**

THE COMPANY’S OWN REGISTER

- A.50 In Part IV we considered the implications of adopting notice-filing for the company’s own register.⁸⁶ We expressed the provisional view that the argument in favour of abolishing the requirement to keep the company’s own register depends very much on what charges or security interests come within the system of filing a financing statement. We said that if the scope of what is registrable under a notice-filing system were to be widened, as we propose in Part VII, to include all security interests (and possibly quasi-security interests) that are created by a company and are not readily discoverable by their nature or from other registers, there would be a case for abolition of the requirement to keep the company’s own register.⁸⁷ We think the same argument applies if the current scheme of registration is amended in the ways already suggested rather than being replaced by notice-filing. Similarly, the alternative seems to be to treat this register as the primary place from which interested persons may obtain information from the company, but we doubt

⁸¹ Registration of Company Charges para 3.7; Final Report para 12.50.

⁸² See Final Report para 12.50.

⁸³ Final Report para 12.50. We assume that this is one of the proposals that was intended to apply whether or not notice-filing is to be adopted: see Final Report para 12.83 and above, para A.2 n 1.

⁸⁴ We point out that it will be rare for the security interest to be relevant since stock-in-trade will normally be subject only to a floating charge.

⁸⁵ See above, para 4.183.

⁸⁶ As required by the Companies Act 1985, s 407.

⁸⁷ See above, para 4.69.

whether this alternative is workable in practice.⁸⁸ **We provisionally propose that the company's own register of charges be abolished.**

THE REGISTER OF COMPANY CHARGES

- A.51 The Companies Act 1985, section 401(1) requires the registrar to keep a register of charges in respect of each company and to enter onto it particulars of registrable charges. The Diamond report recommended that no separate register be required and that the registrar be enabled to replace it by the forms submitted (it was envisaged that there would be an index giving the date, serial number of the document on file and the date and description of the instrument).⁸⁹ The Steering Group suggested that the statutory requirement to keep a separate register summarising the prescribed forms "places an additional administrative burden on Companies House, but adds nothing to the totality of information already available",⁹⁰ and recommended that the requirement for Companies House to maintain separate registers of charges for each company should be abolished.⁹¹
- A.52 The unimplemented amendments under the Companies Act 1989 would have given the registrar discretion as to the form of the register. If the current system of registration is to be kept, subject to the amendments we have described, this would seem to be a sensible approach. **We provisionally propose that any improvement to the existing scheme should give the registrar discretion as to the form of the Companies Register.**

CONCLUSIONS

- A.53 In this Part we have considered a number of amendments to the current transaction-based registration scheme in order to overcome some of the acknowledged difficulties with it. These or similar suggestions might prove attractive to consultees who are not in favour of a notice-filing system, and might overcome some of the problems with the current law we identified in Part III. However, it seems to us that some of the proposals in this Part - such as provisional registration and priority dating from registration - are close to those we provisionally proposed as part of a notice-filing system, but without the additional benefits of such a system (such as permitting multiple transactions to be covered by a single filing⁹²). **Consequently, it is our provisional but firm view that the current scheme for registration of company charges should be replaced by the scheme of notice-filing described in Part IV rather than being amended in the ways that we have outlined in this Appendix.**

⁸⁸ See above, para 3.18. As we noted there, this alternative might imply allowing anyone to inspect a copy of the relevant charge instrument, as would have been the effect of the unimplemented provisions of the Companies Act 1989.

⁸⁹ Diamond report paras 22.2.3-22.2.4.

⁹⁰ Registration of Company Charges para 3.77.

⁹¹ Final Report para 12.69. The responses of consultees appear to have been divided, but a majority favoured abolition.

⁹² See above, para 4.4.

APPENDIX B

A RESTATEMENT OF THE LAW OF SECURITY

INTRODUCTION

- B.1 In Part XI we noted the possible implications for the general rules on security of introducing a notice-filing system that took a functional approach. We pointed out that the overseas systems all contain a degree of codification or restatement of the rules relating to such matters as default, and that both the Crowther and Diamond reports recommended a similar approach.¹ We gave a brief outline of what such a restatement might cover, and then asked consultees whether they considered that such a restatement should be included in legislation that might ultimately apply notice-filing to security interests created by all debtors. We also asked whether it should apply to any more limited scheme applying only to companies.
- B.2 In this Appendix we give more detail of the relevant provisions of the SPPSA and the NZPPSA, and compare their effect to the current law in England and Wales. We also refer to the recommendations of the Crowther and Diamond Reports. We ask consultees to tell us whether they consider that it would be useful to include rules equivalent to those of the SPPSA and the NZPPSA, or equivalent to those proposed by Crowther or Diamond, in any restatement of the law of security. (In some cases we indicate our preliminary view.) We also invite comment on the substance of the rules, though we envisage that, were it to be decided to create a 'restatement' of the law of security, a draft would be circulated for comment. The very short time frame for production of this Consultation Paper has prevented us from completing a draft for consultation at this stage, and indeed has prevented us from reviewing fully either the current law or the policy questions that would be involved in any provisions that would go beyond the current law.

EFFECTIVENESS OF THE SECURITY AGREEMENT

Creation

- B.3 As we noted in Part XI,² under the SPPSA and the NZPPSA a security agreement is effective as between the parties according to its terms,³ but it is not enforceable against third parties unless either the collateral is in the possession of the secured party or the debtor has signed a security agreement that specifies the collateral.⁴ (This is a separate question from either whether the security interest has attached to the property or whether it must also be perfected in order to preserve its priority or to be valid as against purchasers or unsecured creditors in the event of the debtor's insolvency. Even a security interest that would otherwise have attached

¹ See above, para 11.2.

² See above, para 11.16.

³ SPPSA, s 9(1); NZPPSA, s 35.

⁴ SPPSA, s 10(1); NZPPSA, s 36(1).

and that does not require filing for perfection will not be enforceable if these rules are not complied with.)

- B.4 Similarly, the Crowther report recommended that a security interest should not be enforceable against the debtor or a third party unless its creation was evidenced by a memorandum in writing signed by or on behalf of the debtor (or possession was taken of the security or documents representing it).⁵ The Diamond report recommended that, for non-possessory security interests, there should be a written security agreement, or a note or memorandum, signed by or on behalf of the debtor, identifying the secured property and indicating (expressly or implicitly) that the creditor is to have an interest in that property.⁶ In the absence of such writing, the security agreement would be unenforceable against third parties; as between the creditor and debtor, such non-compliance would render the security unenforceable, but would not preclude the enforcement of the personal obligations of the agreement (such as the repayment of the debt with interest).⁷ For possessory security interests, the Diamond report considered separately the question of pledges of tangible property and of documents representing incorporeal property, and suggested that neither sort of pledge should be subject to a requirement for writing.⁸
- B.5 The law of England and Wales has some requirements relating to the creation of a security agreement.⁹ No formality is required for a pledge but there are specific rules relating to formalities for certain types of collateral. For example, a written, signed document for a security agreement is required when the interest charged is itself an equitable interest,¹⁰ and legal assignments of choses in action¹¹ also require signed writing (although the agreements will be effective in equity without it). Transactions regulated by the Consumer Credit Act 1974 are required to be in writing and signed by the debtor.¹²
- B.6 We provisionally think that existing requirements should continue to operate (so that, for example, an agreement regulated under the Consumer Credit Act 1974 would still have to comply with the formalities set out in that statute). We assume that in practice most security agreements (particularly those entered into by businesses) will be in writing and signed on behalf of the debtor.¹³ We are not

⁵ See the Crowther report para 5.6.1.

⁶ Diamond report para 10.3.16. However, the Diamond report also made clear that it did “not want the slightest hint to appear in the [proposed] legislation that a separate agreement dedicated to the creation of a security interest is either necessary or desirable.” *Ibid*, at para 10.5.3.

⁷ Diamond report para 10.3.18. A similar recommendation was made by the Crowther report at para 5.6.3.

⁸ The Diamond report at paras 10.4.4-10.4.24 noted differences in this respect between the Crowther and Halliday reports.

⁹ See above, para 2.5.

¹⁰ Law of Property Act 1925, s 53(1)(c).

¹¹ Law of Property Act 1925, s 136(1).

¹² Consumer Credit Act 1974, s 105.

¹³ Even a pledge is often accompanied by a signed document to prove the nature of the transaction. However we do not think that it is necessary to require a written document for

aware that the lack of any requirement for writing or signature causes problems, but given the existing requirements as to form and current practice, **we provisionally think that it would be sensible to require a written agreement signed by the debtor for all non-possessory security interests.**

- B.7 We have an open mind on whether it would be useful to draw up specimen forms, as had been suggested in the Diamond report.¹⁴
- B.8 Under the current law an agreement for a non-possessory security cannot be effective even as between the parties unless it gives a sufficient description of the property to enable the court to determine what assets fall within it.¹⁵ **We think that a statement that a sufficient description of the property is required should be included in any restatement.**

Attachment

- B.9 The SPPSA, section 12 provides that a security interest attaches when:
- (a) value is given;
 - (b) the debtor has rights in the collateral (where the debtor is a lessee or consignee, this is when it obtains possession); and
 - (c) except for the purpose of enforcing rights between the parties to the security agreement, the security agreement becomes enforceable (within section 10, as explained above),

unless the parties have agreed to postpone attachment. There are also rules for crops, the young of animals, minerals and trees. The NZPPSA, section 40 is in broadly similar terms. The Crowther report recommended a very similar approach.¹⁶

- B.10 Under current law in order for a security interest to attach, the following conditions must be satisfied: there must be agreement between the debtor and creditor that the security interest shall attach to the asset; the asset must be identified; the debtor must have a present interest in the asset or the debtor must have the power to give the asset as security; and there must be an obligation owed by the debtor to the creditor which the asset is designed to secure. An agreement for a non-possessory security can only be effective between the parties where a sufficient description of the property is given in order to enable the court to ascertain which assets come within the security.
- B.11 Save for the reference to lessees and consignees, who under present English law are not regarded as creating security interests, the Saskatchewan provision is effectively

possessory securities except where one is already required by other legislation such as the Consumer Credit Act 1974.

¹⁴ Diamond report para 10.5.1. See also the Halliday report, para 40.

¹⁵ Cf *Tailby v Official Receiver* (1888) 13 App Cas 523, 533. R Goode, *Commercial Law* (2nd ed 1995) p 677.

¹⁶ Crowther report Appendix III para 11.

a restatement of the current English law except in one regard. This is the point noted earlier,¹⁷ that the rights of an execution creditor differ under the two approaches. Under current English law an execution creditor may take goods that are subject to an uncrystallised floating charge, as the secured creditor is not regarded as having rights that have attached to any specific item.¹⁸ In the UCC Revised Article 9 the implication is that the judgment lien' takes priority, as Section 9-317(a)(2) renders an unperfected security interest subordinate to a person who becomes a 'lien creditor' before the security interest is perfected.¹⁹ The same result has been reached under the Ontario PPSA.²⁰ However these results seem to follow from the definition of attachment that covers all goods currently owned by the debtor, rather than from the adoption of notice-filing in itself: neither section 10 nor section 12 of the SPPSA, for example, explicitly require that the secured party have a right to any specific piece of collateral. Clearly thought would have to be given to the rights of execution creditors were a similar definition of attachment to be included in any restatement of the law. **We think that attachment is so central to the notion of security that it would be worth including such a restatement of the rules on attachment. We ask whether, if under the security interest the debtor remains free to dispose of assets in the ordinary course of business, judgment creditors should be able (as at present) to seize goods before the charge has 'crystallised'.**

RIGHTS AND REMEDIES ON DEFAULT²¹

- B.12 Under current law, the main remedies that are used by a secured creditor where default has occurred are possession, sale, foreclosure and the appointment of a receiver.²²

Secured party requiring payment

- B.13 Under the SPPSA and the NZPPSA, in the case of default of a debt or chattel paper, the secured party may require the party liable to pay it, whether or not collections were being made before such notification.²³ Equally, if the secured party is entitled to 'take control' of proceeds of collateral it may require that they be paid to it.²⁴ The secured party enforcing its security interests must also give notice to

¹⁷ See above, para 4.128 n 204.

¹⁸ *Evans v Rival Granite Quarries Ltd* [1910] 2 KB 979, CA (see in particular at 999); and see R Goode, *Commercial Law* (2nd ed 1995) p 742.

¹⁹ See JJ White and R S Summers, *Uniform Commercial Code* (5th ed 2000) p 841.

²⁰ See G McCormack, "Personal Property Security Reform in England and Canada" [2002] JBL 113, 121 and cases there cited.

²¹ Note that under the SPPSA, s 55(4), where the security is over both personal property and land, and the secured party elects to proceed as to both rather than as to just the personal property, this part does not apply.

²² R Goode, *Commercial Law* (2nd ed, 1995) p 689. An additional remedy may be an action on the debtor's personal covenant for payment should there be one. A person may give her property as security for another's debt without undertaking personal liability as a surety.

²³ SPPSA, s 57(2)(a).

²⁴ SPPSA, s 57(2)(b).

the debtor within 15 days of doing so.²⁵ It may then apply the money received, or equally any “account, instrument or security in the form of a debt obligation²⁶ taken as collateral” to the satisfaction of the secured obligation.²⁷ Where the collateral is a licence, the secured party may ‘seize’ it by giving notice to both the debtor and the grantor (or successor) of the licence.²⁸ The secured party may deduct reasonable expenses of collection from amounts so collected or money held as collateral.²⁹

B.14 Under the law of England and Wales the assignee of a debt may notify the debtor of the assignment and thereafter the debtor must pay her, not the assignor.³⁰ Equally, if the assignee can trace the proceeds of collateral she may claim them.³¹ She can apply the money received or negotiable instruments towards satisfaction of the obligation secured.

B.15 **We ask whether it would be useful to include rules on when the secured party can require payment.**

Taking possession

B.16 The SPPSA and NZPPSA provide that possession can be taken where there has been default³² or, under the New Zealand system, where the collateral is ‘at risk’.

Collateral at risk

B.17 Under the NZPPSA, a secured party with priority over all other secured parties may take possession of and sell collateral when the collateral is ‘at risk’.³³ Collateral is ‘at risk’ if the secured party has reasonable grounds to believe that the collateral has been or will be:

destroyed, damaged, endangered, disassembled, removed, concealed, sold, or otherwise disposed of contrary to the provisions of the security agreement.³⁴

B.18 English law seems to have no equivalent to this. Such a provision would seem to be useful, and **we provisionally propose that an equivalent should be included.**

²⁵ SPPSA, s 57(5).

²⁶ For example, a negotiable instrument. Footnote not in original.

²⁷ SPPSA, s 57(5).

²⁸ SPPSA, s 57(3).

²⁹ SPPSA, s 57(4).

³⁰ Halsbury’s Laws vol 32 para 343.

³¹ See above, paras 4.163 ff.

³² SPPSA, s 58(2); NZPPSA, s 109(1)(a).

³³ NZPPSA, s 109(1)(b).

³⁴ NZPPSA, s 109(2).

On default

- B.19 Under the current law, where it has been agreed in the security agreement, all creditors are permitted to sell the security. Under a legal or equitable mortgage or charge by deed a mortgagee or chargee has a power of sale.³⁵ This power of sale exists even where there are no express provisions in the security agreement.³⁶
- B.20 Under the current law of England and Wales, where the right to take possession is expressly provided for in the security instrument it may be exercised regardless of the nature of the security interest (so it may be exercised where the creditor is the holder of a legal mortgage, an equitable mortgage or a charge).³⁷ In the absence of such provision, a legal mortgagee³⁸ is entitled to possession upon execution of the mortgage whether there has been default by the mortgagor or not, a rule that seems to bear little relation to modern practice. This is due to the ownership of the security vesting in the creditor.³⁹ In contrast an equitable chargee, with an encumbrance over the asset but no proprietary interest in it, is not permitted to take possession unless there is a contractual right to do so or a court order has been made.⁴⁰
- B.21 Where the security interest comprises goods that can be seized without the need for entry onto the debtor's property the creditor may take the goods without the need for a court order. However, if the agreement is regulated by the Consumer Credit Act 1974 different provisions apply. Thus, for example, the creditor cannot enforce any security or repossess any goods without first serving a 'default notice';⁴¹ and if the contract is one of hire-purchase or conditional sale and the debtor has paid more than one-third of the price, the goods are protected. The creditor then cannot recover possession without a court order.⁴²
- B.22 The Crowther report suggested that the system it proposed should have a number of rules relating to the rights of the secured party on default, including giving the secured party the right (in the case of business goods) to enter peaceably and to render the secured goods unusable pending payment or repossession, and recommended giving the secured party the right to dispose of secured property from the defendant's premises.⁴³ The Diamond report agreed.⁴⁴

³⁵ Law of Property Act 1925, s 101.

³⁶ Except where the mortgage is over goods covered by the Bills of Sale Acts.

³⁷ R Goode, *Commercial Law* (2nd ed 1995) p 689.

³⁸ R Goode, *Commercial Law* (2nd ed 1995) p 689.

³⁹ The rights and remedies of a chargee of land by way of legal mortgage are the same as that of a legal mortgagee: Law of Property Act 1925, s 87(1).

⁴⁰ R Goode, *Commercial Law* (2nd ed 1995) p 690. Goode notes that it remains unclear whether an equitable mortgagee can take possession without an express provision in the security instrument.

⁴¹ Consumer Credit Act 1974, s 87.

⁴² Consumer Credit Act 1974, s 90.

⁴³ Crowther report paras 5.6.22-5.6.23.

⁴⁴ Diamond report para 14.1.

B.23 The SPPSA provides that, on default, the secured party⁴⁵ may take possession or otherwise enforce the security agreement by any method permitted by law.⁴⁶ There are provisions dealing with property that cannot readily be moved from the debtor's premises or of a kind for which adequate storage facilities are not readily available. In such a case, the secured party may seize or repossess the collateral without removing it in any way in which a sheriff acting pursuant to a writ of execution could seize without removal. The secured party can also dispose of the goods on the debtor's premises, but without causing any greater inconvenience and cost than is necessarily incidental to this.⁴⁷ Where the secured asset is a document of title, the secured party may proceed either as to the document itself or as to the goods covered by it, and a method of enforcement available with respect to the document of title is also available with respect to the goods covered by it.⁴⁸

B.24 The provisions as to possession or enforcement seem to state an obvious principle but one that should be included in a restatement. The provisions as to seizure and disposal may be useful. We would welcome the views of consultees.

Powers and duties of receivers

B.25 Under the current law, the powers of an administrative receiver - that is, a receiver or manager of the whole, or substantially the whole of a company's property, appointed by a floating charge-holder⁴⁹ - are comprehensively set out in Schedule 1 to the Insolvency Act 1986,⁵⁰ but are also generally set out in the debenture. The powers of administrative receivers can be separated in two categories. First, there are the rights that are derived from the security created by the debenture.⁵¹ Secondly, there are the powers which the receiver has which are executed as agent of the company.⁵² These powers are used in order to facilitate the continuance of the business, such as the power to employ and dismiss members of staff.⁵³ The powers as a company agent come to an end when the company goes into liquidation. The receiver is also personally liable for any contract entered into by her in the carrying out of her functions but is entitled to an indemnity out of the assets of the company in respect of the liability incurred.⁵⁴ However, we noted in Part II that the Enterprise Bill currently before Parliament proposes to prohibit the

⁴⁵ Including a receiver: SPPSA, s 58(1).

⁴⁶ SPPSA, s 58(2)(a).

⁴⁷ SPPSA, ss 58(2)(b)-(c). Cf NZPPSA, s 111.

⁴⁸ SPPSA, s 58(2)(d). The NZPPSA, s 112 has a similar provision.

⁴⁹ Insolvency Act 1986, s 29(2).

⁵⁰ The general powers and duties of a receiver are contained in the Insolvency Act 1986, ss 42-43. There are 23 separate powers set out in the Schedule.

⁵¹ This includes powers to hold and dispose of the assets, as well as collecting them.

⁵² R Goode, *Commercial Law* (2nd ed 1995) p 865.

⁵³ Insolvency Act 1986, Schedule 1, para 11.

⁵⁴ Insolvency Act 1986, ss 44(1)(a)-(c).

appointment of an administrative receiver by floating charge holders save in particular situations.⁵⁵

- B.26 A receiver may also be appointed to receive income from the secured property or to manage just part of a company's property. The powers of such a receiver are set out in the Law of Property Act 1925, section 109.
- B.27 Under the SPPSA, a security agreement may provide for the appointment of a receiver and, except as provided in that or any other Act, for the rights and duties of a receiver.⁵⁶
- B.28 A receiver is required to take custody and control of the collateral in accordance with the security agreement or order pursuant to which she is appointed, but unless appointed as a receiver-manager or unless the court orders otherwise, she should not carry on the debtor's business. The receiver must open and maintain in her name an account for the deposit of all money coming under her control; must keep records of all receipts, expenditures and transactions that involve collateral or other property of the debtor (which may be examined by the debtor on written demand); prepare financial statements of the receivership; indicate on business correspondence used or executed in connection with the receivership that the receiver is acting as a receiver; and on completion of her duties, prepare a final account of the administration.⁵⁷
- B.29 The debtor, a sheriff, a person with an interest in the collateral in the custody or control of the receiver, or the authorised representative of any of them, may, by written demand require the receiver to provide copies of the financial statements or the final accounts or to make them available for inspection.⁵⁸
- B.30 In addition to any other powers the court may exercise in its jurisdiction over receivers, on application by an interested person, the court may do one or more of several things. It may appoint a receiver; remove, replace or discharge a receiver, whether appointed by a court or pursuant to a security agreement; give directions on any matter relating to the duties of a receiver; approve the accounts and fix the remuneration of a receiver; notwithstanding anything contained in a security agreement or other document providing for the appointment of a receiver, make an order requiring a receiver, or a person by or on behalf of whom the receiver is appointed, to make good a default in connection with the receiver's custody, management or disposition of the collateral of the debtor or to relieve the person from any default or failure to comply with the relevant Part of the SPPSA; and exercise with respect to receivers appointed pursuant to a security agreement the jurisdiction that it has over receivers appointed by the court.⁵⁹

⁵⁵ See above, para 2.17.

⁵⁶ SPPSA, s 64(2).

⁵⁷ SPPSA, s 64(3).

⁵⁸ SPPSA, s 64(5).

⁵⁹ SPPSA, s 64(8).

- B.31 Unless the court orders otherwise, a receiver is required to comply with sections 59 and 60 only where the receiver disposes of collateral other than in the course of operating the business of a debtor.⁶⁰
- B.32 In New Zealand the Receiverships Act 1993 and the amending Acts⁶¹ set out the powers⁶² and duties of receivers. The receiver has the powers and authorities that are either expressly or impliedly conferred by the agreement, deed or order of the court by which the appointment of the receiver was made.⁶³
- B.33 **We ask consultees whether a restatement should set out the powers and duties of receivers, and the powers of the court, more fully than does the present legislation.**

Sale of the collateral

Power of sale

- B.34 Under the current law, all secured creditors are permitted to sell the security if it has been agreed in the security instrument. There are various statutory restrictions, for example under the Bills of Sale Acts and Consumer Credit Act 1974.⁶⁴ A mortgagee or chargee under a legal or equitable mortgage or charge by deed has a power of sale under the Law of Property Act 1925,⁶⁵ even in the absence of any express provision in the security instrument.⁶⁶ A legal mortgagee⁶⁷ of goods also has an implied right of sale, at common law, upon the mortgagor's default. This is exercisable even where the mortgage is not by deed.⁶⁸ As far as other securities are concerned a pledgee also has an implied right of sale at common law upon the default of the pledgor.⁶⁹
- B.35 A power of sale may be granted by the court for the sale of mortgaged property despite the dissent of others or the mortgagee where the mortgagee does not

⁶⁰ SPPSA, s 64(10).

⁶¹ Receiverships Amendment Act 1994 and the Receiverships Amendment Act 2001.

⁶² Receiverships Act 1993, ss 14, 15 and 31.

⁶³ Receiverships Act 1993, s 14.

⁶⁴ See R Goode, *Commercial Law* (2nd ed 1995) p 691.

⁶⁵ Law of Property Act 1925, s 101. The Law of Property Act 1925, s 205(xvi) defines a mortgage as including "any charge or lien on any property for securing money or money's worth". Property is defined as including "any thing in action, and any interest in real or personal property": *ibid*, s 205(xx).

⁶⁶ The exception to this is where the mortgage is over goods covered by the Bills of Sale Acts. If that is the case then the goods must be held for five days before they are sold. However, in the case of a mortgage that secures money which has become payable under a regulated agreement within the Consumer Credit Act 1974, the seven-day notice must have been served and expired without the default being rectified. These rules are contained in the Consumer Credit Act 1974, s 87(1) and the Bills of Sale Act (1878) Amendment Act 1882, s 7A. See R Goode, *Commercial Law* (2nd ed 1995) p 691.

⁶⁷ The law is unclear as to whether an equitable mortgagee of goods has a right of sale if the mortgagee is in possession: see R Goode, *Commercial Law* (2nd ed 1995) p 691.

⁶⁸ R Goode, *Commercial Law* (2nd ed 1995) p 691.

⁶⁹ *Deverges v Sandeman, Clark & Co* [1902] 1 Ch 579.

appear in the action.⁷⁰ This power of the court is used mainly where there is no power of sale out of court but the courts in some cases are sometimes inclined to make such an order even where there is a power outside of the court.⁷¹

- B.36 Both the SPPSA and the NZPPSA give the secured creditor the power of sale⁷² or disposal of the seized or repossessed goods.⁷³ In addition to this, they set out several rules relating to the exercise of that power of sale.
- B.37 The secured party may delay disposition of all or some of the collateral,⁷⁴ and is allowed to buy it, but only at a public sale, and only for a price that bears a reasonable relationship to its market value.⁷⁵
- B.38 Not less than 20 days before the disposition of the collateral, the secured party (or a receiver) must give a notice⁷⁶ to the debtor or any other person known by the secured party to be an owner of the collateral; a creditor or person with a security interest whose interest is subordinate who has registered a financing statement in the debtor's name or according to serial number (where appropriate), or who has perfected by possession at the time of seizure or repossession; and any other person

⁷⁰ Law of Property Act 1925, s 91(2). The court may order that there should be a "deposit in court of a reasonable sum fixed by the court to meet the expenses of sale and to secure performance of the terms".

⁷¹ For examples of the circumstances in which the courts are inclined to order a power of sale where the power of sale exists out of court, see R Goode, *Commercial Law* (2nd ed 1995) pp 691-692.

⁷² Which can be by private or public sale; as a whole or in commercial units or parts; or (if the security agreement so provides) by lease: see the SPPSA, s 59(3). Where the security agreement so provides, the payment for the collateral being disposed of may be deferred: *ibid*, s 59(4).

⁷³ SPPSA, s 59(2); NZPPSA, s 109(1)(a).

⁷⁴ SPPSA, s 59(5).

⁷⁵ SPPSA, s 59(13). Notwithstanding any other provision, where the collateral is a licence, the collateral may be disposed of only in accordance with the terms and conditions under which the licence was granted or which otherwise pertain to it: *ibid*, s 59(18).

⁷⁶ The notice is required to contain a description of the collateral; the amount required to satisfy the secured obligations; the sums actually in arrears, and a brief description of any default other than non-payment and of the provision of the security agreement the breach of which resulted in the default; the amount of applicable expenses (or where the amount of the expenses has not been determined, a reasonable estimate); a statement that, on payment of the amount due, a person who is entitled to receive the notice may redeem the collateral; a statement that, on payment of the sums in arrears, or on the curing of any other default, as the case may be, together with payment of the amounts due, the debtor may reinstate the security agreement; a statement that, unless the collateral is redeemed or the security agreement is reinstated, the collateral will be disposed of and the debtor may be liable for any deficiency; and details as to any public auction, closed tendering process or private disposition: SPPSA, s 59(7). However, not all of this information is required where the notice is given to a person other than the debtor, or where there is no entitlement to reinstate: see *ibid*, s 59(8). The required contents of a notice given by a receiver are slightly less than for a secured party. The notice is to contain a description of the collateral; a statement that, unless the collateral is redeemed, it will be disposed of; and details of any sale by public auction, closed tender or private disposition: SPPSA, s 59(11).

with an interest in the collateral who has given written notice to the receiver of that interest before notice of disposition is given to the debtor.⁷⁷

- B.39 The notice is not required where the collateral is perishable; the secured party reasonably believes that the collateral will decline substantially in value if not disposed of immediately; the cost of care and storage is disproportionately large in relation to the collateral's value; it is of a type that is to be disposed of by sale on an organised market that handles large volumes of transactions between many different sellers and many different buyers; it is foreign currency; after default, each person entitled to receive a notice of disposition consents in writing to the disposition of the collateral without compliance with the notice requirements; or for any other reason, a court on an *ex parte* application is satisfied that a notice is not required.⁷⁸

Good faith and a commercially reasonable manner

- B.40 The Crowther report proposed requiring the sale to be commercially reasonable in time, price and manner.⁷⁹ The SPPSA and NZPPSA both provide that all rights, duties or obligations arising pursuant to the security agreement or the Act concerned are to be exercised or discharged in good faith and in a commercially reasonable manner.⁸⁰ Both also provide that a person does not act in bad faith merely because she acts with knowledge of another's interest.⁸¹ Under the NZPPSA there is a duty to sell for the best price reasonably obtainable.⁸²
- B.41 Under current law a secured creditor (or receiver appointed by it) does not owe a general duty to use reasonable care when exercising its powers and in dealing with the assets of the mortgagor.⁸³ However equity imposes certain duties including a duty on the secured creditor to take reasonable care to obtain a proper price⁸⁴ and a duty to exercise its power in good faith for the purpose of obtaining repayment.⁸⁵ This duty is owed to the mortgagor and to a subsequent encumbrancer.

⁷⁷ SPPSA, ss 59(6) and (10).

⁷⁸ SPPSA, s 59(16).

⁷⁹ Crowther report para 5.6.18.

⁸⁰ SPPSA, s 65(3); NZPPSA, 25(1).

⁸¹ SPPSA, s 65(4); NZPPSA, 25(2).

⁸² See the NZPPSA, s 110. See generally ss 104-134.

⁸³ See *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949 and *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295. See also R Goode, *Commercial Law* (2nd ed 1995) p 691, and *Medforth v Blake* [2000] Ch 86. In the case of mortgages of goods falling within the Bills of Sale Acts and the Consumer Credit Act 1974 there are additional requirements for the giving of notice.

⁸⁴ *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949.

⁸⁵ *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295.

Effect of disposition on subordinate security interests

- B.42 If seized or repossessed collateral has been sold, all security interests in the collateral and its proceeds that are subordinate to that of the secured party who sold the collateral are extinguished on that sale.⁸⁶

Effect of non-compliance on purchaser/disponee

- B.43 A purchaser who acquires the interest for value and in good faith and who takes possession of it, acquires the collateral free from the debtor's interest, an interest subordinate to that of the debtor, and an interest subordinate to that of the secured party, whether or not the other requirements of section 59 of the SPPSA have been complied with by the secured party.⁸⁷

Guarantors and others who take transfer of collateral

- B.44 A person who is liable to a secured party pursuant to a guarantee, endorsement, covenant, repurchase agreement or the like and who receives a transfer of collateral from the secured party or who is subrogated to the rights of the secured party has thereafter the rights and duties of the secured party; the transfer of collateral is not a disposition of the collateral.⁸⁸

Expenses and application of proceeds

- B.45 After seizing or repossessing the collateral, a secured party may either dispose of it in its existing condition or after repair, processing or preparation for disposition. The proceeds of the disposition are then applied consecutively to the reasonable expenses of seizing, repossessing, holding, repairing, processing or preparing for disposition and disposing of the collateral and any other reasonable expenses incurred by the secured party; and the satisfaction of the obligations secured by the security interest of the party making the disposition; with any surplus being dealt with in accordance with the SPPSA, section 60.⁸⁹

- B.46 **We think that the provisions relating to the power of sale set out above are so central to the remedies of the secured party that they should be included in a restatement, and suggest that each of the points described above should be covered.**

Surplus or deficiency

- B.47 Following the sale of repossessed goods, the SPPSA, section 60(2) provides for the payment of any surplus (unless otherwise provided by law or by agreement) in the following order (but without prejudice to the priority of any claimant): first, a person who has a subordinate security interest and who has registered a financing statement using the debtor's name or the serial number (if of that kind), or one who has perfected by possession at the time of seizure; secondly, any other person with an interest in the surplus, provided they have given a written notice of the

⁸⁶ NZPPSA, s 115.

⁸⁷ SPPSA, s 59(14).

⁸⁸ SPPSA, s 59(15).

⁸⁹ SPPSA, s 59(2).

interest to the secured party⁹⁰ prior to the distribution; and thirdly, the debtor or any other person known by the secured party to be an owner of the collateral.⁹¹ Unless otherwise agreed or provided for by statute, the debtor is liable to pay any deficiency to the secured party.⁹²

- B.48 On the Crowther report recommendations, the debtor was also to remain liable for any deficiency remaining after resale (except where this was caused by the secured party failing to act in a commercially reasonable manner).⁹³ The Diamond report agreed with these views and recommended that they should be implemented.⁹⁴
- B.49 Currently where the secured asset is sold by the creditor it must account to the debtor for any surplus above the amount of the secured sum including costs, charges and expenses which have been properly incurred by the secured party by virtue of the sale.⁹⁵ The creditor is not entitled to keep any surplus after these expenses have been accounted for.⁹⁶ Where the transaction involves a quasi-security there is no obligation to account for any surplus from the sale of repossessed goods. The creditor under a quasi-security agreement is therefore in some ways better off than the holder of a fixed charge over the property would be. We noted in Part VI that this has sometimes led the courts to make some efforts to prevent the creditor being able to take property worth more than the amount owed, or if the property re-possessed was worth more, to retain the excess.⁹⁷
- B.50 **Any restatement forming part of a system that included quasi-securities should clearly set out the rights and duties in respect of surplus.**

Statement of account

- B.51 The SPPSA provides that the secured party (including a receiver) shall, within 30 days of receiving a written request, give a written accounting of the amount received from the disposition; the manner of disposal; the amount applied to expenses; the distribution of the amount received; and the amount of any surplus.⁹⁸ The NZPPSA contains a similar provision, although the only information required is the gross proceeds, the amount of costs and expenses, and the balance owing by either the secured party or the debtor. The requirement to supply the account is not dependent upon a request being made, and the time for compliance is 15 days.⁹⁹

⁹⁰ Including a receiver: SPPSA, s 60(1).

⁹¹ SPPSA, ss 60(2)(a)-(c). The NZPPSA, s 117 has a similar provision.

⁹² SPPSA, s 60(5).

⁹³ See the Crowther report paras 5.6.17-5.6.27.

⁹⁴ Diamond report para 14.1.

⁹⁵ Law of Property Act 1925, s 105.

⁹⁶ Where the security is a pledge the pledgee may apply any surplus to the discharge of any other indebtedness of the pledgor.

⁹⁷ See above, para 6.21, and see *Clough Mill Ltd v Martin* [1985] 1 WLR 111.

⁹⁸ SPPSA, s 60(3).

⁹⁹ NZPPSA, s 116.

Payment of surplus into court

- B.52 Under the SPPSA and the NZPPSA, in the case of dispute as to entitlement to the surplus, the secured party can pay the surplus into court to await application by those claiming entitlement to it.¹⁰⁰
- B.53 **We think that provisions on statement of account and the payment of surplus into court would be useful.**

Foreclosure

- B.54 Foreclosure involves the termination by order of the court of the right to redeem, the effect of which is to vest the mortgaged property in the mortgagee. In England and Wales, foreclosure requires a court order. The mortgagee is then completely free from the equity of redemption.¹⁰¹ The remainder of the debt is extinguished by foreclosure and the mortgagee is assumed to have taken the property in satisfaction of the debt owing.
- B.55 Under the SPPSA, after default, the secured party may propose to take the collateral in satisfaction of the secured obligation, but must give notice of such a proposal to the debtor or any other person known by the secured party to be an owner of the collateral; to a creditor or person with a security interest in the collateral whose interest is subordinate, and who has either registered a financing statement using the debtor's name or according to serial number (if appropriate), or who has perfected by possession when the collateral was seized or repossessed; and to any other person with an interest in the collateral who has given written notice to the secured party of that interest prior to the notice is given to the debtor.¹⁰²
- B.56 If any person who is entitled to such a notice and whose interest would be adversely affected by the secured party's proposal objects within 15 days after the notice was given, the secured party is required to dispose of the goods in accordance with section 59 of the SPPSA (for example, by sale).¹⁰³ Failure to object within 15 days results in the secured party being deemed to have irrevocably elected to take the collateral in satisfaction of the secured obligation, and it is entitled to hold or dispose of the collateral free from all rights and interests of the debtor and from the rights and interests of any person entitled to receive notice who has been given that notice.¹⁰⁴

¹⁰⁰ SPPSA, s 60(4); NZPPSA, s 118.

¹⁰¹ R Goode, *Commercial Law* (2nd ed 1995) p 692. The remedy is severely restricted and, we understand, seldom used. See R Bradgate, *Commercial Law* (3rd ed 2000) para 22.2.1.3.

¹⁰² SPPSA, s 61(1). Similarly NZPPSA, s 120.

¹⁰³ SPPSA, s 61(2); cf NZPPSA, s 121. This is subject to proof of the objector's secured interest being forthcoming if demanded by the secured party; and an objection may be overridden by a court order if the objection is made not in order to protect the objector's interest but for another purpose, or if the value of the property is less than the secured party's interest: see *ibid*, ss 61(5)-(6). (Cf the NZPPSA, s 122.)

¹⁰⁴ SPPSA, s 61(3).

- B.57 **Again, we think that foreclosure is such a central topic that it should be covered in a restatement.**

Right of redemption

- B.58 With respect to mortgages, the mortgagor has a right to redeem, at any time before sale or foreclosure, by tendering payment of the sum due, but this power is sometimes postponed by the terms of the contract.¹⁰⁵
- B.59 The SPPSA provides that, prior to the secured party or receiver disposing of the collateral or before the secured party has irrevocably elected to retain the collateral, a person that is entitled to notice of disposition¹⁰⁶ may redeem the collateral by tendering fulfilment of the obligations secured by the collateral¹⁰⁷ and paying a sum equivalent to reasonable expenses of enforcing the security agreement.¹⁰⁸ The NZPPSA contains similar provisions.¹⁰⁹ The New Zealand legislation does go further by stating that the debtor's right to redeem the collateral has priority over any other person's right to redeem the collateral.¹¹⁰
- B.60 The Crowther report recommended that in a transaction relating to personal property the secured party should have the same right as under the current law to postpone the debtor's contractual right to redeem a mortgage, providing that it did not cause oppression or render the right to redeem illusory.¹¹¹ The Diamond report agreed with these views and recommended that they should be implemented.¹¹² **We agree that the right of redemption should be included in any restatement.**

Reinstatement of security agreement

- B.61 The debtor may reinstate the security agreement prior to the secured party disposing of the collateral or being deemed to have taken the collateral in satisfaction of the obligation secured by it.¹¹³ Reinstatement may occur where the debtor pays the sums in arrears "exclusive of the operation of an acceleration clause in the security agreement";¹¹⁴ remedies any default "by reason of which the

¹⁰⁵ Upon satisfaction of the obligation under a mortgage the mortgagor has a right to redeem, thereby recovering full ownership of the property: see, eg, *Snell's Equity* (30th ed 2000) para 21-02. If a sale is made by a mortgagee, by virtue of a court order, or the mortgagor exercises its power of sale the right of redemption of the mortgagor is overridden: R Goode, *Commercial Law* (2nd ed 1995) p 692.

¹⁰⁶ Under the SPPSA, s 59(6) or s 59(10).

¹⁰⁷ SPPSA, s 62(1)(a)(i).

¹⁰⁸ SPPSA, s 62(1)(a)(ii). This encompasses the expenses of "seizing, repossessing, holding, repairing, processing and preparing the collateral for disposition" actually incurred and any other reasonable expenses actually incurred.

¹⁰⁹ NZPPSA, s 132(1).

¹¹⁰ NZPPSA, s 132(2).

¹¹¹ Crowther report para 5.6.11.

¹¹² Diamond report para 14.1.

¹¹³ See, eg, the NZPPSA, s 133.

¹¹⁴ NZPPSA, s 133(a); SPPSA, s 62(1)(b)(i).

secured party intends to sell the collateral”¹¹⁵ and pays reasonable expenses incurred by the secured party in enforcing the security agreement.¹¹⁶ There are limits on the frequency with which the debtor may reinstate the agreement.¹¹⁷

- B.62 There do not appear to be direct equivalents of these provisions in current English law. The nearest equivalents appear to be the restrictions placed upon a mortgagee’s power to take possession and of sale contained in the Bills of Sale Acts,¹¹⁸ the restrictions on the mortgagee’s power of sale under the Law of Property Act 1925¹¹⁹ and the power of the court to make a ‘time order’ under the Consumer Credit Act 1974.¹²⁰
- B.63 **We invite views on whether a restatement should include a right for the debtor to reinstate the security.**

Powers of court

- B.64 The Saskatchewan system provides that, on the application of a debtor, secured party, creditor, sheriff or person with an interest in the collateral, the court may make orders (including declarations and injunctions) to ensure compliance; to give directions regarding the exercise of rights or the discharge of obligations; to relieve a person from compliance; to stay enforcement of rights; or may make any order necessary to ensure protection of the interest of any person in the collateral.¹²¹ The NZPPSA does not have a specific section referring to applications to court; these are found in individual provisions and are more specific. For example a debtor, judgment creditor or a person with a security interest in personal property of the debtor can apply under section 181 to the court to ensure compliance on behalf of the secured creditor to provide certain information relating to the security interest if they fail to do so under section 177. Under section 128, if a debtor has refused to allow the secured party to remove accession then the latter may apply for a court order to allow it to do so.
- B.65 The SPPSA provides that, on the application of an interested person, the court may make an order determining questions of priority or entitlement to collateral, or direct that an action be brought or an issue tried.¹²² It also provides that where a time limit is prescribed for the doing of something, the court may extend or abridge the time (conditionally or otherwise) for compliance. The application may be made before or after the time limit has expired.¹²³

¹¹⁵ NZPPSA, s 133(b); SPPSA, s 62(1)(b)(ii) (‘dispose’ rather than ‘sell’).

¹¹⁶ NZPPSA, s 133(c); SPPSA, s 62(1)(b)(iii).

¹¹⁷ SPPSA, s 62(2); NZPPSA, s 134.

¹¹⁸ See the 1882 Act, ss 7 and 13.

¹¹⁹ Law of Property Act 1925, s 103.

¹²⁰ Consumer Credit Act 1974, ss 129-130.

¹²¹ SPPSA, s 63(2).

¹²² SPPSA, s 66.

¹²³ SPPSA, s 67.

B.66 Under the present law, the Law of Property Act 1925, section 91(2) provides that a power of sale may be granted by the court for the sale of mortgaged property even where there is dissent among other creditors or from the mortgagee. This only applies where the mortgagee does not appear in the action. This power is mainly used where there is no power of sale out of court.¹²⁴

B.67 **We ask consultees whether it is desirable to set out the powers of the court along the lines of the provisions in the Saskatchewan and New Zealand PPSAs.**

Remedies of secured party when collateral is seized by a third party

B.68 Under a notice-filing system, if a security interest has not been perfected, third parties such as judgment creditors or liquidators are entitled to seize the property that is subject to the security interest. Where the underlying security agreement is a loan, the debtor will still be liable for the outstanding balance and can recover the sums due from the debtor or prove in the insolvency. If however the underlying agreement was a lease or a consignment, the amount payable by the debtor is not so obvious. The SPPSA, section 21 provides that in each case the measure of damages is the value of the leased or consigned goods at the date of seizure plus any further loss suffered as a result of the termination of the lease or consignment.

B.69 **We ask whether similar provisions would be useful in a restatement.**

FIXTURES, CROPS, ACCESSIONS, PROCESSED AND COMMINGLED GOODS

Fixtures and growing crops

B.70 The SPPSA contains provisions for security interests in fixtures and in growing crops. Section 49 provides for notices to be registered in the land titles office; these are subject to similar rules as financing statements (for example, they can be filed before the security interest has been created).¹²⁵ Sections 36 and 37 contain rules on priority of security interests over fixtures and crops. Broadly speaking, the security interest in the fixtures or crops will have priority over security interests in the land. However, those who without fraud and after the goods have become fixtures or while the crops are growing, acquire an interest in the land or make a further advance under an existing mortgage of the land,¹²⁶ will take priority over the security interest in the fixtures or crops if it has not been registered at the time.

B.71 The Diamond report notes that the UCC and the Canadian legislation contains provision for including goods which are attached to land, and which class as “fixtures”.¹²⁷ These provisions perhaps reflect the fact that these systems, as well as those proposed in the Crowther and Diamond reports, apply only to security interests in personal property, and do not cover security interests in land. If a new system of notice-filing for company charges is to reflect the current requirement to

¹²⁴ R Goode, *Commercial Law* (2nd ed 1995) p 691.

¹²⁵ See the SPPSA, s 49(5).

¹²⁶ In this case, priority is only in respect of the advance.

¹²⁷ Diamond report para 18.4.

register (at least) charges over land, it is probably unnecessary to have separate provisions dealing with the question of fixtures. This situation might be different if there were to be a system that excluded interests over land from its scope. (The Australian Law Reform Commission recommended that goods that are fixtures should not be subject to the regime it proposed, and that they should be governed by land law. There should however be provision for the case were the item to become detached again.¹²⁸)

- B.72 Chattels which are subject to hire-purchase or consumer credit agreements and which have been attached to land as fixtures become subject to the mortgage even though they have been affixed after the date of the mortgage. However if the chattel is a business chattel then it may be removed prior to the mortgagee taking possession.¹²⁹

Accessions

- B.73 The SPPSA, section 38 has parallel rules in relation to goods that are installed in or affixed to other goods, giving priority to security interests over the accession as against security interests over the goods as a whole unless the security interest in the accession had been perfected. There are detailed provisions governing the removal of accessions.
- B.74 Under the doctrine of accession where a dominant chattel is attached to another chattel, ownership then rests in the owner of the dominant chattel. The most prevalent areas in which the accession rules are invoked in England and Wales are in cases of retention of title and hire-purchase cases.¹³⁰ Retention of title clauses are often used in order to prevent the supplier of goods from losing title to goods because of the doctrine of accession. In the context of retention of title, where a good is added to another good and is easily removable, without serious injury or destruction to the whole that has been formed, the proprietary rights of the seller are unaffected.¹³¹ Where goods have been attached without the knowledge or consent of the supplier there is a possibility of a claim against the buyer of the goods for breach of contract. This claim does not affect the rules of priority if the buyer becomes insolvent.¹³²

Processed and commingled goods

- B.75 The SPPSA, section 39 sets down priority rules for cases in which goods over which there are security interests are processed or become commingled so that their separate identity is lost.
- B.76 Under the law of England and Wales there are different types of mixing of goods. The main types are accession, confusion and commingling, which does not involve a loss of physical identity of the goods, and processing which does involve a loss of

¹²⁸ ALRC 64, *Personal Property Security* para 5.45.

¹²⁹ Halsbury's Laws vol 32 para 400.

¹³⁰ See generally, G McCormack, "Mixture of Goods" (1990) 10 *Legal Studies* 293.

¹³¹ See *Hendy Lennox (Industrial Engines) Ltd v Grahame Puttick Ltd* [1984] 1 WLR 485.

¹³² G McCormack, *Registration of Company Charges* (1994) p 98.

physical identity of the goods. Cases in this area, in the main, relate to ownership of commingled goods where there has been no loss of identity. These cases suggest that the owners of the goods become tenants in common of the mass in proportion to their respective contributions to the whole. Property in the mass is not lost.¹³³

- B.77 **We ask whether a restatement of the law of security (which would be largely concerned with personal property) should set out rules on fixtures, accessions and processed or commingled goods.**

GENERAL AND MISCELLANEOUS PROVISIONS

- B.78 Both the SPPSA and the NZPPSA contain a number of general and miscellaneous provisions.

Transfer by debtor of ownership of collateral

- B.79 The SPPSA, section 33 states that the debtor's rights in collateral may be transferred, with consent or by the operation of law, notwithstanding a provision in the security agreement that prohibits transfer or declares a transfer to be a default. A transfer by the debtor does not however prejudice the rights of the secured party pursuant to the security agreement.¹³⁴ The Crowther report recommended that the debtor should have the right (until sale or foreclosure by the secured party) to dispose of the security subject to the secured party's security interest.¹³⁵
- B.80 The owner of property may confer on a third party all the rights of ownership including the power of alienation. These rights can be transferred by consent or by operation of law. The owner then no longer has the full rights of ownership but still retains the general property.¹³⁶ Any restriction which substantially takes away the power of alienation is void as it is contrary to the principles of ownership.¹³⁷ A restraint which is only partial which does not deprive the owner of the power of alienation may be good.¹³⁸ These rules apply equally to equitable interests and legal interests.¹³⁹
- B.81 **We ask whether the right to transfer ownership of the collateral should be included in a restatement.**

¹³³ G McCormack, *Registration of Company Charges* (1994) p 99.

¹³⁴ Or otherwise, which includes the right to treat a prohibited transfer as an act of default.

¹³⁵ Crowther report para 5.6.9.

¹³⁶ W J Gough, *Company Charges* (2nd ed 1996) p 38.

¹³⁷ Halsbury's Laws vol 35 para 1269.

¹³⁸ See, eg, *Re Rosher, Rosher v Rosher* (1884) 26 Ch D 801 and *Re Dugdale, Dugdale v Dugdale* (1888) 38 Ch D 176.

¹³⁹ Halsbury's Laws vol 35 para 1269. Thus trusts cannot be created which attempt to prevent the beneficiary from alienating her interest or on the basis that the interest in question is not to be made subject to the claims of creditors. See *Re Fitzgerald, Surman v Fitzgerald* [1904] 1 Ch 573.

No exclusion or limitation of liability

B.82 The SPPSA provides that (unless otherwise provided in the Act), a provision in a security agreement or any other agreement purporting to exclude any duty or onus imposed by the Act, or purporting to limit either the liability of, or amount of damages recoverable from, a person who has failed to discharge any duty or obligation imposed by the Act, is void.¹⁴⁰

B.83 **We ask whether a provision preventing exclusion or limitation of liability is needed.**

Rules on service of documents

B.84 The SPPSA, section 68 sets out detailed rules for the service of documents.¹⁴¹ The rules set out which people may have documents served on them, the means by which service is permitted and where the documents should be served.¹⁴² The rules also set out when service is deemed to be effected.¹⁴³ The NZPPSA sets out rules on the service of documents, which focus upon the method of service, and includes service by electronic mail.¹⁴⁴

B.85 **We ask whether consultees share our view that special rules on service of documents would not be necessary in a restatement.**

¹⁴⁰ SPPSA, s 65(10).

¹⁴¹ See the SPPSA, s 68.

¹⁴² SPPSA, s 68(1).

¹⁴³ SPPSA, s 68(2).

¹⁴⁴ NZPPSA, s 189.