

**The Law Commission**

**Replacing bills of sale:  
a new Goods Mortgages Bill  
Consultation on draft clauses**

**July 2017**

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# Chapter 1: Introduction

- 1.1 Bills of sale are a way in which individuals can use goods they already own as security for loans or other obligations, while retaining possession of those goods. The use of bills of sale has grown from under 3,000 in 2001 to over 30,000 in 2016. They are now mainly used for “logbook loans”, where a borrower grants security over their vehicle. The borrower may continue to use the vehicle while they keep up the repayments, but if they default they can lose it relatively easily, without some important protections that apply to hire-purchase transactions.
- 1.2 Bills of sale are currently governed by two Victorian statutes, the Bills of Sale Act 1878 and the Bills of Sale Amendment Act 1882.<sup>1</sup> In September 2014, HM Treasury asked the Law Commission to review this legislation and make recommendations for its reform.
- 1.3 We consulted in 2015<sup>2</sup> and published a report in 2016.<sup>3</sup> We concluded that the current law is archaic, and wholly unsuited to the 21<sup>st</sup> century. It fails logbook lenders, logbook borrowers, business borrowers and third party purchasers. We recommended that the Bills of Sale Acts should be repealed in their entirety and replaced with a new “Goods Mortgages Act” to govern the way that individuals may use their existing goods as security.
- 1.4 We are now consulting on draft clauses, which are intended to form part of the Goods Mortgages Bill announced by the government in the Queen’s speech in June 2017. Our hope is that the Bill will be suitable for the special Parliamentary procedure for uncontroversial Law Commission Bills.

**We welcome comments by Monday 7 August 2017.**

- 1.5 The draft clauses which accompany these notes implement the recommendations set out in our 2016 report, though in some cases we have developed our thinking in the light of further discussions.
- 1.6 This limited consultation is designed to test whether the draft clauses successfully implement the recommendations we made in our 2016 report. Where we have modified our policy we ask specific questions about those changes. We are also interested in comments on the structure and accessibility of the draft clauses.

<sup>1</sup> The full name of this Act is the Bills of Sale Act (1878) Amendment Act 1882.

<sup>2</sup> Bills of Sale (2015) Law Commission Consultation Paper No 225, accessible at [http://www.lawcom.gov.uk/wp-content/uploads/2015/09/cp225\\_bills\\_of\\_sale.pdf](http://www.lawcom.gov.uk/wp-content/uploads/2015/09/cp225_bills_of_sale.pdf).

<sup>3</sup> Bills of Sale (2016) Law Com No 369, accessible at [http://www.lawcom.gov.uk/wp-content/uploads/2016/09/lc369\\_bills\\_of\\_sale.pdf](http://www.lawcom.gov.uk/wp-content/uploads/2016/09/lc369_bills_of_sale.pdf).

1.7 Other than that, we do not ask questions on the underlying policy in our 2016 report, which has already been subject to consultation.

1.8 Please send your comments by **Monday 7 August 2017** to [bills\\_of\\_sale@lawcommission.gsi.gov.uk](mailto:bills_of_sale@lawcommission.gsi.gov.uk). If responding by post, please address any comments to John Williams, Commercial and Common Law Team, Law Commission, 1st Floor, Tower, Post Point 1.53, 52 Queen Anne's Gate, London SW1H 9AG.

1.9 For further information about the project, see <http://www.lawcom.gov.uk/project/bills-of-sale/> which links to the consultation paper and report.

1.10 In some areas, particularly on the arrangements for registration of goods mortgages, the drafting is not yet complete, and we intend to consult on these clauses separately. If you wish to be involved in this further consultation on registration, do let us know by emailing us at [bills\\_of\\_sale@lawcommission.gsi.gov.uk](mailto:bills_of_sale@lawcommission.gsi.gov.uk).

## AIMS OF THE DRAFT BILL

1.11 Our aim is to replace the Bills of Sale Acts with new legislation, which will:

- (1) provide appropriate protection for vulnerable borrowers, so that goods are not seized too readily;
- (2) protect innocent purchasers who buy goods without realising that they are subject to a security interest;
- (3) remove unnecessary restrictions on secured lending to more sophisticated borrowers, such as high net worth individuals and unincorporated businesses; and
- (4) save costs caused by unnecessarily complex arrangements for the registration of documents.

1.12 The draft Bill is not simply about borrower protection. It also provides a legal framework by which a wide range of individuals can secure loans and other obligations on goods. This underlying legal framework is intended to be flexible and future proof. Bills of sale legislation has not been overhauled since 1882. If past experience is any guide to the future, any legislation passed now may need to cover new and unknown arrangements, well into the 21<sup>st</sup> century and beyond. For this reason, many of the provisions are in general terms. The draft Bill also attempts to place goods mortgages within the broader framework of security law, including the law of aircraft and ship mortgages.

1.13 However, there is also a need for appropriate protection for vulnerable borrowers, especially those taking out logbook loans on their vehicles. The draft Bill reconciles these pressures by distinguishing between those borrowers who need protection and more sophisticated borrowers who do not. The key distinction is between “exempt”

goods mortgages, and other goods mortgages – which we label “non-exempt” goods mortgages in this document. In broad terms, goods mortgages are exempt from the additional protections if they are granted by high net worth individuals, or if they are used by businesses to secure loans for more than £25,000. In both cases, the borrower must acknowledge that the usual protections do not apply.

- 1.14 The distinction between non-exempt and exempt mortgages goes to the heart of the draft Bill and we describe it in more detail in Chapter 2.

## TERMINOLOGY

### Mortgagor and mortgagee

- 1.15 The draft Bill uses the legal terms “mortgagor” and “mortgagee” to refer to the parties to a goods mortgage. In a secured loan agreement, the mortgagor is the borrower who grants the mortgage, while the mortgagee is the lender who receives the security and grants the loan.
- 1.16 We are aware, however, that these terms can be confusing. Many house-buyers, for example, think of a bank as giving them a mortgage, rather than the other way around.
- 1.17 In our 2016 report we referred to the parties as “the borrower” and “the lender”. This is an over-simplification: for example, if a goods mortgage is granted as security for a guarantee rather than a loan, the terms borrower and lender are not strictly accurate. Furthermore, under clause 29(2)(b) of the draft Bill, the term “mortgagee” is defined as including not only the original lender but any other person to whom the rights under the goods mortgage have passed by assignment or operation of law.<sup>4</sup>
- 1.18 However, in this document we continue to refer to the mortgagor as the “borrower” and the mortgagee as the “lender” as a convenient shorthand, because we think these terms are easier to understand.

### Referring to the Bills of Sale Acts

- 1.19 In this document we refer to the Bills of Sale Act 1878 as “the 1878 Act” and to the Bills of Sale Amendment Act 1882 as “the 1882 Act”. Together we refer to them as the Bills of Sale Acts.

## STRUCTURE

- 1.20 The structure of the draft Bill is set out in clause 1 (overview).

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<sup>4</sup> In the case of a mortgagor, it includes those to whom rights and duties have passed by operation of law but not by assignment (clause 30(3)(a)).

## 1 Overview

- (1) This Act contains provision about security over goods.
- (2) In Part 2—
  - (a) sections 2 to 5 contain provision enabling an individual who owns goods to create a goods mortgage over them as security for the discharge of an obligation;
  - (b) section 6 relates to other non-possessory security over goods;
  - (c) section 7 (with Schedule 1) contains provision about the obligations that cannot be secured by a goods mortgage.
- (3) In Part 3—
  - (a) sections 8 to 11 contain provision about the registration of goods mortgages;
  - (b) section 12 deals with further advances by the mortgagee;
  - (c) sections 13 to 17 deal with the position of third parties.
- (4) Part 4 contains provision about the rights of mortgagors and mortgagees.
- (5) Part 5 contains repeals and amendments, provisions about regulations and interpretation, and other final provisions.

1.21 This consultation document loosely follows the structure of the draft Bill:

- (1) Chapter 2 explains the distinction between exempt and non-exempt mortgages. The definition of an exempt goods mortgage is to be found in clause 28 and its effect runs through the whole of the draft Bill.
- (2) Chapter 3 covers the creation of a goods mortgage. It describes how individuals may use existing goods as security for loans or other obligations. It looks at clauses 2 to 4 and 6 to 7.
- (3) Chapter 4 focuses on the document requirements, as set out in clause 5. We compare the simpler requirements for a goods mortgage with the many formalities currently required under bills of sale legislation.
- (4) Chapter 5 outlines our recommendations on registration and asks consultees some questions about how they could work in practice. However, we are not currently consulting on detailed draft clauses on this issue. We will consult further before the draft Bill is introduced into Parliament.

- (5) Chapter 6 deals with third parties. It describes the new duty on owners to provide information; the effect of unregistered goods mortgages; and the new protections for private purchasers who act in good faith without notice of the mortgage.
- (6) The largest part of the draft Bill concerns the rights of borrowers and lenders. We deal with these in four parts of this document:
  - (a) Chapter 7 explains the restrictions on lenders' rights to take possession which apply to all mortgages, whether exempt or non-exempt.
  - (b) Chapter 8 explains further restrictions on lenders' rights to take possession, which apply only to non-exempt mortgages.
  - (c) Chapter 9 explains the borrower's right of voluntary termination, which again applies only to non-exempt mortgages.
  - (d) Chapter 10 explains the lender's power of sale.
- (7) Chapter 11 deals with the rest of the draft Bill including contracting out, repeals and commencement.

1.22 We welcome comments on the structure of the draft Bill.

## Chapter 2: Exempt and non-exempt goods mortgages

- 2.1 Consumer credit legislation distinguishes between those consumers and small businesses who need protection, and those who do not, such as high net worth individuals and businesses borrowing over £25,000. This is because those with greater resources are able to seek and pay for advice and are therefore less vulnerable, in particular to inequalities of bargaining power.
- 2.2 We have followed this distinction in broad terms, though we have adapted and simplified it for the purposes of this legislation. This is explained in more detail below.

### BORROWER PROTECTIONS FOR NON-EXEMPT GOODS MORTGAGES

- 2.3 Several provisions of the draft Bill only apply to non-exempt goods mortgages. These include:
  - (1) a requirement to include warning statements in the mortgage document (clause 5(2));
  - (2) a prohibition on using a goods mortgage to secure a guarantee<sup>5</sup> or revolving credit (clause 7);
  - (3) a requirement on the lender to issue an “opt-in” possession notice before taking possession of the goods, if the borrower has paid back at least one third of the secured sum. This enables the borrower to demand that the lender does not take possession of the goods without a court order (clause 20); and
  - (4) a right of voluntary termination, allowing the borrower to hand over the goods to the lender and to walk away from any further obligations (clause 27).

- 2.4 We use the term “non-exempt” goods mortgage to refer to any goods mortgage which is not exempt under section 28. Given the importance of the distinction, we explain it here and describe it in greater detail in Appendix 1.

### WHICH GOODS MORTGAGES ARE EXEMPT?

- 2.5 In our 2016 report we recommended that the above additional protections should apply to “regulated credit agreements” under the Consumer Credit Act 1974 (“CCA”), but not to obligations which were not regulated under the CCA because they were:
  - (1) loans of more than £25,000 taken out for business purposes; or
  - (2) loans of more than £60,260 to high net worth individuals.

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<sup>5</sup> As we discuss in para 3.70 below, only high net worth individuals may secure a guarantee with a goods mortgage.

2.6 During the drafting process, it became apparent that it would be inappropriate to replicate the CCA concept of a regulated credit agreement in its entirety. The fact that an agreement is not regulated under the terms of the CCA does not mean that the agreement is not regulated elsewhere, or that the borrower is not in need of protection.

2.7 There are several complexities to the definition of a regulated credit agreement which would not be helpful in the context of a goods mortgage. One example is the exclusion of credit agreements for the purpose of acquiring or retaining property rights in land.<sup>6</sup> This would exempt a loan to purchase a plot of land which was also secured on goods, such as a caravan or mobile home. Yet the borrower in these circumstances might be particularly vulnerable and would benefit from the protections of the draft Bill.

2.8 A second example of complexity is that an agreement may be partly regulated and partly unregulated.<sup>7</sup> Here, the CCA regulations apply to the former parts but not the latter. Again, this would make the concept difficult to apply to goods mortgage.

2.9 Instead, we have taken the simpler course, which is to apply the protections to all goods mortgages, unless:

- (1) the “high net worth conditions” are met. Individuals are of “high net worth” if they have a net income totalling at least £150,000 in the preceding financial year or net assets<sup>8</sup> with a total value of at least £500,000; or
- (2) the “business credit conditions” are met. These apply to loans which exceed £25,000 made wholly or predominantly for the purposes of the borrower’s business.

2.10 In either case, the borrower would also need to “opt-out” of the protections of the draft Bill. The goods mortgage must include a declaration to this effect.

2.11 The high net worth and business credit conditions are set out in clause 28. Under clause 28(3)(b), the goods mortgage is only exempt if it includes a declaration that the borrower agrees to forgo the protection of the opt-in procedure (in clause 20) and of the right to voluntary termination (in clause 27). The declaration must comply with prescribed requirements.<sup>9</sup>

2.12 The monetary limits and prescribed requirements will be set out in regulations made by the Treasury under clause 32. The intention is that these regulations will follow the limits and prescribed requirements already used in consumer credit law.

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<sup>6</sup> See article 3(1)(b) of the Directive on credit agreements for consumers relating to residential immovable property 2014/17/EU, Official Journal L 60 of 28.2.2014 p 34.

<sup>7</sup> Consumer Credit Act 1974, s 18(1). An example of a partly regulated agreement is a contract whereby an unincorporated business borrows £26,000 for business purposes (unregulated part) and also hires a car on a hire-purchase basis (regulated part). The Consumer Credit Act 1974 treats the two parts as separate agreements and applies to the regulated part.

<sup>8</sup> Excluding primary residence, life or endowment policies and pension arrangements.

<sup>9</sup> Clause 28 is set out in Appendix 1, where it is discussed in more detail.

- 2.13 One additional complexity is how to value a business loan in a running-account credit facility, such as an overdraft, where the borrower may borrow and repay varying amounts on a rolling basis. The CCA already has a method of valuing loans in these circumstances, and we reproduce the effect of section 10 of the CCA in schedule 1 to the draft Bill.
- 2.14 In Appendix 1 we look in detail at the relevant provisions in consumer credit law, so that consultees can see the how the new regulation-making power will be used.

#### **EXEMPTING MORTGAGES TO HIGH NET WORTH INDIVIDUALS, IRRESPECTIVE OF AMOUNT**

- 2.15 The main change from our 2016 report is that under the draft Bill, *all* goods mortgages granted by high net worth individuals will be exempt, provided that the individual agrees to forgo the protections and the mortgage meets the prescribed requirements. There is no longer a requirement that the loan must exceed £60,260.
- 2.16 Unlike business credit, which may be given to vulnerable sole traders or very small partnerships, credit to high net worth individuals will always concern borrowers of considerable means who can afford legal advice. Accordingly, we do not consider it necessary to provide for a monetary threshold. This provides sophisticated borrowers with greater flexibility.

#### **Consultation Question 1.**

- 2.17 Do consultees agree that high net worth individuals should be able to opt out of protections even if the loan does not exceed £60,260?

# Chapter 3: Creation of goods mortgages

## SCOPE

3.1 Bills of sale that are used as security for loans are known as “security bills”. Security bills occupy a distinct niche in the law of security interests:

- (1) unlike company charges (which are granted by companies and limited liability partnerships), security bills can only be granted by individuals and unincorporated businesses;
- (2) unlike mortgages on land, they are secured on goods;
- (3) unlike hire-purchase they are usually granted on goods which the borrower already owns; and
- (4) unlike pawn-broking (where the lender takes possession of the goods) security bills allow the borrower to keep the goods while making the repayments.

3.2 Goods mortgages sit within this particular area of security law. The draft Bill applies where:

- (1) individuals;
- (2) grant security;
- (3) over qualifying goods;
- (4) which they own;
- (5) to secure the performance of a qualifying obligation.

3.3 These criteria are set out in clauses 2 to 4.

## CLAUSE 2: THE MAIN CONCEPTS

3.4 Clause 2(1) states that an individual who owns qualifying goods may create a charge over those goods as security for the discharge of an obligation. This is referred to as a “goods mortgage”. Below we discuss the concepts of “individual”, “charge” and “goods mortgage”. We then look at “ownership” (drawing on clause 3) and “qualifying goods” (drawing on clause 4).

3.5 Clause 2(2) highlights that for a goods mortgage to be valid the goods must already exist. It is not possible to use future goods as security. The charge must also be created by a document which meets the formality requirements set out in clause 5. The consequences of creating a goods mortgage which fails to meet these requirements are dealt with in clause 6.

3.6 A goods mortgage can secure any obligation (not just a loan), as long as it is not an excluded obligation. Excluded obligations are dealt with in clause 7.

## 2 Goods mortgages

- (1) An individual who owns qualifying goods (see section 4) may create a charge over the goods (in this Act referred to as a “goods mortgage”) as security for the discharge of an obligation.
- (2) The following requirements must be met—
  - (a) the goods exist, and are owned by the individual concerned, at the time when the charge is created;
  - (b) the charge is created by a written instrument complying with section 5;
  - (c) the obligation is not an excluded obligation (see section 7).
- (3) A person whose only interest in goods is an equitable interest arising under a trust is not to be regarded for the purposes of this Act as “owning” the goods.

## “An individual”

3.7 An individual is a natural person (that is, a human being) rather than a legal person (such as a company, limited liability partnership or other corporate entity). The term is commonly used in statutes, without further definition.<sup>10</sup>

3.8 Under English law, an unincorporated partnership is considered to be a group of individuals rather than a corporate entity. This means that the draft Bill applies to individuals who create a charge on behalf of an unincorporated partnership over the assets of the partnership. Its scope is therefore in some respects slightly wider than the CCA which excludes those in partnerships of more than three partners.<sup>11</sup> Unlike the CCA, the draft Bill includes individual partners irrespective of the size of the partnership. Also unlike the CCA,<sup>12</sup> the draft Bill only includes natural persons. Bodies corporate can be partners in an unincorporated partnership, but they cannot grant goods mortgages. Only “human partners” can.

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<sup>10</sup> For example, under the Consumer Rights Act 2015, s 2(3), a consumer is defined as “an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession”. Individual is not defined further.

<sup>11</sup> Consumer Credit Act 1974, s 189(1).

<sup>12</sup> The Consumer Credit Act 1974 appears to include some bodies corporate in the definition of “individual”: see s 189(1).

## **“A charge”**

3.9 The underlying structure of a bill of sale under the current law is that the borrower transfers property to the lender.<sup>13</sup> It is a “true” mortgage, similar to 19th century land mortgages, where title to the property is transferred to the lender, leaving the borrower with the right to take back the property on payment of all outstanding sums (the “equity of redemption”). Now, land mortgages are no longer characterised as transfers of title but as “charges”, which are stand-alone security rights largely regulated by statute.<sup>14</sup>

3.10 Under the draft Bill, the security created over the goods is a statutory legal charge, rather than a transfer of ownership/legal title. This aligns goods mortgages with mortgages of land, ships and aircraft, all of which are best characterised as charges.<sup>15</sup> It also avoids some complexities involved in the transfer-of-title model. In particular, where a borrower creates more than one security interest over the same property, subsequent lenders will also have legal charges, rather than taking security against the equity of redemption as they do under the current law. All charges will be of the same type and will rank in order of priority.

3.11 For the most part, the common law relating to charges is overridden by specific statutory provisions.<sup>16</sup> This is also the case for goods mortgages, where the rights and duties of both parties to the transaction are set out in the draft Bill. For example, the draft Bill sets out the circumstances in which a lender can repossess without a court order. It provides for a statutory power of sale, and the conditions in which it can be exercised.

3.12 However, other issues may arise which are not provided for specifically in the draft Bill. Here we expect that the courts will consider the law that applies to other types of charge. There is extensive case law about the nature and operation of land charges, which was recently applied by the Court of Appeal when considering charges over aircraft.<sup>17</sup> This approach is more sustainable than attempting an exhaustive codification of how a goods mortgage will operate.

3.13 In our 2016 report, we suggested that a goods mortgage may take effect either as a true mortgage or as a charge, depending on the choice of the parties.<sup>18</sup> We have been

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<sup>13</sup> This is the effect of s 9 and the schedule to the Bills of Sale Act (1878) Amendment Act 1882. The schedule states that the agreement takes effect by way of assignment.

<sup>14</sup> Section 51 of the Land Registration Act 2002 describes the security interest on land as “a charge by deed by way of legal mortgage”. For a discussion of the history of this characterisation, see E Cooke, *Land Law* (2nd ed 2012) p 137.

<sup>15</sup> For mortgages of registered land on or after 13 October 2003 this is the effect of the Land Registration Act 2002, s 23(1) and s 51. For aircraft mortgages see H Beale, M Bridge, L Gullifer, E Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 14.51. It is not entirely clear whether ship mortgages are statutory charges but this is the prevailing view: see H Beale, M Bridge, L Gullifer, E Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 14.40. For more details see Appendix 2.

<sup>16</sup> In the case of land mortgages, for example, see the Administration of Justice Act 1970, s 36 and the Administration of Justice Act 1973, s 8.

<sup>17</sup> *PK Airfinance SARL v Alpstream AG* [2015] EWCA Civ 1318, [2016] 1 CLC 135.

<sup>18</sup> Bills of Sale (2016) Law Com No 369, para 4.42.

convinced that this is unnecessarily complex, adding to the length of the legislation without providing any benefits to either lenders or borrowers.

3.14 We explore the practical differences between a charge and a transfer of title in Appendix 2 and reach the conclusion that relatively little turns on the distinction.

### Consultation Question 2.

3.15 Do consultees agree that it is right to characterise a goods mortgage as a “charge”, in accordance with all other commonly-used modern security interests?

### The label of “goods mortgage”

3.16 We wish to remove the confusing language of “bills of sale” and replace it with a term that borrowers can understand. We consulted on a variety of labels and concluded that “goods mortgage” was most readily understood.<sup>19</sup> This terminology is also familiar to lawyers, as charges on land, ships and aircraft are already referred to as “mortgages”.

### OWNERSHIP

3.17 Under the Bills of Sale Acts, a security bill is void (except as against the grantor) where the grantor of the bill was not the “true owner” of the goods at the time the bill was granted.<sup>20</sup> This concept of a “true owner” has been interpreted broadly by the courts. It includes:

- (1) a trustee holding only the legal interest in the goods;<sup>21</sup>
- (2) a beneficiary holding only a beneficial interest;<sup>22</sup> and
- (3) grantors who hold the goods as joint owners, owners in common or as partners, who could mortgage their share in the property.<sup>23</sup>

3.18 The draft Bill adopts a narrower concept of ownership. It recognises three types of ownership: sole ownership; joint ownership and ownership in common. Clause 2 deals with sole ownership, clause 3 deals with other two. Clause 2(3) states that an equitable interest under a trust is insufficient.

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<sup>19</sup> Bills of Sale (2016) Law Com No 369, para 4.15.

<sup>20</sup> Bills of Sale Act (1878) Amendment Act 1882, s 5.

<sup>21</sup> *In re Sarl, ex p Williams* [1892] 2 QB 591, where the court held that the words “true owner” included absolute owners, and also those who are the true legal owners of the chattels at the time of execution of the bill of sale.

<sup>22</sup> *Re Feild, ex p Pratt* (1890) 63 LT 289, where a bill of sale was held to be valid when granted by a joint tenant in equity under a marriage settlement.

<sup>23</sup> The case law refers to the joint owners and owners in common by the more traditional terms of “joint tenants” and “tenants in common”. See also *Re Tamplin and Son, ex parte Barnett* [1886-90] All ER Rep 844, where a partner was the “true owner” of partnership property to the extent of his share in the property under the terms of the partnership.

### 3 Goods mortgages: co-owners

- (1) Where qualifying goods are owned jointly by two or more individuals, those individuals may together create a charge over the goods as security for the discharge of an obligation.
- (2) Where qualifying goods are owned in common by two or more persons, any of those persons who is an individual may create a charge over his or her undivided share in the goods as security for the discharge of an obligation.
- (3) The following requirements must be met—
  - (a) the goods exist, and are owned by the person or persons concerned, at the time when the charge is created;
  - (b) the charge is created by a written instrument complying with section 5;
  - (c) the obligation is not an excluded obligation (see section 7).
- (4) References to ownership jointly or in common with others by an individual include references to ownership jointly or in common with others by an individual as a member of a partnership (other than a limited liability partnership).
- (5) A charge created under subsection (1) or (2) is a “goods mortgage”.

### Joint ownership and ownership in common

3.19 The distinction between joint ownership and ownership in common is well established in English law. Joint ownership means that each of the owners has an undivided right over the whole property. On the death of one joint owner, their interest passes to the other. Owners in common each own a defined share, which is not necessarily an equal share. That share can be sold separately, and passes along with the owner's estate on death.

3.20 At common law, where two or more persons purchase goods together they are held to be joint owners, unless they show an intention to the contrary.<sup>24</sup> By contrast, in the case of partnerships, there is a strong presumption that goods are owned in common.<sup>25</sup>

<sup>24</sup> As an exception to the rule, the default position for racehorses and ships is that they are owned in common. See M Bridge, *The Law of Property* (1st ed 2013) 4-001.

<sup>25</sup> See *Bathurst v Scarborow* [2004] EWCA Civ 411 at [44] per Lord Justice Rix.

This means that under the current law a single partner can grant a bill of sale on their share of goods.<sup>26</sup>

- 3.21 The draft Bill draws on this existing distinction. Under clause 3, where two or more people hold property jointly, they must act jointly to create a goods mortgage. Where property is held in common, each owner may create a goods mortgage over their separate share. Clause 3(4) confirms that these principles apply to property held by unincorporated partnerships.
- 3.22 These definitions are intended to include trustees, who hold the legal title to trust property. Trustees will therefore be able to grant goods mortgages over trust property, subject to the terms of the trust.

### **Beneficiaries under trusts**

- 3.23 Clause 2(3) deals with cases in which property is held on trust for a beneficiary, who has only an equitable interest in the goods. This does not amount to “ownership” for the purposes of the draft Bill. In our view, it would be wrong to allow both trustees and beneficiaries to grant goods mortgages over the same goods.
- 3.24 We do not think that a beneficial interest can be seen as ownership of tangible, moveable goods. In legal terms, the rights of beneficiaries under a trust are normally treated as intangible rights (“things in action”) rather than “things in possession”, such as goods.<sup>27</sup> Moreover, a beneficiary is not an “owner” in the way someone who has direct title is: beneficiaries with only subordinate rights (that do not necessarily amount to a right to take possession) or mere expectations to have rights over goods should not be able to enter into a transaction which could result in the lender taking physical possession of the goods.

### **Consultation Question 3.**

- 3.25 Do consultees agree that beneficiaries under trusts should not be able to grant goods mortgages?

## **WHAT GOODS CAN BE USED FOR A GOODS MORTGAGE?**

### **The goods must exist**

- 3.26 One of the purposes of the bills of sale legislation was to prevent individuals from borrowing money against goods which they did not own, but which they might own in the future (sometimes referred to as “after-acquired property”). Thus section 5 of the

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<sup>26</sup> In *Re Tamplin & Son, ex p Barnett* (1890) 59 LJQB 194 one of two partners executed a bill of sale of the partnership property purporting to convey, not only his own share, but the whole of the property. This was deemed to represent a valid bill of sale over the 50% share that the partner had.

<sup>27</sup> See, for example, G Tolhurst, *The Assignment of Contractual Rights* (2nd ed 2016) p 11, Falcon Chambers and P Morgan (eds), *Fisher and Lightwood's Law of Mortgage* (14th ed 2014) 17-1.

1882 Act states that the grantor of the bill of sale must be the true owner of the secured property “at the time of the execution of the bill of sale”.

3.27 The draft Bill preserves this prohibition on borrowing money against future goods. As we argued in our 2016 report, security over future goods has the potential to be exploitative.<sup>28</sup> Clause 2(2)(a) therefore states that the goods must exist and be owned by the individual concerned at the time the charge is created.<sup>29</sup>

3.28 The 1882 Act provided some exceptions to the use of future property as security. Under section 6(2) of the 1882 Act where fixtures, plant and trade machinery are substituted for the fixtures, plant or trade machinery named in the schedule to the original bill of sale, they become subject to the security. The draft Bill removes this exception. A lender will only acquire an interest in the specific goods which have been mortgaged – not in future goods of the same category.

3.29 However, we envisage that individuals will be able to finance the purchase of goods by granting a goods mortgage over those goods (in the way that land mortgages are used to buy land and property). In order to do so, the contractual arrangements will have to provide that the title to the goods passes to the buyer before the buyer charges those goods under a goods mortgage.

#### **Qualifying goods under clause 4**

3.30 Clause 4 provides further details of the type of goods which can be made subject to a goods mortgage. It sets out the general principle: the draft Bill applies to tangible goods. This is subject to two additions (growing crops and fixtures) and five exclusions (mainly aircraft and ships).

#### **4 Qualifying goods**

- (1) This section applies for the interpretation of this Act.
- (2) “Goods” means any of the following—
  - (a) tangible moveable property,
  - (b) growing crops, if charged separately from any interest in the land, and
  - (c) other things that are attached to or form part of land but are capable of being severed from the land, if the things are charged separately from any interest in the land.]
- (3) “Qualifying goods” means goods other than—
  - (a) excluded items, or

<sup>28</sup> Bills of Sale (2016) Law Com No 369, paras 4.68 to 4.72.

<sup>29</sup> See also clause 3(3)(a) for co-owned goods.

- (b) goods that are outside England and Wales at the time when the charge over them is created.

(4) In subsection (3) “excluded items” means—

- (a) aircraft registered in the United Kingdom;
- (b) anything that is by virtue of provision made under subsection (2)(f) of section 86 of the Civil Aviation Act 1982 included in a mortgage registered by virtue of that section;
- (c) ships registered on Part I of the register maintained under section 8 of the Merchant Shipping Act 1995;
- (d) ships registered with full registration on Part II of that register;
- (e) currency notes or coins that (in either case) are legal tender in the United Kingdom or elsewhere.

## Tangible goods

3.31 The draft Bill applies only to tangible moveable goods (see clause 4(2)(a)) – that is things one can touch and move. It does not apply to “things in action”<sup>30</sup> and other forms of intangible property. In particular, it does not cover security on company shares or bonds or intellectual property rights. It is currently possible for individuals to grant security interests over these forms of intangible property, but not under bills of sale legislation. Security on intangible property is outside the scope of this project and we are not proposing any changes to the current position.

## Growing crops

3.32 A separate statutory regime exists to allow farmers to grant charges over crops, stock and other agricultural assets: the Agricultural Credits Act 1928. However, it is currently also possible for farmers to use a bill of sale to borrow money on agricultural assets (including growing crops). It appears that some farmers do use bills of sale, possibly because agricultural charges must be granted to a bank,<sup>31</sup> and they wish to borrow from other lenders.

3.33 The draft Bill maintains the current position. In our 2016 report we acknowledged that having two separate means of creating charges over agricultural assets was not ideal.<sup>32</sup> However, a review of the Agricultural Credits Act 1928 to harmonise the

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<sup>30</sup> A thing in action has been defined as “a right of proceeding in a court of law to procure the payment of a sum of money (eg on a bill of exchange, policy of insurance), or to recover pecuniary damages for the infliction of a wrong or the non-performance of a contract.” M G Woodley, *Osborn’s Concise Law Dictionary* (12th ed 2013).

<sup>31</sup> Agricultural Credits Act 1928, s 5.

<sup>32</sup> See the discussion in Bills of Sale (2016) Law Com No 369, paras 4.35 to 4.38.

system is outside the scope of our project. The dual system does not appear to create problems in practice.

3.34 Clause 4(2)(b) specifically includes growing crops, as they are not always considered to be goods at common law. Crops have been treated as goods rather than as forming part of the land where:

- (1) the crops are “fructus industrielles”<sup>33</sup> – the product of “labour and industry”<sup>34</sup>;
- (2) the owner of the land sells what growing crop is on the land (whether it is a “natural” or “industrial” crop) on the terms that he will sever them from the land and deliver them to the purchaser.<sup>35</sup>

3.35 The natural growth of the soil, such as grass, timber and fruit on trees (“fructus naturales”) is considered to be part of the land.<sup>36</sup> Under the draft Bill, both types of crop (industrial and natural) may be made subject to a goods mortgage when charged separately from the land.

## Fixtures

3.36 The draft Bill captures items which are fixed to land. Clause 4(2)(c) refers to “other things that are attached to land or form part of land but are capable of being severed from the land”. Clause 13(1)(b) uses a shorthand version of the same concept. This is intended to mean “fixtures” and not anything else, such as buildings on the land. We are considering simply stating “fixtures” in clauses 4(2)(c) and 13(1)(b) in order to be very clear about the scope of these provisions.

3.37 At common law, a fixture becomes part of the land to which it is attached, and would not be considered moveable property.<sup>37</sup> However, current bills of sale legislation specifically refers to fixtures. Section 4 of the 1878 Act includes:

- (1) trade machinery, even if fixed to land; and
- (2) other fixtures, when assigned or charged separately from the land.

3.38 Clause 4(2)(c) simplifies these provisions by including all fixtures which may be severed from the land.

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<sup>33</sup> “Industrial crops” are fruits or crops produced by the labour of the year in sowing and reaping, planting and gathering, eg corn and potatoes.

<sup>34</sup> See *Marshall v Green* [1874-80] All ER Rep Ext 2198 at 2202.

<sup>35</sup> Sale of Goods Act 1979, s 61; *Washbourn v Burrows* (1847) 154 ER 45.

<sup>36</sup> Halsbury’s Laws of England, *Agricultural land* vol 1 (2008), para 370.

<sup>37</sup> It is a “contradiction in terms” to state that a fixture remains personal property: *Melluish v BMI (No 3) Ltd* [1996] AC 454 at 473.

## Priority over land mortgages

3.39 Deeming fixtures and growing crops to be goods (as the Bills of Sale Acts do and as the draft Bill does in clause 4(2)) leads to some complexity in terms of the interaction between goods mortgages and land mortgages.

3.40 We have attached a more detailed explanation of the nature of fixtures and their interaction with land law in Appendix 3. The current rule is that, where the land to which the fixtures or growing crops are attached is subject to a land mortgage, the land mortgagee is entitled to the fixtures and crops, to the exclusion of the bill of sale grantee. A mortgage of land comprises, without the need for specific mention, all fixtures which are annexed to the land at the time of the mortgage or which become annexed any time afterwards during the continuance of the land mortgage.<sup>38</sup> As courts have adopted an inclusive definition of “fixtures”, this could potentially affect a significant number of goods mortgages.

3.41 Bills of sale lenders appear to be unable to protect their interest in goods which can be affixed to land. Where there is overlap between a land mortgage and a bill of sale over fixtures attached to that land, the land mortgage engulfs the fixtures.<sup>39</sup> It does not make any difference that the fixtures could have been removed or that they were attached after the land mortgage was granted.<sup>40</sup>

3.42 Our concern is that the current law has unfair consequences for goods mortgages lenders who lend against goods which could become fixtures. For example, a lender could lend money against an antique mirror, or a statue, without it being obvious that the item would become a fixture.<sup>41</sup> Then the borrower could attach the mirror or statue to their mortgaged house and the land mortgage lender would get the benefit.

3.43 Even when it is obvious that the item subject to the goods mortgage would be affixed to land (such as machinery which is needed for trade on industrial premises), the law gives little recourse to the goods mortgagee. The goods mortgage lender could check that the borrower's land is not mortgaged, but they could not prevent it from being mortgaged in the future.

3.44 There are three broad scenarios in which goods mortgages could overlap with land mortgages:

- (1) the item subject to a goods mortgage is affixed to the land and a land mortgage is subsequently granted over the land;

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<sup>38</sup> See Halsbury's Laws of England, *Mortgage* vol 77 (2016) para 169; see also the Law of Property Act 1925 ss 62(1) and 205(1)(ix).

<sup>39</sup> *Longbottom v Berry* (1869-70) LR 5 QB 123. Although this case pre-dates the Bills of Sale Acts 1878 and 1882, it was cited with approval in *Reynolds v Ashby & Son Ltd* [1904] AC 466 and appears to reflect the current law.

<sup>40</sup> In *Longbottom v Berry* (1869-70) LR 5 QB 123, the mortgagor granted a mortgage over his land, then bought machinery, affixed it to the land and granted a bill of sale over the machinery. The land mortgagee took the land and the fixtures.

<sup>41</sup> See *D'Eyncourt v Gregory* (1866) LR 3 Eq 382 and *Kennedy v Secretary of State for Wales* [1996] EGCS 17 for examples of art and decorative objects which were held to be fixtures.

- (2) the item is affixed to the land when the goods mortgage is granted, and there is already a land mortgage in effect over the land;
- (3) the item is not affixed to the land when the goods mortgage is granted, but becomes a fixture afterwards (and, before the good is affixed, the land becomes subject to a land mortgage).

3.45 Clause 13 is in tentative form (thus in square brackets). Its intended effect is that the goods mortgage lender should have priority in cases 1 and 3 and the land mortgage lender should have priority in case 2. It is in part influenced by section 8(6) of the Agricultural Credits Act 1928.

3.46 We do not think that this policy refinement will prove controversial. The land mortgagee's interests are preserved where the land mortgagee takes a mortgage over land which includes unencumbered fixtures. Where the land mortgage comes after the goods mortgage (case 1) or where the land mortgage does not include the fixtures to start with (case 3), it seems fair for the goods mortgage to have priority.

3.47 Where the land mortgage post-dates the goods mortgage on fixtures or growing crops, the land mortgage lender can check the goods mortgage register if they are particularly interested in one of the fixtures on the land (for example, because the fixture is particularly valuable). As we are deeming fixtures and growing crops to be goods, the goods mortgages over these items will not be registrable as land charges. If the goods mortgage borrower is also the land mortgage borrower, they will have a duty under the draft Bill to inform the land mortgage lender about the goods mortgage over the fixtures (clause 14(3)).

3.48 We are currently also considering whether goods mortgagees can and/or should have to place a notice on the land register of their interests on fixtures. This would be similar to hire-purchase lenders with title to fixtures.<sup>42</sup> We welcome comments on this.

**Consultation Question 4.**

3.49 Do consultees agree with our proposed scheme of priority between a goods mortgage over fixtures and growing crops and a land mortgage?

**Consultation Question 5.**

3.50 If not, would it be preferable to take out fixtures and growing crops from our definition of "goods" so that they could not be made subject to a goods mortgage at all?

<sup>42</sup> Lenders in hire-purchase agreements may be able to protect their interests to some extent from the consequences of the law of fixtures, by registering a notice against the land: see *Megarry & Wade: The Law of Real Property* (8th ed 2012) 23-024 (the relevant paragraph is quoted in Appendix 3).

## Excluded goods

3.51 Several items which would otherwise fall within the definition of “goods” in clause 4(2), are then “excluded” from the category of “qualifying goods”. They are set out in clause 4(4).

### Aircraft

3.52 Mortgages over UK-registered aircraft are registered in a specialised aircraft register held by the UK Civil Aviation Authority (“CAA”),<sup>43</sup> and are excluded from the Bills of Sale Acts.<sup>44</sup> Our policy is to maintain this position. Under clause 4(4)(a), UK-registered aircraft are excluded. They must be mortgaged under the Mortgaging of Aircraft Order 1972 (“the 1972 Order”) and not as goods mortgages.

3.53 The position over aircraft parts is more complex. Presently, aircraft engines and other spare parts could be made subject to a bill of sale – though in some circumstances they can also be mortgaged under the 1972 Order. Under article 3 of the 1972 Order, aircraft may be mortgaged together with engines and any “store of spare parts”. Subsection 4(4)(b) of the draft Bill excludes any aircraft-related items which are already subject to an aircraft mortgage. On the other hand, it allows an individual to grant a goods mortgage over aircraft parts which have not been mortgaged together with the aircraft.

3.54 In addition to domestic registration, security over aircraft can be registered internationally. Security interests in “aircraft objects” created under the Cape Town Convention<sup>45</sup> can be registered as “international interests” with the International Registry.<sup>46</sup>

3.55 A registered international interest has priority over interests registered in national registers (including aircraft mortgages registered with the CAA) and any unregistered interests. The International Registry regime is additional to domestic registers, and aircraft mortgages continue to be registrable with the CAA. Similarly, international interests over spare parts will also take priority over registered goods mortgages relating to the same goods.

3.56 While a security bill of sale over a non-UK registered aircraft remains possible in law,<sup>47</sup> in practice we have been unable to find any cases. As we are maintaining the current law, it would be possible to grant a goods mortgage over aircraft registered outside the UK.

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<sup>43</sup> Under the Mortgaging of Aircraft Order 1972 SI 1972 No 1268.

<sup>44</sup> Bills of Sale legislation does not apply to mortgages of UK-registered aircraft made on or after 1 October 1972. See Mortgaging of Aircraft Order 1972 SI 1972 No 1268, art 16(1).

<sup>45</sup> The Cape Town Convention on International Interests in Mobile Equipment 2001.

<sup>46</sup> An international interest can be created where a security agreement in respect of an aircraft object is entered into by a debtor located in a contracting state at the time the agreement is concluded, or where the aircraft is registered in a contracting state.

<sup>47</sup> See *Shawcross and Beaumont: Air Law* (June 2017) Div IV para [47].

## Ships

3.57 At present, all ship mortgages are excluded from the scope of the Bills of Sale Acts.<sup>48</sup>

3.58 As with aircraft, a separate legal regime governs security over certain ships.<sup>49</sup> The Merchant Shipping Act 1995 (“the 1995 Act”) together with The Merchant Shipping (Registration of Ships) Regulations 1993 provide for a single central register for ships. This is divided in four parts:

- (1) Part I for ships owned by qualified persons which are neither fishing vessels nor registered as small ships.
- (2) Part II for fishing vessels. Owners have a choice between full registration and simple registration.
- (3) Part III for small ships.
- (4) Part IV for bareboat chartered ships.

3.59 The 1995 Act sets out a scheme for the registration of mortgages, which applies to ships registered under Part I and to fishing vessels with full registration. Where these ships are mortgaged, the mortgage must be registered in the central register against the ship. However, these provisions do not apply to bareboat chartered ships,<sup>50</sup> small ships<sup>51</sup>, fishing vessels with only simple registration<sup>52</sup> or unregistered ships.

3.60 Bareboat charters pose no particular problem, as they are subject to the mortgaging rules of their country of registration. However, there are potential problems in respect of small ships, fishing vessels with only simple registration and unregistered ships of any kind. It is possible to create a legal mortgage over these vessels at common law, but there is no obligation to register that mortgage.

3.61 In most cases, mortgages on these types of ships are registered – either because the owners are incorporated<sup>53</sup> or because they choose to register their ship under Part I or Part II with full registration. Nevertheless, there are situations in which third party purchasers of the ships fall victim to the gap in the law of ship mortgage registration.

3.62 One such case was *The Shizelle*,<sup>54</sup> where a mortgage was granted against an unregistered ship. The ship was subsequently acquired by third party purchasers in

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<sup>48</sup> See the Bills of Sale Act 1878 Act, s 4: “the expression ‘bill of sale’ ... shall not include ... transfers or assignments of any ship or vessel or any share thereof”.

<sup>49</sup> Under the Merchant Shipping Act 1995 and the Merchant Shipping (Registration of Ship) Regulations 1993 SI 1993 No 3138.

<sup>50</sup> Merchant Shipping Act 1995, s 17(7).

<sup>51</sup> Merchant Shipping Act 1995, s 10(4) and Merchant Shipping (Registration of Ship) Regulations 1993 SI 1993 No 3138, reg 91.

<sup>52</sup> Merchant Shipping (Registration of Ship) Regulations 1993 SI 1993 No 3138, reg 3.

<sup>53</sup> Where the owners of the ship are incorporated in England and Wales or have a place of business in England and Wales, the mortgage on the ship must be registered against them at Companies House.

<sup>54</sup> *The Shizelle* [1992] 2 Lloyd’s Rep 444.

good faith with no notice of the mortgage. The court held that the unregistered mortgage was enforceable against the purchasers although they had no means of finding out about it. However, the court took the opportunity to express regret at the gap in the statutory provisions which led to this conclusion.<sup>55</sup> This criticism was echoed by academics, who argued that this problem ought to be rectified for the protection of innocent purchasers.<sup>56</sup>

3.63 The draft Bill as currently drafted addresses this issue. Clauses 4(4)(c) and (d) exclude any ship mortgage which has to be registered under the 1995 Act, either under Part I or fully registered fishing vessels under Part II. However, other ship mortgages granted by individuals would fall within the goods mortgages regime. This means that they would be invalid unless they were registered under the regime set out in the draft Bill. If the ship owners granting these types of mortgages did not wish to come within the goods mortgages regime, they would still have the alternative of registering their ships under Part I or Part II (full registration) and abiding by the mortgage registration rules under the 1995 Act.

3.64 This represents a change to the policy we set out in our report, where we recommended that the draft Bill should not apply to ships at all.<sup>57</sup> We think the change could be justified by the need to protect buyers of ships subject to a mortgage that is not required to be registered at the moment. We have made contact with the Maritime and Coastguard Agency, responsible for the ship register, to discuss whether our approach is suitable. However, we are also interested in consultees' views.

#### **Consultation Question 6.**

3.65 Do consultees consider that ship mortgages which are not covered by the specialist ship mortgage regime could be brought within the scope of the draft Bill without causing difficulty to the existing regime for ship mortgages?

#### **Coins and notes which are legal tender**

3.66 Clause 4(4)(e) excludes notes and coins which may be used as legal tender in the UK or overseas. This exclusion is similar to that in the Sale of Goods Act 1979, which prevents "money" being counted as "goods".<sup>58</sup> This would not prevent individuals from using antique coins or banknotes as security.

<sup>55</sup> *The Shizelle* [1992] 2 Lloyd's Rep 444 at 451: "The legislature has left out of the Merchant Shipping Acts vessels under a certain size (Benyon v. Cresswell), without bringing them within the Bills of Sale Act or any other statutory system of registration of mortgages ... I hope that the lacuna can be filled by introducing a system of registration of mortgages for all British ships ...".

<sup>56</sup> See A Mandaraka-Sheppard, *Modern Maritime Law Volume 2: Managing Risks and Liabilities* (3rd ed 2013) 6.4; H Beale, *The Law of Security and Title-based Financing* (2nd ed 2012) 14.42.

<sup>57</sup> Bills of Sale (2016) Law Com No 369, paras 4.34, 4.40.

<sup>58</sup> Sale of Goods Act 1979, s 61(1).

## WHAT OBLIGATIONS CAN BE SECURED?

### Removing the current restrictions

3.67 Effectively, security bills of sale can only be used to secure fixed sum loans, where the amount of the loan and repayment schedule is set out in advance. This is because the document creating a security bill must include 12 separate pieces of information, including the loan amount, the rate of interest, the repayment instalments and the date by which repayment is to be made.<sup>59</sup>

3.68 During the course of our project we were told that this hampers the ability of unincorporated businesses to borrow money on the security of their goods. In particular, they cannot use goods as security for more flexible forms of credit, such as overdrafts or other “running-account” credit facilities, where the borrower is free to borrow different amounts from time to time up to a maximum limit. We were also told that it causes problems where a company director is asked to guarantee the company’s loans and wishes to use his or her own goods to secure the guarantee. High net worth individuals may own valuable paintings or antiques, but the Bills of Sale Acts prevent them from using these to secure a guarantee, because the amount and repayment dates cannot be specified in advance.

3.69 We wish to remove unnecessary regulation which prevents businesses and high net worth individuals from using goods to secure a wider range of obligations – not just fixed sum loans. As a starting point, clause 2(1) is drafted widely: a goods mortgage may be used as security to discharge any obligation. However, this is subject to the borrower protection measures in clause 7, which exclude certain obligations.

### The need for borrower protection

3.70 Following our 2016 report, advice agencies expressed concern that borrowers could be exploited if goods mortgages were used too widely. Citizens Advice drew our attention to the rising number of people seeking their help with problems over “guarantor loans”. This is where “the borrower gives the name of a guarantor, normally a friend or family member, who is then pursued for payment if the borrower can’t repay”.<sup>60</sup> Advice agencies told us that these loans carry a substantial risk that the guarantors will be faced with unexpected demands for payment, but people were often unaware of this danger. They thought that the problems would be aggravated substantially if the guarantor also risked losing valuable goods, such as a car.

3.71 Advice agencies were also concerned at the prospect that consumers would be asked to provide vehicles as security for overdrafts or credit card debts. They pointed out that these credit arrangements could last for years. While borrowers are in work they might give a goods mortgage with little thought, on the ground that they are not concerned about their ability to repay. These arrangements might come back to haunt them

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<sup>59</sup> Under s 9 of the Bills of Sale Act (1878) Amendment Act 1882, a bill used for security is void unless it is made in accordance with the form in the schedule to the Act. This information is required by the form in the schedule.

<sup>60</sup> See press release of 19 February 2017 at <https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/citizens-advice-reports-rise-in-guarantor-loan-problems/>

several years later when their circumstances change, they are unable to pay their debts and as a consequence find their cars repossessed.

- 3.72 So far we are not aware of any demand to allow consumers to secure overdrafts or credit card debts on goods. We have therefore rethought our policy in this area. We now recommend that only certain borrowers should be able to secure guarantees and running-account credit on goods.
- 3.73 This new policy is set out in clause 7. It provides that only high net worth individuals would be able to use a goods mortgage to secure a guarantee. These individuals are more likely and able to seek legal advice before entering into secured transactions, allowing them to evaluate the risks of the transaction.
- 3.74 Meanwhile, the use of goods mortgages to secure running-account credit would be restricted to businesses borrowing large amounts (that is, over the prescribed CCA limit of £25,000) and high net worth individuals. Again, these borrowers can be expected to evaluate the risks involved and to afford legal advice.

**Consultation Question 7.**

- 3.75 Do consultees agree that only high net worth individuals should be able to use goods mortgages to secure guarantees?

**Consultation Question 8.**

- 3.76 Do consultees agree that only high net worth individuals and businesses borrowing over £25,000 should be able to use goods mortgages to secure running-account credit?

## 7 Excluded obligations

- (1) This section makes provision about the obligations that are excluded obligations for the purposes of sections 2(2)(c) and 3(3)(c) (and so cannot be secured by a goods mortgage).
- (2) A guarantee is an excluded obligation unless—
  - (a) the high net worth conditions in section 28(4) are met, and
  - (b) the goods mortgage includes a declaration by the mortgagor which—
    - (i) acknowledges that the mortgagor will not have available the protection and remedies that would be available to the mortgagor under sections 20(1) and 27(2) in the case of a goods mortgage other than an exempt goods mortgage, and
    - (ii) complies with prescribed requirements.
- (3) The obligation of the debtor under an agreement for running-account credit is an excluded obligation unless—
  - (a) the high net worth conditions in section 28(4) or the business credit conditions in section 28(5) are met, and
  - (b) the goods mortgage includes a declaration by the mortgagor which—
    - (i) acknowledges that the mortgagor will not have available the protection and remedies that would be available to the mortgagor under sections 20(1) and 27(2) in the case of a goods mortgage other than an exempt goods mortgage, and
    - (ii) complies with prescribed requirements.
- (4) For the meaning of “exempt goods mortgage”, see section 28.
- (5) In this Act “guarantee” includes an indemnity.
- (6) Schedule 1 makes provision for the purposes of this section about the meaning of “running-account credit” and related matters.

## Guarantees

3.77 The effect of clause 7(2) is that only high net worth individuals who opt out of the additional protections under the draft Bill can use a goods mortgage to secure a

guarantee. For a discussion of the high net worth conditions, see Chapter 2 and Appendix 1.

3.78 The courts have defined a “guarantee” as:

a contract whereby the surety (the guarantor) promises the creditor to be responsible for the due performance by the principal of his existing or future obligations to the creditor if the principal fails to perform them or any of them.<sup>61</sup>

3.79 Clause 7(7) extends this definition by including indemnities. In a pure guarantee, the guarantor is only liable if the principal is liable. In other words if the principal borrower has a defence against the action, the guarantor has the same defence. However, under an indemnity, the person in the position of the guarantor is liable to pay even if the agreement with the principal borrower is unenforceable for some reason.<sup>62</sup>

3.80 Individuals who are not “high net worth” would not be able to use goods to secure guarantees, even if the guarantee is for a business loan over £25,000. This is because an individual who guarantees a business loan is acting in a personal as well as a business capacity. They put their own property on the line and may be particularly vulnerable in the event of a default.

### **Running-account credit**

3.81 Under clause 7(3) a borrower may only use a goods mortgage to secure running-account credit if they meet the high net worth conditions or the business credit conditions. The business credit conditions are introduced in Chapter 2 and explained in Appendix 1.

3.82 Running-account credit is defined in section 10 of the CCA, which draws a distinction between “fixed-sum” and “running-account” credit:

- (1) Under a fixed-sum credit arrangement, a debtor is provided with a specified amount of credit (received either in one amount or by instalments).<sup>63</sup>
- (2) Under a running-account credit facility, the debtor is enabled to receive credit from time to time, up to a fixed maximum referred to as a “credit limit”. The sum available fluctuates from time to time, to take into account repayments by the debtor.<sup>64</sup>

3.83 Common examples of running-account credit – sometimes referred to as “revolving” credit – are overdrafts, credit cards and credit lines provided by business suppliers.

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<sup>61</sup> *Vossloh AG v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch), [2011] 2 All ER (Comm) 307 at [23]. This was cited with approval in G Andrews and R Millett, *The Law of Guarantees* (7th ed 2015) para 1-004.

<sup>62</sup> The concept of indemnity has a broad meaning, and a narrower meaning. The broad meaning is an obligation to make good a loss suffered by another. The narrower meaning refers to contracts where the person giving an indemnity does so by securing the performance of another’s obligation to the creditor. The draft clause refers to the narrower sense. See G Andrews and R Millett, *The Law of Guarantees* (7th ed 2015) paras 1-013 and 1-014.

<sup>63</sup> Consumer Credit Act 1974, s 10(1)(b).

<sup>64</sup> Consumer Credit Act 1974, s 10(1)(a).

3.84 Clause 7(6) refers readers to schedule 1 to the draft Bill which replicates the CCA definition of running-account credit.

### Should other obligations be excluded?

3.85 Our starting point is that, at least for more commercially-aware borrowers, the legislation should be written in broad terms, to allow individuals to use goods to secure a wide range of obligations. Not all the obligations will necessarily be to pay money; examples of non-monetary obligations include obligations to return shares under a stock lending agreement and obligations to supply stock or commodities.

3.86 This raises questions about whether there should be any further prohibitions on the types of obligations which individuals can secure under a goods mortgage. During consultation, the City of London Law Society suggested that people might be exploited if unscrupulous persons were able to take goods mortgages for the personal performance of services. They suggested that compelling an individual to perform services under the threat of losing essential property might be akin to “trucking, bondage or slavery”.<sup>65</sup>

3.87 Presently, goods can be used to secure obligations other than fixed-sum loans under absolute bills of sale. Absolute bills of sale are rare nowadays,<sup>66</sup> and absolute bills of sale relating to non-monetary obligations were rare even shortly after the Bills of Sale Acts were passed.<sup>67</sup>

3.88 Land mortgages,<sup>68</sup> aircraft mortgages<sup>69</sup> and ship mortgages<sup>70</sup> can be used to secure non-monetary obligations. Similarly, the Personal Property Securities Acts of New Zealand<sup>71</sup> and Australia<sup>72</sup> allow goods to be used as securities for “an obligation”.

3.89 We have no evidence to suggest that bills of sale or any of the above types of security have been used to exploit people in connection to personal services, but there is at least a theoretical risk. Since the 2016 report, we have spoken to the Gangmasters and Labour Abuse Authority and the English Collective of Prostitutes, who did not think enabling goods mortgages for all obligations would cause difficulties. We have also contacted the Equality and Human Rights Committee and Focus on Labour Exploitation (FLEX), who did not have any examples of current abuses (under bills of sale or any other type of security).

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<sup>65</sup> Bills of Sale (2016) Law Com No 3694, para 4.25.

<sup>66</sup> We did not find any absolute bills of sale when we searched the High Court register for this project.

<sup>67</sup> J Weir, *Law of Bills of Sale* (1896) p 1; see also G McBain, “Repealing the Bills of Sale Acts” (2011) 5 *Journal of Business Law* 475 at 480.

<sup>68</sup> Land Registration Act 2002, s 132 defines a land mortgage as being “for securing money or money’s worth”.

<sup>69</sup> Mortgaging of Aircraft Order 1972 SI 1972 No 1268, art 3 defines a mortgage as “security for a loan or other valuable consideration”.

<sup>70</sup> Merchant Shipping Act 1995, Sch 1, para 7(1) defines ship mortgages as “security for the repayment of a loan or the discharge of any other obligation”.

<sup>71</sup> Personal Property Securities Acts 1999 (NZ), s 4.

<sup>72</sup> Personal Property Securities Acts 2009 (Cth), s 9.

3.90 There are also other protections in place against serious exploitation. Section 1 of the Modern Slavery Act 2015 prohibits “forced or compulsory labour” and “servitude”.<sup>73</sup> This would also include cases of “debt bondage”.<sup>74</sup>

3.91 We are still considering whether any further restrictions are necessary or desirable to limit the type of obligation which can be secured, in order to assuage any concerns.

**Consultation Question 9.**

3.92 We welcome views about whether it is necessary to prevent goods mortgages from being used to secure the performance of services.

**Consultation Question 10.**

3.93 We welcome comments on any disadvantages of a restriction which prevents goods mortgages being used to secure non-monetary obligations (such as an obligation to return shares in stock lending), either in a consumer or business context.

**What happens to forms of security which do not conform with the draft Bill?**

3.94 Some ways in which individuals can use goods as security under the current law are not affected by the draft Bill. In particular, the draft Bill will not affect:

- (1) other types of security, such as pledges or liens, where the lender has possession of the goods. Examples of such “possessory securities” include pawn-broking and “the repairer’s lien” by which repairers have the right to retain articles until their bill has been paid;
- (2) agricultural charges;
- (3) mortgages over goods which are not “qualifying goods”. As we have seen, clause 4 excludes mortgages over intangibles, such as shares or intellectual property, as well as mortgages on ship and aircraft which can be registered in specialist registries; and

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<sup>73</sup> The section reads: “a person commits an offence if ... the person requires another person to perform forced or compulsory labour and the circumstances are such that the person knows or ought to know that the other person is being required to perform forced or compulsory labour”. In determining whether there is forced or compulsory labour, regard may be had to all circumstances, including any work or services provided by the person and the personal circumstances and vulnerability of the person.

<sup>74</sup> Subsection 1(2) provides that “the references to holding a person in slavery or servitude or requiring a person to perform forced or compulsory labour are to be construed in accordance with Article 4 of the Human Rights Convention”. The ECtHR has referred to “debt bondage” (as per the Supplementary Convention on the Abolition of Slavery, the Slave Trade and Institutions and Practices Similar to Slavery (7 September 1956; UN TS vol 266 p 3), Article 1) as an instance of forced labour.

(4) hire-purchase and conditional sale.

3.95 However, some types of mortgages will not be permitted at all. This includes mortgages:

- (1) over future goods;
- (2) over jointly-held property, where the interest is not created by all owners; or
- (3) used to secure guarantees or revolving credit, when made by consumers who are not high net worth or do not fulfil the business credit conditions.

3.96 Clause 6 renders some mortgages and charges over goods void if they do not comply with the provisions of the draft Bill. This is an anti-avoidance provision, intended to prevent people from disguising goods mortgages as another type of transaction in order to avoid the requirements and protection measures under the draft Bill.

## **6 Other non-possessory security on goods**

- (1) This section applies to any agreement or arrangement that is entered into by an individual and is not—
  - (a) a goods mortgage (as defined by sections 2 and 3),
  - (b) a pledge, lien or other security under which the goods are to remain in the possession of, or under the custody of, the person to whom the obligation being secured is owed until the obligation is discharged,
  - (c) an agricultural charge under Part 2 of the Agricultural Credits Act 1928, or
  - (d) a mortgage capable of being registered by virtue of section 86 of the Civil Aviation Act 1982.
- (2) The agreement or arrangement is void to the extent that it would (apart from this subsection)—
  - (a) create a mortgage or charge over qualifying goods owned by the individual, or subsequently to be acquired by the individual, as security for the discharge of an obligation, or
  - (b) create a mortgage or charge over an undivided share in qualifying goods owned by the individual in common with others, or subsequently to be acquired by the individual in common with others, as security for the discharge of an obligation.
- (3) A pledge, lien or other security—
  - (a) which has effect over qualifying goods owned by an individual,

- (b) which is not a goods mortgage, and
- (c) under which the goods are to remain in the possession of, or under the custody of, the person to whom the obligation being secured is owed until the obligation is discharged,

becomes void if, before the obligation being secured is discharged, the person to whom the obligation is owed passes custody of the goods to the person by whom the pledge, lien or other security is given.

- (4) Nothing in this section—
  - (a) affects the validity of the obligation whose discharge the agreement or arrangement purports to secure, or
  - (b) affects the validity of any hire-purchase agreement or conditional sale agreement.

3.97 Clause 6(1) lists security interests which are valid, and compatible with the draft Bill.

3.98 Clause 6(2) then renders void any other agreement for security which creates a mortgage or charge over qualifying goods owned by the individual, or subsequently to be acquired by the individual.

3.99 Although not expressly caught by this clause, attempts to circumvent the draft Bill by way of sale and lease-back will also be invalidated. The courts have already re-characterised sale and lease-back and sale and buy-back arrangements as invalid bills of sale or hire-purchase agreements, especially if necessary to ensure consumer protection.<sup>75</sup> What matters is the substance, not the form of the agreement<sup>76</sup> – if the arrangement is in essence a loan secured against the goods of an individual, the draft Bill applies and thus renders any transaction not in conformity with our formality requirements void.

3.100 Under clause 6(4)(a) the lender may still pursue the borrower for the money, but no longer has any right to the goods (whether the goods are in the possession of the borrower or of a third party).

3.101 Clause 6(4)(b) makes it clear that the draft Bill does not affect true “quasi-security” agreements, such as hire-purchase and conditional sale, which will continue irrespective of this legislation.

#### **Pledges where the borrower has custody of the goods**

3.102 The draft Bill is not intended to affect any “possessory” security (such as pledges and liens) where the lender is in possession of the goods. Clause 6(1)(b) defines this

<sup>75</sup> See H Beale, M Bridge, L Gullifer, E Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 7.54 and 7.57.

<sup>76</sup> For the re-characterisation of sale and buy-back as a bill of sale, see *Re Watson* (1890) 25 QBD 27.

concept widely, by including both physical “custody” and a legal right to possession. For example, a lender would have custody of a painting held in its own vaults. The lender would have broader “legal possession” if it had lent the painting to an art gallery, but had the right to recall it.

3.103 However, we are aware of a form of pawn-broking in which the lender allows the borrower to continue to use the goods. These are sometimes called “pledges by attornment”.<sup>77</sup> Here, the lender gives the borrower a pledge receipt, and then allows the borrower to keep the goods as a bailee of the lender. On this basis, the borrower has custody, but the lender can argue that it has still has possession because it has the right to recall the goods. The same effect can be brought about through other devices, such as “trust receipts”.<sup>78</sup>

3.104 Pledges by attornment have the same practical effect as goods mortgages. We are concerned that they could be used as a way to avoid the protections provided in the legislation, including the borrower’s right of voluntary termination and their right to require the lender to seek a court order before taking possession. They also create a risk for purchasers who buy the goods, who have no way of finding out about the lender’s interest.

3.105 To prevent this form of avoidance, clause 6(3) provides that a pledge or lien becomes void as soon as custody of the goods is passed to the borrower. We have used the word “custody” rather than “possession” because giving back “possession” to the creator of the possessory security would just bring the possessory security to an end.<sup>79</sup>

3.106 If the lender to whom the possessory security is given hands back custody of the security to the borrower (under a “trust receipt”, a “pledge by attornment” or in any other legally creative way), that would be a goods mortgage and would have to comply with our requirements. If it did not comply, the security would be invalidated.

3.107 Again, the lender may still pursue the borrower for the money, but no longer has a right to the goods. This means that a lender who wishes to take what is in substance a “non-possessory” security from an individual must meet the conditions set out in the draft Bill.

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<sup>77</sup> See H Beale, M Bridge, L Gullifer, E Lomnicka, *The Law of Security and Title-based Financing* (2nd ed 2012) 5.26 to 5.27.

<sup>78</sup> See M Bridge, *The Law of Personal Property* (1st ed 2013) 7-024, footnote 87.

<sup>79</sup> See M Bridge, *The Law of Personal Property* (1st ed 2013) 7-024.

**EXAMPLE: a pledge by attorney is void**

Individual (A) borrows money from lender (B). B asks for the repayment of this loan to be secured over A's car. A delivers the car to B as a pledge.

Before the loan is repaid, B agrees that A can use the car. A acknowledges that the car remains subject to the pledge, and that A holds the car as bailee of B and to the order of B.

From the moment that the car leaves the actual possession of B, the security is rendered void by clause 6(3), because it has not been created as a valid goods mortgage. A nevertheless remains liable to repay the loan to B.

Lenders and borrowers could still use this sort of arrangement, but they would need to create a valid goods mortgage.

3.108 We welcome views on whether this is the right way to prevent avoidance, or whether it would have any unintended effects. For example, it may go too far in restricting what parties can agree in relation to "custody" under possessory security agreements. It may also inadvertently invalidate transactions which are desirable.

**Consultation Question 11.**

3.109 Do consultees agree that pledges and other possessory security arrangements should become void if the borrower is given custody of the goods?

# Chapter 4: Document requirements

- 4.1 To be valid, a bill of sale must comply with 12 separate formalities.<sup>80</sup> We found these requirements to be onerous, opaque and unnecessarily restrictive.<sup>81</sup> The language of the standard form set out in the 1882 Act is archaic, and more likely to confuse borrowers than inform them. Research found that borrowers rarely examined the detail of logbook loan paperwork, which consists of “complex lengthy documents, often not written in ‘plain English’”.<sup>82</sup>
- 4.2 It is easy for lenders to make mistakes over the documentation. If they do, the sanction is severe and disproportionate. At present, the lender not only loses any rights to the goods but also loses the right to have the underlying debt repaid.

## THE GOODS MORTGAGE DOCUMENT: OUR RECOMMENDATIONS AND CLAUSE 5

- 4.3 In our 2016 report, we recommended that the paperwork should be simplified, but that the documentation should contain certain prominent warnings for borrowers. We also said that the penalties for failing to comply with the formality requirements should be less onerous. We discuss these elements in more detail below.
- 4.4 Clause 5 provides that the detailed content of the goods mortgage will be set out in regulations made by the Treasury, based on these recommendations.

### Less complex paperwork

- 4.5 In our 2016 report we argued that a goods mortgage was a significant transaction. We thought that there was still a need for a written document, signed by the borrower in the presence of a witness. However, we said there should be fewer requirements about the content. In practice, the goods mortgage document will sit alongside a credit agreement document, and there is no need for the goods mortgage to replicate the information in the credit agreement. The goods mortgage may be separate from the credit agreement, but this is not compulsory.<sup>83</sup>
- 4.6 The goods mortgage document should contain:
  - (1) the date of the goods mortgage;
  - (2) the names and addresses of the borrower and lender;
  - (3) a description of the obligation which is secured by the goods mortgage;

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<sup>80</sup> For more details see the commentary in our consultation paper: Bills of Sale (2015) Law Commission Consultation Paper No 225, ch 3.

<sup>81</sup> Bills of Sale (2016) Law Com No 3694, paras 2.16 to 2.23.

<sup>82</sup> FCA, *Consumer Credit Research: Payday Loans, Logbook Loans and Debt Management Services* (2014) p 27.

<sup>83</sup> Bills of Sale (2016) Law Com No 369, para 5.27.

- (4) the name and address of the witness;
- (5) a specific description of the goods; and
- (6) the relevant prominent statements (unless the goods mortgage is an “exempt” goods mortgage – clause 5(3)).

4.7 There are a few points to note about these requirements:

- (1) **The need for a “specific description”.** This is similar to the requirement that goods be “specifically described” under the Bills of Sale Acts.<sup>84</sup> What counts as a specific description will be highly context-dependent: describing a car may be easier than describing an antique. However, we think that the courts can come to a sensible view on whether a description is “specific” on a given set of facts. There is case law on bills of sale which may assist.<sup>85</sup>
- (2) **Witnesses.** There is no restriction on who may witness a signature – so long as they meet basic requirements such as being mentally competent to perform that function, and are of age. This would allow an agent of the lender, a friend of the borrower, or any other individual, to act as a witness.
- (3) **Electronic documentation.** We want to permit goods mortgage documentation to be completed and signed digitally. Electronic documentation would provide a cost and time saving to lenders. We are of the view that the regulations should state that a digital signature will suffice, with the witness also being able to sign electronically.<sup>86</sup> CCA-regulated consumer credit agreements can be signed electronically,<sup>87</sup> so we do not anticipate any issues in relation to consumer protection. A practice note on electronic signatures has been published by the Law Society, which may be of assistance.<sup>88</sup>

### Prominent statements

4.8 We said that there was a need to provide consumers who are not high net worth and small businesses (businesses borrowing £25,000 or less) with a clear warning that they may lose the goods if they do not keep up the repayments. We also thought that the document should warn borrowers that they may be guilty of a criminal offence if they sold the goods before paying off the loan – that is, if they sell the goods without telling the purchaser about the existence of the goods mortgage.<sup>89</sup>

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<sup>84</sup> Bills of Sale Act (1878) Amendment Act 1882, ss 4 to 6.

<sup>85</sup> For example *Davidson v Carlton Bank* [1893] 1 QB 82; *Carpenter v Deen* (1889) 23 QBD 566; *Witt v Banner* (1887) 20 QBD 114.

<sup>86</sup> Bills of Sale (2016) Law Com No 369, para 5.20.

<sup>87</sup> *Bassano v Toft* [2014] EWHC 377 (QB), [2014] CTLC 117.

<sup>88</sup> Available at <http://www.lawsociety.org.uk/support-services/advice/practice-notes/execution-of-a-document-using-an-electronic-signature/>

<sup>89</sup> Clause 14 of the draft Bill (discussed below) contains an obligation on the borrower to tell the prospective purchaser about the goods mortgage. Failure to do so may amount to fraud, as set out in clause 5(2).

#### Wording of the prominent statements

4.9 In our report we recommended that different statements should apply to mortgages over vehicles and mortgages over other goods. For vehicles we recommended statements along the following lines:

**YOUR VEHICLE MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR LOAN**

**IF YOU SELL THE VEHICLE BEFORE YOU PAY OFF YOUR LOAN, YOU MAY BE GUILTY OF A CRIMINAL OFFENCE**

#### Consultation Question 12.

4.10 Do you consider the wording of these warnings to be appropriate?

4.11 We propose to use adapted versions of the statements for other goods.

4.12 As well as being required to tell a prospective purchaser about the existence of the goods mortgage, owners must also disclose the existence of a goods mortgage to another lender (clause 14(3)). Again, they may be guilty of a criminal offence if they do not. We think it is right that the borrower is required to tell a subsequent lender about existing goods mortgages, allowing the lender to find out about the mortgage even if it has not yet appeared on the registers.

4.13 However, we welcome comments on whether the document should also contain a warning to this effect (as currently required by clause 5(2)(b)(ii)). We do not wish to include unnecessary warnings – as prominence given to one issue always distracts from the prominence given to another. During the consultation we were told that it creates serious problems if a logbook borrower sells the vehicle to a private purchaser. By contrast, second logbook loans are much less of a problem as lenders protect themselves by checking the asset finance registers run by Cap HPI, Experian and CDL.

#### Consultation Question 13.

4.14 Do you think it is necessary to include a prominent warning for borrowers that they should not seek a second loan on the vehicle without disclosing the existence of a first loan?

#### A less onerous sanction

4.15 We thought that the sanction should be changed. We recommended that a lender who fails to comply with the relevant formality requirements should lose any right to the

goods – both as against the borrower and third parties.<sup>90</sup> However, the lender would still be entitled to repayment of the loan, unlike under the current law.

4.16 Our recommendations will be implemented by clause 5 of the draft Bill and the regulations made under it.

## 5 Requirements to be met in relation to instrument

- (1) The instrument creating a goods mortgage must—
  - (a) contain prescribed provisions, and
  - (b) be signed or otherwise authenticated by the prescribed persons and in the prescribed manner.
- (2) The Treasury must by regulations require the inclusion in the instrument of statements in such form as the Treasury consider appropriate for the purpose of warning the mortgagor—
  - (a) that the mortgagor risks losing the goods if the obligation secured by the goods mortgage is not discharged, and
  - (b) that the mortgagor may commit an offence under the Fraud Act 2006 if, while the goods remain subject to the goods mortgage, the mortgagor—
    - (i) makes a disposition of the goods without previously disclosing to the purchaser the existence of the goods mortgage, or
    - (ii) creates a further security over the goods without previously disclosing to the person to whom the security is given the existence of the goods mortgage.
- (3) Subsection (2) does not apply in the case of an exempt goods mortgage (see section 28).

## Changes since the 2016 report

4.17 In our report, we proposed that the goods mortgage document should include a statement that “YOU TRANSFER OWNERSHIP OF YOUR VEHICLE TO US UNTIL YOU HAVE REPAYED YOUR LOAN”. As discussed in Chapter 3 we have now decided that a goods mortgage should take effect as a charge rather than a “true” mortgage (involving a transfer of title). Given this, it is no longer correct to say that ownership is transferred.

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<sup>90</sup> Bills of Sale (2016) Law Com No 3694, paras 5.55 to 5.60.

4.18 We also recommended in the report that a witness would need to state their occupation. However, we have been unable to find other statutes requiring the witness' occupation to be stated (even in respect of documents with rigid formality requirements, such as wills). Given the strict sanction for non-compliance with formalities for goods mortgages (invalidity of the mortgage), we no longer consider that the witness' occupation should be required by the draft Bill or associated regulations. The parties may still state the occupation of the witness if they wish.

**Consultation Question 14.**

4.19 Do you agree that it is unnecessary for the mortgage document to require the occupation of the witness?

## Chapter 5: Registration and priority

- 5.1 In our consultation paper and report, we discussed the current system of registration for bills of sale at the High Court.<sup>91</sup> We noted that logbook lenders also register their interests voluntarily with commercially-run asset finance registers. In practice, other logbook lenders and vehicle trade purchasers tend to rely on searches of these commercial registers when considering whether to grant finance to a potential borrower.
- 5.2 In our report we recommended that, to have effect against third parties, goods mortgages should be registered.<sup>92</sup> Although we acknowledged there were cogent reasons for the development of a comprehensive electronic register of security interests, we felt that such a register was unlikely to be achieved as part of the reform of bills of sale.<sup>93</sup> We recommended that, for the purposes of registration, vehicle mortgages should be distinguished from goods mortgages on other assets. Our recommendation was that vehicle mortgages should be registered at suitable asset finance registers, to be designated by the Treasury, and goods mortgages over other assets should remain registered at the High Court register.<sup>94</sup>
- 5.3 We are currently in discussions with the Treasury and the Ministry of Justice about these recommendations and their practical implications. The Treasury and the Ministry of Justice are considering the best way to ensure a comprehensive system of registration based on the following key principles:
  - (1) Goods mortgages must be registered in order to be enforced against third parties and trustees in bankruptcy.
  - (2) Where two or more goods mortgages are created over the same goods, those mortgages have priority according to the times at which they were registered.
- 5.4 As a result, this consultation does not include detailed provisions on registration.
- 5.5 We hope to consult separately on registration provisions shortly. If you wish to be involved in that consultation, please let us know by email as soon as possible at [bills\\_of\\_sale@lawcommission.gsi.gov.uk](mailto:bills_of_sale@lawcommission.gsi.gov.uk).
- 5.6 Below we outline our high-level thinking, based on our recommended division between vehicle mortgages and goods mortgages over other assets. We ask for consultees' views about particular aspects of the recommended arrangements.

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<sup>91</sup> Bills of Sale (2016) Law Com No 369, ch 6; Bills of Sale (2015) Law Commission Consultation Paper No 225, chs 5, 10.

<sup>92</sup> Bills of Sale (2016) Law Com No 369, paras 6.23, 6.47.

<sup>93</sup> Bills of Sale (2016) Law Com No 369, para 6.53.

<sup>94</sup> Bills of Sale (2016) Law Com No 369, para 6.23.

## GENERAL APPROACH

- 5.7 In our report, we recommended designating existing asset finance registers for registration of vehicle mortgages because they already have established online databases and an accessible user interface allowing for searches.
- 5.8 In order for private asset finance registers to put themselves forward for designation, the requirements must allow them to run a commercially-viable service. Where more than one register is designated, there must be arrangements to ensure that the priority of multiple mortgages over the same goods is easily determined, even if they were registered with different providers.
- 5.9 The private asset finance registers are less well-equipped to deal with non-vehicle mortgages. We recommended that these should remain with the High Court, but that the High Court process should be updated as the current paper-based High Court registration regime is unfit for purpose.

### Consultation Question 15.

- 5.10 If you have particular concerns about the practical consequences of dividing goods mortgages between the High Court register and private asset finance registers, we would welcome your comments.

## CLAUSE 8 MEANING OF “GENERAL GOODS MORTGAGE” AND “VEHICLE MORTGAGE”

- 5.11 Clause 8 of the draft Bill defines “general goods mortgage” and “vehicle mortgage”. The type of mortgage determines where it should be registered – a designated asset finance register (for vehicle mortgages) or the High Court (for general goods mortgages).

### 8 Meaning of “general goods mortgage” and “vehicle mortgage”

- (1) This section has effect for the interpretation of this Part.
- (2) A goods mortgage is a “general goods mortgage” if the goods to which it relates consist of or include goods other than qualifying vehicles.
- (3) A goods mortgage is a “vehicle mortgage” if the goods to which it relates consist of or include one or more qualifying vehicles.
- (4) “Qualifying vehicle” means—
  - (a) a vehicle registered under the Vehicle Excise and Registration Act 1994, or
  - (b) a mechanically propelled vehicle which, although not so registered—

- (i) is intended or adapted for use on roads to which the public has access, and
- (ii) bears a vehicle identification number, allocated in accordance with standards issued by the International Organization for Standards, or another unique identification code.

5.12 A goods mortgage is a “general goods mortgage” if it relates to goods other than qualifying vehicles. A “vehicle mortgage” is a goods mortgage which relates to qualifying vehicles. “Qualifying vehicle” is defined in clause 8(4).

5.13 In our report, we recommended that “vehicle” should be defined as “any vehicle registered with the Driver and Vehicle Licensing Agency”.<sup>95</sup> However, following further research, it has become apparent that a broader definition would be preferable because not all cars are registered with the DVLA. For example, vehicles which are brought to England from the EU may not be initially registered with the DVLA. Other vehicles may have been deliberately taken off the road and may no longer be registered with the DVLA.

5.14 The draft clause 8(4) proposes an updated definition, which comprises:

- (1) DVLA registration (that is, under the Vehicle Excise and Registration Act 1994); or
- (2) A vehicle intended for use on public roads which has a Vehicle Identification Number (VIN) or other unique identifier (such as a serial number).

The purpose of this provision is to cover all vehicles, regardless of their provenance or whether they are registered with the DVLA.

5.15 We think that the benefits of the definition of “vehicle mortgage” in clause 8 are two-fold: the definition is wide enough to encompass the vast majority of vehicles over which a goods mortgage may be granted, and is clear enough to provide a “bright line” test and legal certainty.

5.16 Based on our discussions to date, we think that there may be some vehicles which are registered with the DVLA but which do not have a VIN. We would welcome comment on whether this is the case.

**Consultation Question 16.**

5.17 Do consultees have experience of registering a vehicle which has been registered at the DVLA but does not have a VIN or other unique identifier?

<sup>95</sup> Bills of Sale (2016) Law Com No 369, para 6.10.

**Consultation Question 17.**

5.18 Do consultees agree that the definition of “vehicle mortgage” is sufficiently clear and wide to cover the types of vehicles over which a goods mortgage is likely to be granted?

**GENERAL GOODS MORTGAGES – REGISTRATION AT THE HIGH COURT**

5.19 As discussed above, we have recommended that general goods mortgages should continue to be registered at the High Court. Questions of priority between lenders who have mortgages over the same goods would be determined by the time of registration.

5.20 In our report we recommended certain measures to simplify the High Court register.<sup>96</sup> A key recommendation was that lenders should be able to email documents to the High Court for registration and receive an automatic reply, confirming the date and time of registration. Priority between competing goods mortgages would be determined by the time and date of that automatic reply. We are currently discussing these recommendations with the Treasury and the Ministry of Justice.

5.21 Registration of a general goods mortgage could be discharged on an application by either a borrower or a lender on production of relevant evidence. There should be a duty on the lender to discharge the registration. There should also be a procedure enabling the borrower to take action (at the lender's expense) if the lender fails to do so.

5.22 We also think that there should be provisions dealing with the automatic expiration of the registration of a general goods mortgage. This would occur ten years after the mortgage was registered or last renewed, unless the goods mortgage had previously been discharged.

**VEHICLE MORTGAGES – REGISTRATION AT A DESIGNATED ASSET FINANCE REGISTER**

5.23 In our report we recommended that vehicle mortgages should be registered with commercial asset finance registers, and should no longer be registered at the High Court.<sup>97</sup> We recommended that the asset finance registers should be designated by the Treasury.

5.24 We understand that there is a risk that private asset finance registers may take a commercial decision not to apply to become designated, or may later wish to surrender their designation. In this case, we think that the register of vehicle mortgages should be transferred back to the High Court or another public register.

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<sup>96</sup> Bills of Sale (2016) Law Com No 369, para 6.69.

<sup>97</sup> Bills of Sale (2016) Law Com No 369, para 6.23.

## Operation of designated asset finance registers

5.25 We discussed above our current thinking as to the operation of the High Court register. Similarly, we think that designated asset finance registers must:

- (1) Enter applications for registration of vehicle mortgages in the order of their receipt. As with general goods mortgages, priority between vehicle mortgages over the same vehicle would be determined by the time at which they were registered.
- (2) Discharge the registration of a vehicle mortgage on an application by either a borrower or lender, on production of evidence that the goods mortgage has been discharged. Again, we think that there should be a duty on the lender to discharge the registration. There should also be a procedure enabling the borrower to take action (at the lender's expense) if the lender fails to do so.

5.26 We understand from our discussions with asset finance registers that they already discharge entries on their registers where requested by lenders or borrowers, upon the production of evidence from the lender.

## Designated operators

5.27 In our report, we noted that in the United Kingdom, registration of finance interests over vehicles is offered by three private firms: Cap HPI, Experian and CDL.<sup>98</sup> We considered that the designation of existing providers would have the advantage of retaining their commercial experience of registering logbook loans over vehicles.

5.28 The Treasury has experience in designating banks and credit reference agencies. The Small Business, Enterprise and Employment Act 2015 and the Small and Medium Sized Business (Credit Information) Regulations 2015 give the Treasury the power to designate banks and credit reference agencies.<sup>99</sup> These designated bodies are then placed under obligations to share credit information with finance providers with the aim of improving access to credit for businesses.<sup>100</sup>

5.29 We think that a similar model could be used for the designation of asset finance registers.

## Criteria

5.30 We recommended that asset finance registries seeking designation should meet four criteria:<sup>101</sup>

- (1) adequate data-sharing;
- (2) robust technology (coupled with indemnities);

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<sup>98</sup> Bills of Sale (2016) Law Com No 369, para 6.24.

<sup>99</sup> Small and Medium Sized Business (Credit Information) Regulations 2015 SI 2015 no 1945.

<sup>100</sup> Bills of Sale (2016) Law Com No 369, para 6.30.

<sup>101</sup> Bills of Sale (2016) Law Com No 369, para 6.34.

- (3) a suitable cost structure; and
- (4) a complaints system.

5.31 Below, we focus on data-sharing and ask consultees about the ways this could be achieved.

### **Adequate data-sharing**

- 5.32 Under the current arrangements, the order of priority of multiple bills of sale granted over the same vehicle is determined by the order of registration at the High Court. This is so despite the fact that most lenders also register with commercial asset finance registers.
- 5.33 If vehicle mortgages were no longer registered at the High Court, questions of priority would be determined according to the times at which such mortgages were registered on an asset finance register. The issue of adequate data-sharing therefore needs to be considered carefully in the context of the designation of multiple operators of asset finance registers. A lender may register a goods mortgage over a vehicle with register "A", but without adequate data-sharing a subsequent lender may not discover that interest when they check the vehicle with register "B".
- 5.34 We have been told that asset finance registers currently share data according to the Finance & Leasing Association's Best Practice on Asset Registration.<sup>102</sup> Pursuant to this guidance, which is not binding, data received by one register by 6 pm will be made available to the other registers the same day and should be reflected on all registers by 8 am the following morning.<sup>103</sup> This causes an inevitable delay and a period of time during which the asset finance registers may hold inconsistent information.
- 5.35 This is particularly an issue when lenders are faced with fraudulent borrowers, who may visit several lenders in a day, offering an interest over their vehicle in return for a loan. We have been told anecdotally that this is not currently a widespread problem but we would welcome consultees' views.

#### **Consultation Question 18.**

- 5.36 We welcome comments on how often lenders and registers are faced with multiple registrations of interests over the same vehicle within a short timeframe, and the impact of this.

5.37 We are considering ways to mitigate this risk.

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<sup>102</sup> FLA *Best Practice on Asset Registration* (August 2016).

<sup>103</sup> FLA *Best Practice on Asset Registration* (August 2016) para 6.10.

## Requiring an indemnity

- 5.38 All asset finance registers currently offer an indemnity or data guarantee for consumers. It is not clear whether all the indemnities offered also cover loss to lenders caused by inaccurate or incomplete information. This may depend on the commercial arrangement between a lender and an asset finance register.
- 5.39 We are considering whether designated asset finance registers should be required to offer an indemnity to lenders which would cover loss caused by inaccurate or inconsistent information. This requirement could not be circumvented by contract.
- 5.40 Such a requirement would have the benefit of protecting subsequent lenders. However, we acknowledge that requiring such an indemnity may be reflected in the cost to lenders of registering and searching, although this cost should be low, as the indemnity is likely to be called upon only relatively rarely.
- 5.41 We are also considering whether to prescribe a minimum cap on any indemnity offered.

## Alternative options

### Real-time data-sharing between registers

- 5.42 An alternative approach which has been suggested to us is to impose a requirement for real-time data sharing between the designated asset finance registers. However, we understand that with the current infrastructure of asset finance registers this is not possible and it may require substantial investment in order to set up such a system.

### Provision of information by lenders

- 5.43 Another option would be to require lenders to register goods mortgages with all designated asset finance registers. This option would mean that all designated asset finance registers would be provided with the same information and would not need to share data. However, it would increase costs and administrative burdens on lenders.

### Consultation Question 19.

- 5.44 We welcome consultees' views on the different options for ensuring adequate data-sharing.

## TACKING

- 5.45 The draft Bill allows borrowers to grant multiple goods mortgages over the same goods. As stated above, priority between multiple mortgages will be determined by the time of their registration. This general priority rule is qualified by the rules on "tacking" outlined in the draft Bill. Tacking occurs where a prior lender makes "further

advances”,<sup>104</sup> which are secured in priority to subsequent mortgages that are already registered over the same goods.

5.46 Take the following example. A lender (L1) takes a goods mortgage to secure an agreement for running-account credit. L1 advances sums under that agreement. At a later date, another lender (L2) takes a second goods mortgage over the same goods, to secure a loan of a fixed sum. After L2 registers the second goods mortgage, L1 makes further advances under the running-account credit. L1 attempts to “tack” those further advances to the first goods mortgage – if successful, this would enable L1 to seek repayment for those further advances in priority to L2. This is despite the fact that the further advances came after L2’s loan.

5.47 Tacking is possible whenever there are further advances made under an agreement, whether or not the agreement was made expressly for securing further advances. For example, the initial loan may have been made as a one-off fixed loan, or on the express assumption that there are to be further advances (such as with running-account credit), or on the understanding that further advances are obligatory.

## Clause 12

5.48 Clause 12 sets out the circumstances in which prior mortgagees will be permitted to tack further advances.

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<sup>104</sup> In the ordinary case, “a further advance” will be a top up loan, or a drawdown under a revolving credit facility. For a detailed recent consideration of “further advances” see *Re Black Ant Co Ltd* [2016] EWCA Civ 30, [2016] 2 P&CR DG2.

## 12 Tacking and further advances

- (1) The mortgagee under a registered goods mortgage may make a further advance on the security of the goods mortgage ranking in priority to subsequent goods mortgages—
  - (a) if an arrangement has been made to that effect with the subsequent mortgagees,
  - (b) if, at the time when the further advance is made, the subsequent goods mortgage is not registered, or
  - (c) if the prior goods mortgage imposes an obligation on the prior mortgagee to make further advances.
- (2) Subsection (1) applies whether or not the prior goods mortgage was made expressly for securing further advances.
- (3) If the prior goods mortgage was made expressly for securing a current account or other further advances, the prior mortgagee may also make a further advance ranking in priority to a subsequent goods mortgage if—
  - (a) the subsequent mortgage was not registered at the time when the prior goods mortgage was registered or when the last search of the relevant register by or on behalf of the prior mortgagee was made, whichever happened last, and
  - (b) at the time when the further advance is made, the prior mortgagee has no actual notice of the registration of the subsequent goods mortgage.
- (4) Tacking in relation to a goods mortgage is possible only as provided by this section.
- (5) In this section “registered”, in relation to a goods mortgage, means—
  - (a) if or to the extent that the goods mortgage relates to goods other than qualifying vehicles, registered under section 9;
  - (b) if or to the extent that the goods mortgage relates to one or more qualifying vehicles, registered under section 10;

and the reference to the “relevant register” is to be read accordingly.

## Discussion

5.49 The content of this section is based on section 94 of the Law of Property Act 1925 (“the LPA”). It is less compressed and, we hope, clearer than section 94, and includes

references where required to other parts of the draft Bill. However, it is our intention that case-law relating to section 94 of the LPA be considered when interpreting this provision.

5.50 Clause 12(1) states that tacking is permitted in certain specified circumstances. Clause 12(3) makes further provision for cases in which the prior goods mortgage was made “expressly for securing further advances”. In conjunction with clause 12(4), these are the only circumstances in which tacking is permitted under a goods mortgage.

5.51 Under the draft Bill, there are three cases in which tacking is allowed:

- (1) where the lender has come to an arrangement with subsequent lenders concerning tacking (clause 12(1)(a));
- (2) where the subsequent goods mortgage has not been registered before the making of the further advance (clause 12(1)(b)); and
- (3) where the lender is obliged by the goods mortgage to make further advances (clause 12(1)(c)).

5.52 Under clause 12(1)(a), tacking is permitted to the extent of the agreement with the subsequent lenders.

5.53 Clause 12(3) qualifies clauses 12(1)(b) and (c): where the subsequent goods mortgage is not initially registered but becomes registered by the time of the further advance, the prior lender cannot tack unless the prior mortgage was made expressly for securing a current account or other further advances. Even then, if the prior lender has actual notice of the subsequent mortgage at the time of making the further advance, they cannot tack.

5.54 We do not think that first lenders should be protected if they have actual notice of second mortgage at the time they make a further advance. However, we do not consider it reasonable to expect the lenders to check the register before making further advances which are expressly contemplated by the mortgage agreement. Clause 12(3) enables subsequent lenders who registered their mortgage before the further advance to protect themselves by giving actual notice of their interest in the goods to the prior lender.

**Consultation Question 20.**

5.55 Do consultees agree with our proposed provisions on tacking? If not, do consultees think that the Bill should forbid tacking for goods mortgages?

## Chapter 6: Third parties

- 6.1 Goods mortgages may not only affect the two parties to the mortgage agreement, but also third parties – such as purchasers and other lenders, who want to obtain rights over the mortgaged goods. Furthermore, if the borrower becomes bankrupt, a goods mortgage would affect the borrower's other creditors because the value of the goods would not be available to be distributed to them.
- 6.2 The draft Bill includes three provisions dealing with third parties:
  - (1) Clause 14 places a duty on the owners of goods subject to a mortgage to disclose the existence of that mortgage.
  - (2) Clause 15 protects third party purchasers. Following a transfer (or “disposition”) the goods mortgage will cease to exist in two circumstances:
    - (a) if the mortgage has not been registered; or
    - (b) if the disposition is to a private purchaser who acts in good faith without notice of the goods mortgage.
  - (3) Clause 17 states that an unregistered goods mortgage is void against a trustee in bankruptcy.
- 6.3 We look at the effect of these provisions in this chapter. We start with the new duty on owners to disclose a goods mortgage. We then examine the effect of unregistered goods mortgages, and we describe the protection for private purchasers who act in good faith without notice of an existing goods mortgage.

### **CLAUSE 14: THE DUTY TO DISCLOSE**

- 6.4 Clause 14 imposes a duty on the owner of goods to disclose the existence of a goods mortgage to prospective purchasers and other lenders. The effect of this duty is to engage the Fraud Act 2006. This means that an owner would commit a criminal offence if they breached the duty dishonestly with an intention to make a gain or to cause a loss to another. As we have seen, the mortgage document will warn borrowers of this consequence.

#### **14 Duty of owner to disclose existence of goods mortgage**

- (1) This section applies where a person owns goods which are subject to a goods mortgage (“the current mortgage”).
- (2) If the owner of the goods disposes of the goods to a purchaser without discharging the obligation secured by the current mortgage, the owner is under a duty to disclose to the purchaser the existence of the current mortgage before the disposition.
- (3) If the owner of the goods creates a further goods mortgage or other security over the goods without discharging the obligation secured by the current mortgage, the owner is under a duty to disclose to the person to whom the further goods mortgage or other security is provided the existence of the current mortgage, before creating the further goods mortgage or other security.
- (4) Where an undivided share in goods is subject to a goods mortgage, references in this section to the goods are to be read as references to the undivided share.
- (5) For the meanings of “disposition” and “purchaser”, see section 34.

- 6.5 Clause 14 applies where goods are subject to a goods mortgage, which is referred to as the “current mortgage” (clause 14(1)).
- 6.6 Clauses 14(2) and (3) then require owners to disclose the existence of the current mortgage when they:
  - (1) dispose of the goods to a purchaser; or
  - (2) create a further goods mortgage or other security over the goods.
- 6.7 The duty applies to all “owners” of mortgaged goods, not just the borrower: it includes anyone who becomes the owner of the goods while they are subject to the goods mortgage. For example, a borrower may sell mortgaged goods to a dealer who is aware of the mortgage. The dealer may not sell the goods to another purchaser without disclosing the existence of the mortgage. The duty to disclose applies even if the owner (for example, a trade purchaser or recipient of gift) does not in fact know about the goods mortgage, though in such cases, the owner would not be liable for fraud if they did not act dishonestly.
- 6.8 The words “disposition” and “purchaser” are defined in clause 34. We look at clause 34 in more depth at paragraph 6.29 below.

#### **Interaction with the Fraud Act 2006**

- 6.9 The duty to disclose the existence of the goods mortgage is not drafted as an actionable breach of statutory duty. In our view, in the absence of express provision,

the courts will not interpret this clause to mean that owners who fail to disclose goods mortgages can be sued for damages by persons who lose out as a result of not knowing about the goods mortgage. Rather, we intend this duty to operate with the Fraud Act 2006.

- 6.10 Under section 1 of the Fraud Act 2006, a person is guilty of fraud if they are in breach of one of three sections of the Act, which provide for different ways of committing the offence. Fraud is a serious offence which carries a maximum sentence of 10 years in prison.
- 6.11 For the purposes of this discussion, the relevant provision is section 3 of the Fraud Act 2006. It reads:

A person is in breach of this section if he—

- (a) dishonestly fails to disclose to another person information which he is under a legal duty to disclose, and
- (b) intends, by failing to disclose the information—
  - (i) to make a gain for himself or another, or
  - (ii) to cause loss to another or to expose another to a risk of loss.

- 6.12 Section 3 will therefore apply where:

- (1) there is a legal duty on an individual to disclose certain information;
- (2) that information is not disclosed;
- (3) the failure to disclose is dishonest; and
- (4) it is done with the intention to make a gain (for the individual or another) or to cause loss to another, or to expose another to the risk of loss.

- 6.13 Clause 14 of the draft Bill places a legal duty on owners of property to disclose the existence of a goods mortgage where required. This ensures that the first limb of section 3 is fulfilled. The question of whether the information was disclosed will be an issue of fact for the court to consider.

### Dishonesty

- 6.14 The meaning of dishonesty is set out in the leading case of *R v Ghosh*.<sup>105</sup> Although the case itself concerned theft, it has been held to apply to section 3 of the Fraud Act 2006.<sup>106</sup>
- 6.15 There are two limbs to the test: one objective, the other subjective.

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<sup>105</sup> *R v Ghosh* [1982] QB 1053, [1982] 2 All ER 689.

<sup>106</sup> *R v Razooq* [2012] EWCA Crim 674.

- (1) First, the jury<sup>107</sup> should consider whether the accused acted dishonestly by the standards of ordinary and honest people (objective limb).
- (2) If so, the jury should consider whether the accused must have realised that what they were doing was dishonest by those standards (subjective limb).

#### Intention to make a gain or cause a loss

6.16 This is a wide test, which may be fulfilled in several ways. In most cases an owner who sells goods subject to a non-disclosed goods mortgage will be intending to make a gain for themselves and to expose either the third party or the lender to a risk of loss.

### UNREGISTERED MORTGAGES

6.17 Under the 1882 Act, an unregistered security bill is void. It cannot be enforced against either third parties or against the borrower.

6.18 In our 2016 report we recommended that an unregistered goods mortgage should not be enforceable against a third party or trustee in bankruptcy but that it should be enforceable against the borrower.<sup>108</sup> This reflects the purpose of registration, which is to give notice to trade buyers, to other lenders and to other creditors. Registration has no effect on borrowers, who will already be aware of the existence of the mortgage.

6.19 This policy is implemented in clause 15 and clause 17. Clause 15 applies where goods have been sold (or otherwise “disposed” of) to another owner. It provides that if the non-registration provision is met (as defined in subsection (2)), then the goods cease to be subject to the good mortgage under subsection (4).

6.20 Under clause 17, an unregistered goods mortgage is also ineffective against a trustee in bankruptcy. If the individual who owns the good becomes bankrupt, the good mortgage is void against the trustee of the bankrupt’s estate unless it has been registered.

### PROTECTION FOR PRIVATE PURCHASERS

6.21 Under hire-purchase legislation, a purchaser who buys a vehicle for private purposes in good faith and without notice of the hire-purchase agreement becomes the owner of the vehicle.<sup>109</sup> This protection does not currently apply to bills of sale. Instead, those who unwittingly buy a vehicle subject to a logbook loan may find themselves faced with unpalatable options: essentially, to repay someone else’s loan or to lose the vehicle. This has led to cases of hardship, generating much criticism of the logbook loan industry.<sup>110</sup>

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<sup>107</sup> If the case is heard in the magistrates’ court, this would be the magistrates (who decide both questions of fact and law) rather than the jury.

<sup>108</sup> Bills of Sale (2016) Law Com No 369, para 6.47.

<sup>109</sup> Hire Purchase Act 1964, ss 27 to 29. See Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 12.12 to 12.25 for further details.

<sup>110</sup> Bills of Sale (2016) Law Com No 369, paras 3.19 to 3.21.

6.22 The draft Bill provides that private purchasers take free of a goods mortgage if they act in good faith without notice of the mortgage. This protection is set out in clauses 15 and 16.

6.23 The policy follows hire-purchase legislation as set out in sections 27 to 29 of the Hire Purchase Act 1964. We have not simply replicated these provisions, but sought to simplify them and make them clearer for our draft Bill. Furthermore, clauses 15 and 16 apply to all goods, unlike the Hire Purchase Act 1964 which applies only to vehicles.

## **15 Protection of purchasers**

- (1) This section applies if—
  - (a) goods are subject to a goods mortgage,
  - (b) before the obligation secured by the goods mortgage has been discharged, the owner of the goods disposes of the goods to another person (“the purchaser”), and
  - (c) the non-registration condition or the protected purchaser condition is met (or both are met).
- (2) The non-registration condition is that at the time of the disposition the goods mortgage is not registered—
  - (a) in the case of goods other than a qualifying vehicle, under section 9, or
  - (b) in the case of a qualifying vehicle, under section 10.
- (3) The protected purchaser condition is that the purchaser—
  - (a) is a private purchaser, and
  - (b) is a purchaser of the goods in good faith without notice of the goods mortgage.
- (4) On the disposition to the purchaser, the goods cease to be subject to the goods mortgage.
- (5) This section does not exonerate the mortgagor and if different the person making the disposition to the purchaser from any liability (whether criminal or civil) to which either of them would be subject apart from this section.
- (6) This section is to be read with section 16.

## 16 Interpretation of section 15

- (1) This section makes provision about the interpretation of section 15.
- (2) A person becomes a purchaser of goods if, and at the time when, a disposition of the goods (see section 34) is made to the person.
- (3) “Trade or finance purchaser”, in relation to goods of any kind, means a purchaser who, at the time of the disposition made to the purchaser, carries on a business which consists, wholly or partly—
  - (a) of purchasing goods of that kind for the purpose of offering or exposing them for sale, or
  - (b) of providing finance by purchasing goods of that kind for the purpose of bailing them under hire-purchase agreements or agreeing to sell them under conditional sale agreements.
- (4) “Private purchaser”, in relation to goods of any kind, means a purchaser who, at the time of the disposition made to the purchaser, does not carry on a business falling within subsection (3).
- (5) A person is to be taken to be a purchaser of goods without notice of a goods mortgage if, at the time of the disposition made to the person, the person has no actual notice that the goods are subject to a goods mortgage.
- (6) Where an undivided share in goods is subject to a goods mortgage, references to goods, including the references in subsections (2) and (5) of this section, are to be read as references to the undivided share.

## The scope of private purchaser protection

6.24 Clause 15 applies where:

- (1) the goods in question are subject to a goods mortgage;
- (2) before the discharge of the secured obligation, the borrower or any subsequent owner of the goods disposes of the goods to another person;
- (3) the person who receives the goods is a private purchaser; and
- (4) the purchaser is acting in good faith, without notice of the goods mortgage.

6.25 In these circumstances, “the goods cease to be subject to the goods mortgage” (clause 15(4)).

6.26 Note that the protection applies not only when the goods are disposed of by the borrower but also by any “any subsequent owner”. This covers the case in which the

innocent private purchaser obtains secured goods from an intermediary. An example might be where the borrower gives a car subject to a goods mortgage to a relative, who then sells it to an innocent private purchaser. The relative would take the car subject to the mortgages but the innocent private purchaser would not.

- 6.27 Instead of adopting the complex presumptions in section 29 of the Hire Purchase Act 1964, the draft Bill includes a simple rule. An innocent private purchaser always takes free of goods mortgages, wherever in the chain of transfers and dispositions they happen to be. Similarly, anyone taking the goods from or after the innocent private purchaser will take free.
- 6.28 Below we look in more detail at four concepts: “disposition”; “private” (as opposed to “trade”) purchaser; “in good faith without notice”; and “ceasing to be subject to a goods mortgage”.

### **“Disposition”**

- 6.29 A disposition is defined in clause 34.

#### **34 Meaning of “disposition” etc**

- (1) In this Act “disposition” means—
  - (a) a contract of sale, as defined by section 2 of the Sale of Goods Act 1979, or
  - (b) a contract under which the owner of goods transfers or agrees to transfer ownership of the goods to another person and—
    - (i) the other person provides or agrees to provide consideration otherwise than by paying a price, or
    - (ii) the contract is, for any other reason, not a contract for sale or a hire-purchase agreement;

and “dispose of” is to be read accordingly.
- (2) For the purposes of this Act, a person becomes a “purchaser” of goods if, and at the time when, a disposition of the goods is made to that person.

- 6.30 A disposition has three elements. All three elements involve a contract – in other words, the purchaser must give something in return. This protection would not apply to gifts.
- 6.31 Clause 34(1)(a) refers to a “contract for sale” as defined by section 2 of the Sale of Goods Act 1979. Here the seller transfers or agrees to transfer ownership to the buyer for a money consideration, called the price.

6.32 Clause 34(1)(b) follows section 8 of the Consumer Rights Act 2015. It applies where the owner transfers or agrees to transfer ownership for some other consideration, as in part-exchange or barter contracts. The explanatory notes to the Consumer Rights Act 2015 explain the provisions of section 8 in the following way:<sup>111</sup>

A contract would be a contract for transfer rather than a sales contract if either (i) there is no monetary value assigned, or (ii) the contract is a mixed contract whether for a monetary price or not and, whilst goods are supplied, the transfer of goods is not sufficiently central to the contract to be a sales contract. If no monetary value is assigned to the goods, this does not preclude money from forming part of the consideration of the contract. For example, if the trader offers goods A in exchange for goods B and a cash fee, no value has been assigned to either goods A or B so the contract would fall under section 8, despite some money changing hands.

6.33 We welcome views on whether to follow clause 8 of the Consumer Rights Acts 2015 in this way. Our aim is to encapsulate the concept of a contract to transfer ownership of goods for value in a clear way, drawing on other commonly used definitions.

**Consultation Question 21.**

6.34 Do consultees think that clause 34 clearly expresses the concept of a contract to transfer ownership of goods for value?

**“Private” purchaser**

6.35 Under clause 16(4), a “private purchaser” is not a “trade or finance purchaser”.

6.36 Clause 16(3) defines a trade or finance purchaser. It applies to those who carry on a business consisting (wholly or partly) of purchasing goods of the same kind as the goods subject to the goods mortgage for the purpose of:

- (1) offering or exposing them for sale; or
- (2) providing finance through hire-purchase or conditional sale arrangements.

6.37 These definitions of “private” and “trade or finance” purchasers are similar to those contained in section 29(2) of the Hire Purchase Act 1964.

**Good faith without notice**

6.38 Under clause 15(3)(b), in order to take free, a private purchaser must act in good faith and without notice of the goods mortgage.

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<sup>111</sup> Explanatory notes to the Consumer Rights Act 2015, paragraph 58. Available at <http://www.legislation.gov.uk/ukpga/2015/15/notes/division/3/1/3/2/1>.

6.39 “Good faith” refers to honesty, in a broad sense.<sup>112</sup> The good faith test excludes purchasers who do not have actual notice but act less than honestly.

6.40 As for “notice”, clause 16(5) confirms that this means “actual” notice – rather than some form of “constructive” notice.<sup>113</sup>

### **The effect of ceasing to be subject to a goods mortgage**

6.41 Where all of the conditions are met, the goods cease to be subject to the goods mortgage (clause 15(4)).

6.42 It may be that clause 15(4) only operates in relation to one of several mortgages which exist over the asset. In such a case, only that mortgage will cease to exist. The remaining mortgages will have their priority adjusted accordingly. For example, if there are two goods mortgages over an asset which is sold to an innocent private purchaser, and the private purchaser is told only about one of the goods mortgages, that goods mortgage will continue to attach to the good, whereas the other one will be extinguished.

### **Liability of the owner who makes a disposition**

6.43 Clause 15(5) clarifies that this protection has no effect on any liability of the borrower or person making the disposition.

6.44 The original mortgagor will continue to be liable to pay the debt to the lender.

6.45 It may be that the person disposing of the goods is someone other than the original mortgagor, such as a trade purchaser. In that case the lender could bring an action against them in conversion, which is a tort concerning the misappropriation of goods.<sup>114</sup>

### **Action in conversion**

6.46 A lender can bring an action in conversion if the lender has an “immediate right to possession” of the goods at the time of disposition. It does not depend on having ownership of the goods.<sup>115</sup>

6.47 Whether a lender has “an immediate right to possession” of the goods at the time of the disposition may depend on the terms of the goods mortgage.

6.48 Generally speaking, a lender may sue in conversion once there is default under the mortgage agreement.<sup>116</sup> We expect that in most cases, the disposition of the goods to

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<sup>112</sup> See *Dodds v Yorkshire Bank Finance* [1992] CCLR 92.

<sup>113</sup> Constructive notice is where notice is presumed in the circumstances, for example because the mortgage is registered; as opposed to the party having actually received notice as a matter of fact.

<sup>114</sup> Halsbury’s Laws of England, *Tort* vol 97 (2015) para 604.

<sup>115</sup> *Clerk & Lindsell on Tort* (21st ed 2016), 17-44.

<sup>116</sup> This is the position for ship mortgages, which are also charges on goods: *The Manor* [1907] P 339. In hire-purchase, the wrongful sale of the hired goods is a fundamental (repudiatory) breach of the agreement which gives the hire-purchase lender an immediate right to possession for the purposes of conversion: see

a third party will breach the terms of the goods mortgage. Accordingly, the lender would have the right to immediate possession by the time the goods are with the trade purchaser and would have the right to sue in conversion if the trade purchaser makes a disposition to another party.<sup>117</sup>

#### Action for reversionary injury

6.49 However, where a lender does not have an immediate right to possession by the time the trade purchaser makes a disposition, it may still be able to bring an action for reversionary injury.<sup>118</sup> This is a tort which lies in respect of:

[A]ny act which would, but for the problem of the claimant's lack of title to sue, amount to ... conversion, provided it has the effect of depriving him either temporarily or permanently of the benefit of his reversionary interest, ... because the goods are wrongfully disposed of by a transaction whereby the donee acquires a good title, so preventing recovery of them.<sup>119</sup>

#### A possible long-term solution?

6.50 In our 2016 report we said that in the longer term, vehicle provenance checks may become a normal and routine part of buying a second-hand vehicle.<sup>120</sup> If so, then it would no longer be necessary to protect private purchasers. Instead, the fact that a vehicle mortgage is registered in an asset finance registry could be considered enough to give all purchasers sufficient notice. In these circumstances, one could argue that a purchaser who failed to check should suffer the consequences.

6.51 We suggested that protection for innocent private purchasers may no longer be necessary if:

- (1) consumers routinely conducted a vehicle provenance check before purchasing a second-hand vehicle;
- (2) there was widespread knowledge of the need to check;
- (3) vehicle provenance checks for consumers were free or almost free; and
- (4) confusing "text checks" were no longer available.

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*Union Transport Finance v British Car Auctions* [1978] 2 All ER 385. In that case the hire-purchase lenders became entitled to immediate possession of the car when the owner changed the registration plate and entered the car into an auction.

<sup>117</sup> It does not matter that both the trade purchaser and the lender have property interests in the goods. Persons with concurring interests in goods can sue each other in conversion: see Halsbury's Laws of England, *Personal property* vol 80 (2013), para 840 (discussing co-owners).

<sup>118</sup> See generally *Clerk & Lindsell on Tort* (21st ed 2016) 17-148 to 17-149 and S Green, "Understanding the wrongful interference actions" (2010) 74(1) *Conveyancer and Property Lawyer* 15.

<sup>119</sup> *Clerk & Lindsell on Tort* (21st ed 2016) 17-149.

<sup>120</sup> Bills of Sale (2016) Law Com No 369, para 8.37.

- 6.52 We recommended that the legislation should include a regulation-making power so that if this situation were achieved, the protection for private purchasers of vehicles could be repealed.
- 6.53 However, we have not included this in the draft Bill, as our discussions with stakeholders and government suggest that in practice such a power is unlikely to be exercised.

# Chapter 7: Taking possession – general provisions

## INTRODUCTION

- 7.1 Clauses 18 to 30 of the draft Bill deal with the rights of the lender (mortgagor) and borrower (mortgagee). The most important right for the lender is to take possession of the goods, but this right is subject to restrictions.
- 7.2 In this chapter we consider two general restrictions on the lender's right of possession, which apply to all goods mortgages.
  - (1) Clause 18 limits the circumstances in which the lender may take possession of the goods.
  - (2) Clause 19 prevents a lender from entering premises to take possession without either consent or a court order.
- 7.3 These clauses apply to all goods mortgages. In Chapter 8 we look at the additional protective measures available to those with non-exempt goods mortgages. By non-exempt mortgages we mean those which are not granted by high net worth individuals or to secure business loans of more than £25,000.<sup>121</sup>

## WHEN MAY A LENDER TAKE POSSESSION?

- 7.4 Under section 7 of the 1882 Act, a lender may only take possession of the goods in specified circumstances. In broad terms, a lender may only seize the goods:
  - (1) if the borrower:
    - (a) is in default in the repayment of the loan;
    - (b) defaults in the performance of any agreement for the maintenance of the secured goods;
    - (c) becomes bankrupt;
    - (d) fraudulently removes the goods from the premises; or
  - (2) if a creditor has levied an execution judgment or distrained against the goods.
- 7.5 Clause 18 preserves the policy underlying section 7, but updates the list in clearer, contemporary terms. Under clause 29(1) of the draft Bill, the terms of the agreement cannot provide for additional grounds for possession if it would reduce the protection provided by this list.

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<sup>121</sup> For a discussion of non-exempt mortgages see Chapter 2 above.

## **18 Restriction on mortgagee taking possession of goods**

- (1) The mortgagee under a goods mortgage is not entitled to take possession of the goods from the mortgagor unless one or more of the following applies—
  - (a) any sum whose payment is secured by the goods mortgage has not been paid at the time when it became due,
  - (b) the mortgagor has failed to comply with a term of the goods mortgage relating to the maintenance or insurance of the goods,
  - (c) the mortgagor has moved the goods in breach of a term of the goods mortgage,
  - (d) the mortgagor has offered the goods for sale without the consent of the mortgagee,
  - (e) a relevant non-financial obligation has not been discharged at the time when it ought to have been discharged,
  - (f) the goods have become liable to be seized under a warrant of execution to satisfy a court judgment,
  - (g) since the goods mortgage was created, the mortgagor—
    - (i) has been made bankrupt (under Part 9 of the Insolvency Act 1986),
    - (ii) has been adjudged bankrupt by a court in Northern Ireland,
    - (iii) has had his or her estate sequestrated by a court in Scotland, or
    - (iv) has been subject to a similar order or judgment made by a court in a territory outside the United Kingdom.
- (2) In subsection (1)(e) a “relevant non-financial obligation” means an obligation that is secured by the goods mortgage but is not—
  - (a) an obligation to pay money,
  - (b) an obligation ancillary to an obligation to pay money,
  - (c) an obligation arising under a term of the kind mentioned in subsection (1)(b) or (c) or under a term restricting the disposal of the goods.

7.6 The most common reason for taking possession is that the borrower has failed to pay a sum when it becomes due. The lender may also take possession if the borrower has failed to discharge a relevant non-financial obligation, or has broken a term of the agreement to maintain or insure the goods. The “relevant non-financial obligation” refers to cases in which the obligation secured is not an obligation to pay money (for example, an obligation to supply stock or to return shares).<sup>122</sup> However, this does not apply where the main obligation is to pay money. Clause 18(2)(b) confirms that the lender may not possess the goods because the borrower has broken an obligation ancillary to payment, such as a requirement to use a particular payment method.

7.7 The main change is that the draft Bill does not refer to “fraudulently removing goods”. In our 2016 report we commented that this was a difficult concept to understand: it is not clear when taking goods outside the country might or might not amount to “fraud”.<sup>123</sup> We thought that it was intended to capture offering the goods for sale or moving the goods in breach of a term of the agreement. These are now specifically provided for in clauses 18(1)(d) and 18(1)(e).

## TAKING POSSESSION FROM PREMISES

7.8 Hire-purchase creditors are not entitled to enter premises to take possession of goods. Section 92(1) of the Consumer Credit Act 1974 (CCA) states that:

Except under an order of the court, the creditor or owner shall not be entitled to enter any premises to take possession of goods subject to a regulated hire-purchase agreement, regulated conditional sale agreement or regulated consumer hire agreement.

7.9 Under section 92(3) of the CCA, a breach of this section is actionable as a breach of statutory duty.

7.10 Consumer groups argued strongly that the Goods Mortgages Bill should replicate section 92 of the CCA. We agree. It is an important protection, and not only for borrowers. It also protects the occupiers of premises more generally and guards against disorder.

7.11 Clause 19 of the draft Bill replicates section 92 of the CCA.

### 19 Entry onto premises

- (1) Except under an order of the court, the mortgagee under a goods mortgage is not entitled to enter any premises to take possession of the goods.
- (2) An entry in contravention of subsection (1) is actionable as a breach of statutory duty.

<sup>122</sup> See para 385, above.

<sup>123</sup> Bills of Sale (2016) Law Com No 369, para 4.56.

7.12 The section 92 prohibition on entering without a court order applies equally to a third party's premises.<sup>124</sup> Academic commentary and judicial decisions on the meaning of "premises" in other contexts provide some guidance on what "premises" is likely to include.<sup>125</sup>

7.13 This clause should be read alongside the provisions on contracting out, which are set out in clause 29 of the draft Bill, and which mirror section 173 of the CCA. Clause 29(3) states that

a provision of this Act under which a thing may be done in relation to any person only on an order of the court is not to be taken to prevent its being done at any time with that person's consent given at that time.

7.14 Thus the lender may enter either with a court order or with consent. The consent must be genuine and voluntary<sup>126</sup> and given at the time (not when the agreement is signed). It is not clear from case-law under the CCA whether the relevant consent is that of the borrower or of the occupier of the premises from which the goods are being taken (or both).<sup>127</sup>

7.15 The current draft of clause 19 maintains the wording of clause 92 of the CCA. Nevertheless, we think it may be helpful to clarify whose consent is needed in order to enter premises. In our view, it should be the consent of the occupier of the premises (whether that is the borrower or some other person). The purpose of this clause is to prevent lenders from trespassing on or breaking into premises to recover goods, rather than to protect the borrower. There are other protections to stop lenders from taking goods they are not entitled to, notably the requirement for a possession notice. Where the lender is otherwise fully entitled to the goods under the draft Bill but the goods are on premises, the borrower's consent is not necessary (and it would cause lenders to waste costs in applying for a court order).

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<sup>124</sup> *Goode: Consumer Credit Law and Practice* Div II (April 2017) 5.182.

<sup>125</sup> For example, E Lomnicka, P Dobson, *Encyclopaedia of Consumer Credit Law* (January 2017) vol 1 para 2-093 states: "Premises do not necessarily require the presence of a building or structure (*Gardiner v Sevenoaks RDC* [1950] 2 All E.R. 84 and see *John A Pike (Butchers) Ltd v Independent Insurance Co Ltd* [1998] Lloyd's Rep.I.R. 410 CA) but they must have 'metes and bounds' (*Andrews v Andrews and Mears* [1908] 2 K.B. 567, 570) and some element of permanency (*West Mersea UDC v Fraser* [1950] 2 K.B. 119). Thus entry upon a caravan site, a building site or the driveway of a house will be entry on premises. But the taking possession of a motor vehicle parked on a public road will not infringe this section."

<sup>126</sup> See, in the context of hire-purchase: *Mercantile Credit Co Ltd v Cross* [1965] 2 QB 205, [1965] 1 All ER 577.

<sup>127</sup> *Goode: Consumer Credit Law and Practice* Div II (April 2017) 5.182: "The general prohibition [in s 92(1) Consumer Credit Act 1974] applies equally to entry on a third party's premises and thus restricts the creditor's already very limited rights at common law to effect such entry without the landowner's consent. The relationship between this prohibition and CCA 1974, s 173(3) is, however, obscure; one would expect the consent of the third party to entry by the creditor or owner to be sufficient, but CCA 1974, s 173(3) could be construed as requiring the consent of the debtor or hirer, whether or not he has any connection with the owner of the land on which the goods are situated." See also E Lomnicka, P Dobson, *Encyclopaedia of Consumer Credit Law* (January 2017) 2-073.

7.16 It is worth illustrating the points above with some examples. Examples (2) and (3) assume the relevant consent to be the occupier's consent.

- (1) *Example 1:* a lender visits the borrower's home and asks to speak to the borrower. The borrower invites them in. This invitation is not sufficient to allow the lender to take the goods. Section 25(3) would only provide a defence if the borrower gave consent for the lender to enter and to take the goods.
- (2) *Example 2:* a high net worth individual has mortgaged a valuable painting, which has been lent to a public gallery. The fact that the gallery is open to the public would not be sufficient for the lender to enter and seize the painting from the wall. To seize the painting the lender would either need a court order or the consent of the gallery.
- (3) *Example 3:* a logbook lender wishes to take possession of a vehicle in a supermarket carpark. This would require the explicit consent of the supermarket. If the supermarket thought that seizing vehicles on their premises might cause disorder, they could prevent it.

**Consultation Question 22.**

7.17 Do consultees think that the draft Bill should specify whose consent is needed for clause 19?

**Consultation Question 23.**

7.18 Do consultees agree that the occupier of the premises (rather than the borrower) should be the person required to consent to the lender entering premises to repossess the goods?

## Chapter 8: Additional protections for non-exempt mortgage – the opt-in procedure

- 8.1 A major problem with the bills of sale legislation is that it does not provide borrowers with appropriate protection against goods being seized too readily. For hire-purchase agreements, the lender is required to obtain a court order before repossessing goods where the borrower has paid at least one third of the total loan amount. In our consultation paper we proposed that where a goods mortgage secures a “regulated credit agreement” borrowers should have the same level of protection as borrowers using hire-purchase.<sup>128</sup>
- 8.2 The issue proved controversial. There was general agreement that where borrowers engaged with the court process, the right to put one’s case to a court was beneficial. Borrowers in temporary financial difficulties could be given time to pay. However, it was pointed out that around 80% of hire-purchase borrowers failed to engage, and here the court process could become an expensive rubber stamp. Court fees are several hundreds of pounds and are likely to continue rising. These costs will inevitably be passed to borrowers who can ill afford them.
- 8.3 In 2016, we recommended that non-exempt borrowers who have paid at least one third of the loan amount should have the right to demand that the lender obtains a court order – but that they should specifically “opt-in” to this right.<sup>129</sup> Our recommendations were based on logbook lenders’ experience of a similar “opt-in” procedure in Wisconsin and in-depth discussions with advice agencies. Our aim was to encourage borrowers to seek advice and to make appropriate choices, as well as to ensure easy access to the courts if they need more time to pay.
- 8.4 The opt-in procedure applies only to non-exempt mortgages and is set out in clauses 20 to 24 of the draft Bill:
  - (1) Clause 20 states when a possession notice must be given.
  - (2) Clause 21 outlines the content of the notice.
  - (3) Clause 22 explains the interaction between the possession notice and default notices under the Consumer Credit Act 1974 (CCA).
  - (4) Clause 23 sets out the consequences of breaching clauses 20 or 21.
  - (5) Clause 24 gives the courts additional powers where the lender applies for a court order.

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<sup>128</sup> Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 11.7 to 11.45.

<sup>129</sup> Bills of Sale (2016) Law Com No 369, paras 7.51 to 7.85.

8.5 Below, we look at each in turn. It is also worth mentioning at this stage that we are aware of the new pre-action protocol for debt claims which comes into force on 1 October 2017.<sup>130</sup> We are currently considering its impact on the draft Bill.

## WHEN WILL THE OPT-IN PROCEDURE APPLY?

### 20 Possession notice required before taking possession

- (1) The giving to the mortgagor of a notice complying with section 21 ("a possession notice") is necessary before the mortgagee can take possession of the goods.
- (2) Subsection (1) does not prevent the mortgagee taking possession without giving a possession notice if—
  - (a) the following conditions are met—
    - (i) the obligation secured is one that can be discharged by the payment of money,
    - (ii) at the time when the goods mortgage was created, the redemption total could be determined, and
    - (iii) at the time when the mortgagee takes possession of the goods, less than one third of the redemption total has been paid, or
  - (b) the goods mortgage is an exempt goods mortgage (see section 28).
- (3) "The redemption total" means the total sum that is to be payable by the mortgagor in order to discharge the obligation secured by the goods mortgage, including interest but excluding any sum payable as a penalty.
- (4) Where the obligation can be discharged either by the payment of money or by other means, it is to be assumed for the purposes of subsection (3) that the mortgagor does not discharge it by those other means.

8.6 Clause 20(1) states a basic rule – that the mortgagee must give the mortgagor a possession notice before taking possession of the goods.

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<sup>130</sup> Available at <https://www.justice.gov.uk/courts/procedure-rules/civil/pdf/protocols/pre-action-protocol-for-debt-claims.pdf>.

8.7 In our 2016 report we explained that if the issue were disputed, the lender would need to prove that the notice was delivered. This could be done by a variety of means, including using registered post, an email read receipt, or calling the borrower to confirm receipt.<sup>131</sup>

8.8 However, under clause 20(2), there are two situations in which a possession notice need not be given:

- (1) where less than one third of the amount secured has been paid (the “one third rule”); or
- (2) where the goods mortgage is “exempt”.

### **The “one third rule”**

8.9 This mirrors the provision in hire-purchase law, whereby a lender need not obtain a court order where the borrower has paid less than one third of the total loan amount.<sup>132</sup> The rationale is that a borrower who has paid one third or more of the loan has indicated a serious intention and made a significant effort to discharge the debt.

8.10 Clause 20(2)(a)(ii) provides that the “one third rule” only applies where “the redemption total could be determined” at the time the goods mortgage was created. Clause 20(3) defines the “redemption total” as the total sum to be paid by the borrower in order to discharge the secured obligation, including interest. In some circumstances, the total sum cannot be determined in advance; for example, loans with a variable interest rate. In these circumstances, the rule does not apply – the lender must provide a possession notice even where repayments total less than one third.

### **Exempt goods mortgages**

8.11 Clause 20(2)(b) confirms that these provisions do not apply to exempt mortgages. As discussed in Chapter 2, exempt mortgages are those which meet the high net worth or business credit criteria in clause 28.

## **WHAT MUST BE IN THE POSSESSION NOTICE?**

### **21 Possession notice**

- (1) A possession notice must be in the prescribed form and contain prescribed information.
- (2) Regulations made by virtue of subsection (1) must require a possession notice to—

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<sup>131</sup> Bills of Sale (2016) Law Com No 369, paras 7.53 to 7.54.

<sup>132</sup> Consumer Credit Act 1974, s 90(1).

- (a) state that the mortgagee considers that one or more of the conditions in section 18(1) is met, specifying which condition and why the mortgagee considers that it is met,
- (b) state that the mortgagor may exercise the right conferred by section 27 (mortgagor's right to terminate),
- (c) state that the mortgagor may within a prescribed period ("the notice period")—
  - (i) require the mortgagee not to take possession of the goods unless authorised to do so by an order of the court, or
  - (ii) inform the mortgagee of the mortgagor's intention to seek advice,
- (d) indicate the amount of any costs that may become payable by the mortgagor under an order of the court if the mortgagor acts under paragraph (c)(i) and the mortgagee applies for such an order, and
- (e) state that the mortgagee intends to take possession of the goods unless within the notice period the mortgagor—
  - (i) remedies the breach to which the notice relates (if the breach is capable of remedy), or
  - (ii) acts under subsection (c)(i) or (ii) or under section 27.

(3) If the mortgagor informs the mortgagee under subsection (2)(c)(ii), within the notice period, of the mortgagor's intention to seek advice, the mortgagor may within a further prescribed period ("the advice period"), require the mortgagee not to take possession of the goods unless authorised to do so by an order of the court.

(4) Where a possession notice has been given to the mortgagor, the mortgagee is not entitled to take possession of the goods—

- (a) before the end of the notice period, and
- (b) if the mortgagor acts under subsection (2)(c)(ii), during the advice period.

(5) If the mortgagor so requires under subsection (2)(c)(i) or (3), the mortgagee may not take possession of the goods except under an order of the court.

(6) If before the relevant time the mortgagor remedies the breach to which the possession notice relates, the breach is to be treated as not having occurred.

(7) In subsection (6) "the relevant time" means the end of the notice period or, if the mortgagor acts under subsection (2)(c)(ii), the end of the advice period.

8.12 We recommended that before repossession, the lender should send the borrower a prescribed form. This should include a clear explanation of both lenders' and borrowers' rights and we said that consumers should be consulted on the form the notice should take.<sup>133</sup>

8.13 Thus clause 21 provides that the notice must specify the circumstance which entitles the lender to take possession (clause 21(2)(a)); tell borrowers about the right to voluntary termination (clause 21(2)(b) – which the borrower may or may not be able to exercise, depending on the circumstances; and indicate the costs of a court order (clause 21(2)(d)). We discuss the prescribed content of the possession notice below.

### **Three options**

8.14 The form will give the borrower three options:

- (1) require the lender to seek a court order;
- (2) terminate voluntarily, by handing the goods to the lender in full and final settlement; or
- (3) indicate a desire to seek debt advice, which would halt the possession process for a period of time.

8.15 These options are set out in clauses 21(2)(b) and (c). Under clause 20(2)(e), the lender must tell the borrower that it intends to take possession unless the borrower exercises one of these choices or pays the arrears.<sup>134</sup>

8.16 We think that the third option is particularly important, as it would encourage borrowers to seek advice and provide sufficient time for issues to be resolved without the intervention of the court.

### **Time limits**

8.17 We suggested that the lender should wait 14 days for the borrower to return the form. If the borrower does nothing, the lender may then take possession of the goods.

8.18 However, a borrower who made the third choice would be entitled to extend this waiting period to seek advice. We suggested that this additional stay should be for a further 28 days. During this time the borrower could terminate voluntarily or require the lender to seek a court order.

8.19 We said that these time limits would need to be realistic. In particular, the 28 day stay would need to be based on evidence of how long it actually takes to see a debt

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<sup>133</sup> Bills of Sale (2016) Law Com No 369, para 7.100(5).

<sup>134</sup> In most cases, the lender will issue a possession notice because of arrears. In the rare case where the notice is issued for other reasons, the borrower may remedy the breach specified in the notice.

adviser. We recommended that the time limits should be set out in regulations rather than primary legislation, to allow greater flexibility.<sup>135</sup>

8.20 To implement this recommendation clause 21 refers to two periods to be prescribed in regulations. Clause 21(2)(c) refers to a prescribed “notice period” for the borrower to return the form. Clause 21(3) refers to a further prescribed “advice period”.

## INTERACTION WITH A DEFAULT NOTICE UNDER THE CCA

8.21 Where the underlying agreement is a “regulated credit agreement”, the CCA requires the lender to provide a borrower with a default notice before taking any action to enforce the security.

8.22 Clause 22 clarifies that the possession notice is in addition to the default notice, not a substitute for it.

### 22 Defaults under consumer credit agreements

- (1) This section applies if the goods mortgage was given to secure the payment of money under a regulated agreement to which subsection (1) of section 87 of the Consumer Credit Act 1974 (need for default notice) applies.
- (2) A possession notice—
  - (a) may not be given until the restriction imposed by section 88(2) of that Act has ceased to apply to the goods mortgage, and
  - (b) may not be given if, by virtue of section 89 of that Act (compliance with default notice), the default is treated as not having occurred.
- (3) If because of section 20(2) no possession notice is required—
  - (a) the mortgagee is not entitled to take possession of the goods on the basis that a condition in section 18(1) is met unless the restriction imposed by section 88(2) of the Consumer Credit Act 1974 has ceased to apply to the goods mortgage, and
  - (b) section 18(1)(a) to (f) does not apply to a default that is treated by section 89 of that Act as not having occurred.

## The CCA provisions: the lender must serve a default notice and wait 14 days

8.23 Section 87(1) of the CCA requires a lender to serve a default notice before recovering possession of goods or enforcing a security. It reads:

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<sup>135</sup> Bills of Sale (2016) Law Com No 369, para 7.100(9).

Service of a notice on the debtor or hirer in accordance with section 88 (a “default notice”) is necessary before the creditor or owner can become entitled, by reason of any breach by the debtor or hirer of a regulated agreement,—

- (a) to terminate the agreement, or
- (b) to demand earlier payment of any sum, or
- (c) to recover possession of any goods or land, or
- (d) to treat any right conferred on the debtor or hirer by the agreement as terminated, restricted or deferred, or
- (e) to enforce any security.

8.24 Section 88(2) of the CCA then requires the lender to wait 14 days before taking action:

A date specified under subsection (1) must not be less than [14] days after the date of service of the default notice, and the creditor or owner shall not take action such as is mentioned in section 87(1) before the date so specified or (if no requirement is made under subsection (1)) before those [14] days have elapsed.

8.25 Under section 89 of the CCA, the default is treated as not having occurred if remedial action has been taken within the time specified.

#### **The requirement for a default notice continues to apply**

- 8.26 As we said in our 2016 report, “it is important that the opt-in notice is not sent too early in the process”.<sup>136</sup> Default notices are common and often result in further payment or negotiations. We said that the possession notice should only be sent following a default notice when the lender is on the cusp of court action.
- 8.27 Clause 22(2) requires the lender to serve a default notice and wait for the 14 days prescribed in section 88(2) of the CCA to expire. They may only serve a possession notice if the default has not been remedied during this period.
- 8.28 Where the borrower has paid less than a third of the loan, no possession notice is required. Clause 22(3) specifies that the lender must still issue a default notice and wait 14 days before taking action. Again, possession is only permitted if the default has not been remedied.<sup>137</sup>
- 8.29 Please see Appendix 4 for a table outlining how many days of respite a borrower would get, according to whether the underlying agreement is regulated by the CCA and whether the borrower is entitled to a possession notice under the draft Bill. The table also mentions the five days that the borrower would get after the goods are

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<sup>136</sup> Bills of Sale (2016) Law Com No 369, para 7.51.

<sup>137</sup> Clause 18(1)(g) is excluded from the scope of this section, on the grounds that the borrower cannot “remedy” a personal insolvency in the same manner as other defaults.

reposessed but before they are sold by the lender (explained below in Chapter 10).<sup>138</sup>

## CONSEQUENCES OF TAKING POSSESSION UNLAWFULLY

8.30 Clause 23 deals with the situation where a lender has taken possession:

- (1) without satisfying at least one of the grounds in clause 18;
- (2) without giving the borrower the prescribed possession notice (clause 20); or
- (3) in contravention of the possession notice time limits or the borrower's demand for a court order (clause 21).

### 23 Consequences of breach of section 18, 20 or 21

If the mortgagee takes possession of the goods to which a goods mortgage relates in contravention of section 18, 20 or 21, the mortgagor—

- (a) is entitled to have the goods returned, and
- (b) is released from all further liability under the obligation secured by the goods mortgage.

8.31 Clause 23 is similar but not identical to section 91 of the CCA, which deals with cases of wrongful repossession under hire-purchase and conditional sale agreements. Section 91 of the CCA provides that the underlying agreement terminates, and that the debtor is both released from future liability under the agreement, and entitled to recover all sums paid under the agreement. However, it does not provide for the return of the goods.

8.32 Clause 23 of the draft Bill achieves a different balance: it allows for the goods to be returned, but less does not provide for the return of the sums paid. For example, if the secured obligation is a loan, the borrower would not be liable for sums still outstanding when clause 23 is triggered. But the obligation is not rendered void from the start, so the borrower would not be entitled to refund of the money already repaid under the loan.

8.33 We think the different approach is justified by differences in the type of agreement. Both provisions attempt to return the parties to the position they were in before the agreement was made. In the case of hire-purchase, the borrower does not own the goods, whereas for a goods mortgage the borrower owns the goods both before and during the agreement.

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<sup>138</sup> From para 10.10.

## POWERS OF THE COURT WHERE THE LENDER SEEKS A POSSESSION ORDER

8.34 Where the borrower exercises their rights under clause 21(2)(c), the lender must apply for a court order before taking possession.

8.35 In our 2016 report, we explained “time orders” under the CCA<sup>139</sup> and recommended that the court should have the same powers in relation to a goods mortgage.<sup>140</sup> The court has vast powers under time orders, including the power to allow the borrower:

- (1) to pay the sums owed to the lender in such instalments and at such times as the court considers reasonable, having regard to the borrower’s means;<sup>141</sup>
- (2) to remedy any non-monetary defaults within any period the court deems suitable;<sup>142</sup> and
- (3) to make future payments under the loan according to a schedule that the court considers suitable.<sup>143</sup>

8.36 Under section 129(1)(c), the court already has the power to make a time order in an action to enforce security in relation to a regulated agreement. This would include goods mortgages where the underlying obligation is regulated.<sup>144</sup>

8.37 We have considered whether sections 71(1), (2) and 88 of the County Courts Act 1984 already confer sufficient powers on the court to deal with goods mortgages securing agreements not regulated by the CCA. These sections state that the court may order payment by such instalments payable at such times as the court may fix, and suspend or stay any judgment or order for payment, or any execution of such a judgment or order, where it appears a party is unable to pay.

8.38 Sections 71 and 88 appear to apply to money claims and judgments only (as opposed to claims and judgments for the enforcement of a security). In the case of land mortgages, the court’s discretion to suspend an order for payment on proceedings for a money judgment needs to be exercised consistently with the exercise of discretion to suspend or stay an order or judgment for possession.<sup>145</sup>

8.39 Accordingly, we have modelled clause 24 of the draft Bill on section 36 of the Administration of Justice Act 1970 in order to grant the court powers similar to those under time orders for goods mortgages not securing a regulated credit agreement. These powers are less broad than for time orders. For example, the court cannot restructure future loan instalments and cannot give the borrower more time unless the

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<sup>139</sup> Bills of Sale (2016) Law Com No 369, paras 7.7 to 7.9.

<sup>140</sup> Bills of Sale (2016) Law Com No 369, para 7.28.

<sup>141</sup> Consumer Credit Act 1974, s 129(2)(a).

<sup>142</sup> Consumer Credit Act 1974, s 129(2)(b).

<sup>143</sup> *Goode: Consumer Credit Law and Practice* Div I (2017) [46.172] to [46.174].

<sup>144</sup> *Goode: Consumer Credit Law and Practice* Div I (2017) [46.158]: “the power to make time orders is not confined to actions for the recovery of protected goods but extends to almost every type of action concerned with a regulated agreement ... or security given in relation to a regulated agreement”.

<sup>145</sup> Halsbury’s Laws of England, *Mortgage* vol 77 (2016), 562.

borrower is likely to pay the loan within a reasonable period. Nevertheless, we have not replicated section 8(2) of the Administration of Justice Act 1973, which qualifies section 36 – so the court has wider discretion than in land mortgage cases.

8.40 We think it is justifiable to narrow the court's discretion in relation to non-regulated agreements, as most borrowers under non-regulated agreements will either not be consumers, or will be high net worth individuals and therefore able to afford legal advice and representation.

#### **24 Additional powers of court where mortgagee seeks possession of goods**

- (1) This section applies where in any proceedings the mortgagee under a goods mortgage seeks possession of the goods.
- (2) The court may exercise any of the powers conferred by this section if it appears to the court that in the event of its exercising the power the mortgagor is likely to be able within a reasonable period—
  - (a) to pay any sums due under the goods mortgage, or
  - (b) to remedy a default consisting of a breach of any other obligation arising under or by virtue of the goods mortgage.
- (3) The court—
  - (a) may adjourn the proceedings for such period or periods as the court thinks reasonable, or
  - (b) on giving judgment, or making an order, for the delivery up of the goods that are subject to the goods mortgage, or at any time before the execution of such a judgment or order, may—
    - (i) stay or suspend execution of the judgment or order, or
    - (ii) postpone the date for the delivery of possession, for such period or periods as the court thinks reasonable.
- (4) The adjournment, stay, suspension or postponement may be made subject to such conditions with regard to the payment by the mortgagor of any sum secured by the goods mortgage or the remedying of any default as the court thinks fit.
- (5) The court may from time to time vary or revoke any condition imposed by virtue of this section.
- (6) Nothing in this section applies if the goods mortgage secures an agreement which is a regulated agreement within the meaning of the Consumer Credit Act 1974 (but see section 129 of that Act).

# Chapter 9: Additional protections for non-exempt mortgages – voluntary termination

- 9.1 Court hearings protect borrowers who could pay off the loan if they had additional time to do so. However, they do little to help those with no realistic prospect of repaying the loan, and may simply increase the expense the borrower must bear. Borrowers who have little hope of ever repaying the debt need to be able to extricate themselves from the loan by handing back the goods and walking away from the agreement.
- 9.2 In hire-purchase law, a hirer who has paid half the total hire-purchase price may return the goods and be released from further liability.<sup>146</sup> In a hire-purchase context, this has proved controversial, as the value of new goods depreciates rapidly.<sup>147</sup> It is less controversial for logbook loans. Logbook lenders who are members of the Consumer Credit Trade Association (CCTA) provide a more extensive right on a voluntary basis. Under the CCTA's Code of Practice,<sup>148</sup> borrowers can terminate the agreement at any point, and handing back the goods is done in full and final settlement of all sums (including sums in arrears). This right is subject to some restrictions which we have also broadly adopted in the draft Bill (clause 27(5)).
- 9.3 In 2016 we recommended that where a goods mortgage secures a regulated credit agreement, borrowers should have a legal right of voluntary termination, modelled on the CCTA code.<sup>149</sup>

## CLAUSE 27: THE RIGHT TO TERMINATE

- 9.4 Clause 27 reflects this recommendation. As with the opt-in procedure, it only applies to non-exempt mortgages.

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<sup>146</sup> Consumer Credit Act 1974, ss 99 to 100.

<sup>147</sup> Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 11.53 to 11.54.

<sup>148</sup> CCTA Code of Practice (2017) "Bills of sale for consumer lending regulated under the Consumer Credit Act", para 4.8.11.

<sup>149</sup> Bills of Sale (2016) Law Com No 369, paras 7.116 to 7.124.

## 27 Mortgagor's right to terminate

- (1) This section applies to a goods mortgage that is not an exempt goods mortgage.
- (2) The mortgagor is entitled to terminate the goods mortgage by—
  - (a) informing the mortgagee of the mortgagor's intention to terminate the goods mortgage, and
  - (b) as soon as reasonably practicable after doing so, delivering the goods to the mortgagee.
- (3) If the mortgagee refuses to accept goods that the mortgagor offers or attempts to deliver to the mortgagee after informing the mortgagee of an intention to terminate the goods mortgage, the goods are to be taken for the purposes of subsection (2) to have been delivered to the mortgagee.
- (4) The right given by subsection (2) cannot be exercised in relation to a goods mortgage if another goods mortgage over the goods has been registered and the other mortgagee (or mortgagees) have not agreed to the termination.
- (5) The mortgagee may refuse termination under subsection (2) by the mortgagor if—
  - (a) the mortgagee has applied to the court for possession of the goods,
  - (b) the mortgagee is entitled to take possession of the goods without such an order and has incurred expenditure in attempting to take possession of them,
  - (c) the state of the goods is affected by damage deliberately caused by any person since the creation of the goods mortgage, or
  - (d) the goods have suffered damage that—
    - (i) is attributable to a failure by the mortgagor to comply with a term of the goods mortgage requiring the mortgagor to take reasonable care of the goods, and
    - (ii) has a significant adverse effect on the market value of the goods.
- (6) On termination of a goods mortgage under subsection (2)—
  - (a) the mortgagor is released from all further liability under the obligation secured by the goods mortgage, and

(b) property in the goods passes to the mortgagee.

(7) If the mortgagee refuses termination on any of the grounds in subsection (5), the mortgagee must return the goods to the mortgagor.

9.5 Under clause 27(2), the borrower must inform the lender of their intention to terminate, and deliver the goods as soon as reasonably practicable. Under clause 27(6), the borrower is released from further liability under the secured obligation.

9.6 As with the CCTA Code, the borrower is entitled to hand the vehicle or other goods to the lender, in full and final settlement of all outstanding amounts. This right applies from the commencement of the credit agreement. It is to be available until the lender has issued court proceedings or (if court proceedings are not needed) incurred expenditure in attempting to repossess the goods – for example, by instructing repossession agents.

9.7 The right to voluntary termination permits ordinary wear and tear. However, the borrower loses this right if the vehicle or other goods have sustained intentional damage or the borrower has failed to take reasonable care of them to an extent that adversely and significantly affects the resale value.

9.8 Subsections (5)(c) and (d) mirror the CCTA code, whereby the vehicle is accepted in its current condition unless there has been some malicious damage, or a significant lack of care. These provisions are narrower than under hire-purchase law, which requires the borrower to compensate the lender for a failure to take reasonable care of the goods.<sup>150</sup> This right to compensation could be applied to minor scratches and has been interpreted differently by different hire-purchase lenders.<sup>151</sup>

9.9 Clause 27(4) applies where there is more than one mortgage on the goods. Here the right to voluntary termination can only be exercised with the agreement of all the lenders. If the lenders agree, handing over the goods would extinguish the borrower's liability towards all lenders.

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<sup>150</sup> Consumer Credit Act 1974, s 100(4).

<sup>151</sup> Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 11.60 to 11.61.

## Chapter 10: The lender's power of sale

- 10.1 At common law, a lender who is entitled to take possession of secured goods also has power to sell them. The 1882 Act places a restriction on this right by requiring the lender to wait for five clear days between seizing the goods and selling them.<sup>152</sup>
- 10.2 Clauses 25 and 26 preserve the broad effect of the current law. Under clause 25, lenders are given a power of sale, subject to the requirement in clause 26 that they wait five working days.
- 10.3 There is substantial case law about how a power of sale is exercised, and how the proceeds of sale must be accounted for. We intend that the common law rules in this area will apply in the goods mortgages context. Here, we provide a short summary of the lender's duties as set out in case law.
- 10.4 A lender who sells mortgaged property owes duties in equity:
  - (1) to act in good faith and for proper purposes, and
  - (2) to take reasonable care to obtain a proper price.
- 10.5 These duties are owed to: the borrower; any subsequent lender; a co-mortgagor (co-borrower); and a guarantor of the borrower's debt.<sup>153</sup> The lender also has to account for any surplus made on sale to any other lenders and/or the borrower.<sup>154</sup>
- 10.6 The duties apply equally to lenders whether they are mortgagees or chargees.<sup>155</sup> Most of the case law regarding lenders' duties concerns land mortgages, but the Court of Appeal has confirmed that the duties apply beyond the land context.<sup>156</sup> *Halsbury's Laws* also notes that these duties apply to grantees of bills of sale.<sup>157</sup>
- 10.7 The duties can be excluded by agreement, but where this is attempted, the courts have interpreted such clauses very narrowly. For example, a clause which allowed the mortgagee to sell the security "on such terms and for such consideration as the mortgagee thinks fit" was interpreted to mean "... as the mortgagee thinks fit *within the*

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<sup>152</sup> Bills of Sale Act (1878) Amendment Act 1882, s 13.

<sup>153</sup> *PK Airfinance SARL v Alpstream AG* [2015] EWCA Civ 1318, [2016] 1 CLC 135 at [115] to [116].

<sup>154</sup> *Megarry & Wade: The Law of Real Property* (8th ed 2012), paras 25-020 and 25-021.

<sup>155</sup> *First City Corp Ltd v Downsview Nominees Ltd* [1993] AC 295 at 311, [1993] 3 All ER 626 at 634.

<sup>156</sup> *PK Airfinance SARL v Alpstream AG* [2015] EWCA Civ 1318, [2016] 1 CLC 135 at [115] to [121], where the court applied the above duties to aircraft mortgagees; *Den Norske Bank ASA v Acemex Management Co Ltd* [2003] EWCA Civ 1559, [2004] 1 All ER (Comm) 904 at [23] to [25], where the court applied the above duties to ship mortgagees.

<sup>157</sup> *Halsbury's Laws of England Financial Instruments and Transactions* vol 49 (2015) para 574, citing *Mutual Finance Ltd v Cuckmere Brick Co Ltd* [1971] Ch 949 (a land mortgage case) as applying to bills of sale.

*limits of the duty of reasonable care imposed by the general law*.<sup>158</sup> Furthermore, we anticipate that most goods mortgages will be contracts to which the Consumer Rights Act 2015 applies.<sup>159</sup> Sections 61 to 76 of that Act contain provisions on unfair terms, which are likely to invalidate a term that purports to exclude the duties on lenders discussed above.

## THE POWER OF SALE

### 25 Mortgagee's power of sale

- (1) If the mortgagee under a goods mortgage has taken possession of the goods, the mortgagee has power to sell the goods.
- (2) This is subject to the following provisions of this section and to section 26.
- (3) If the goods mortgage is not registered but another goods mortgage over the goods is registered, the mortgagee under the unregistered goods mortgage may not sell the goods.
- (4) Where two or more goods mortgages are registered in relation to the same goods, a subsequent mortgagee may not, except under an order of the court, sell the goods without the concurrence of every prior mortgagee.
- (5) Section 101 of the Law of Property Act 1925 (which contains provisions relating to mortgages made by deed) does not apply in relation to a goods mortgage.

- 10.8 Clause 25(4) makes provision for the possibility of multiple mortgages over the same goods. If this is the case, a subsequent mortgagee may not, except by order of the court, sell the goods without the concurrence of every prior mortgagee. This provision is modelled on a similar rule in the Merchant Shipping Act 1995.<sup>160</sup> It is designed to ensure that the position of the first mortgagee is not prejudiced in the event that a subsequent mortgagee becomes entitled to sell the secured asset.
- 10.9 Clause 25(5) states that section 101 of the Law of Property Act 1925 does not apply in relation to a goods mortgage. Section 101 applies to mortgages made by deed and includes various restrictions on how sales are conducted, including a requirement that

<sup>158</sup> *Bishop v Bonham* [1988] BCLC 656 at 667.

<sup>159</sup> This is in contrast to land mortgages, which are excluded from the protections in the Consumer Rights Act 2015.

<sup>160</sup> Merchant Shipping Act 1995, sch 1, para 8.

any conveyance under the statutory power of sale be made by deed.<sup>161</sup> It also appears to be inconsistent with the five day time limit. As it is possible to execute a valid goods mortgage in the form of a deed, this could give rise to problems. Clause 25(5) makes the position clear.

## GOODS SEIZED NOT TO BE SOLD UNTIL FIVE WORKING DAYS HAVE PASSED

### 26 Goods seized not to be sold until 5 days have passed

- (1) If the mortgagee takes possession of the goods to which a goods mortgage relates, the mortgagee must not sell the goods before the end of the fifth working day following the day on which possession is taken.
- (2) The mortgagor may before the end of the fifth working day apply to the court and the court, if satisfied that, by reason of the payment of money or otherwise, the condition in section 18(1) has ceased to be met, may—
  - (a) restrain the mortgagee from removing or selling the goods,
  - (b) order the return of the goods to the mortgagor, or
  - (c) make such other order as the court thinks just.
- (3) “Working day” means a day other than a Saturday, a Sunday, Good Friday, Christmas Day or a bank holiday under the Banking and Financial Dealings Act 1971 in England or Wales.
- (4) This section does not apply where the mortgagee takes possession under an order of the court.

10.10 Under the 1882 Act, a lender must leave a period of five clear days between taking possession of the secured goods and selling them. Clause 26 extends this time period marginally by providing that the lender must wait for five working days. Clause 26(3) specifies the definition of “working day”.

10.11 Under clause 26(2), the borrower may make an application to court for the return of goods to them, provided they do so before the end of the fifth working day. If the reasons for taking possession under clause 18(1) no longer apply, the court may order the return of the goods. To make use of the summary procedure under section 7 of

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<sup>161</sup> There is case law suggesting that section 101 of the Law of Property Act 1925 does not currently apply to security bills of sale: see *Calvert v Thomas* (1887) 19 QBD 204 and *Re Morritt, ex p Official Receiver* (1886) 18 QBD 222.

the 1882 Act, the borrower has to actually tender the sums due to the lender in full before the end of the five days.<sup>162</sup>

10.12 Under the draft Bill, the five day respite applies whenever the lender takes possession without a court order, even if the borrower has received a possession notice and opted for the additional advice period. Any further period of delay involves costs (including mounting interest and storage costs).<sup>163</sup> We welcome views on whether the additional delay after seizure is still needed in all circumstances.

**Consultation Question 24.**

10.13 Do consultees think that it is desirable to prevent lenders from selling goods for five working days after taking possession without a court order? If so, is this protection necessary in all such circumstances?

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<sup>162</sup> *Johnson v Diprose* [1893] 1 QB 512.

<sup>163</sup> We were told the lenders charge £2 per day plus VAT plus an administration charge of £20 for the storage of cars. It is likely that they would charge more for more valuable assets (such as art).

# Chapter 11: Contracting out, interpretation, repeals and final provisions

11.1 In this chapter we discuss contracting out (clause 29); the interpretation provisions (including clause 30); the effect of the repeal of the Bills of Sale Acts on “absolute bills” (clause 31); and the final provisions (clauses 32 to 38). We also discuss the implications of the draft Bill for general assignments of book debts (set out in paragraph 10 of schedule 2).

## CONTRACTING OUT

11.2 As we have seen, the draft Bill contains several provisions to protect borrowers (including restrictions on the lender’s right to take possession and the borrower’s right of voluntary termination). Clause 29 provides that these cannot be excluded or reduced by a contractual term (whether that term is in the goods mortgage document or in a related agreement). Any term purporting to reduce protections in this way would be void.

11.3 This does not preclude contractual terms which grant borrowers additional rights, such as further restrictions on taking possession.

### 29 Contracting-out forbidden

- (1) A term contained in a goods mortgage, or in any agreement secured by or related to a goods mortgage, is void if, and to the extent that, it is inconsistent with a provision for the protection of the mortgagor contained in this Act or in any regulations made under this Act.
- (2) Where the provision specifies the duty or liability of the mortgagor in certain circumstances, the term is inconsistent with that provision if it purports to impose, directly or indirectly, an additional duty or liability on the mortgagor in those circumstances.
- (3) Despite subsection (1), a provision of this Act under which a thing may be done in relation to any person only on an order of the court is not to be taken to prevent its being done at any time with that person’s consent given at that time.
- (4) The refusal of the consent mentioned in subsection (3) is not to give rise to any liability.

11.4 Clauses 29(1) and (2) are almost identical to similar provisions in section 173(1) and (2) of the Consumer Credit Act 1974 (CCA).

11.5 Subsections (3) and (4) are based on section 173(3) of the CCA, which we have rephrased and divided in the interests of clarity. As we discuss in Chapter 7, it is possible for the lender to take possession with consent, but this must be given at the time. The consent must also be genuine. The borrower must not face any additional liability for refusing consent.

## INTERPRETATION

11.6 Clause 35 lists 16 terms which are either defined under the draft Bill or by the CCA.

11.7 In this document, we discuss two definitions alongside the substantive provisions to which they relate:

- (1) The definition of “credit” and “credit agreement” in clause 33 relates mainly to the “business credit conditions”. It has the effect of ensuring that “credit”, “credit agreement” and “the total charge for credit” are interpreted consistently with consumer credit legislation. We discuss this in Appendix 1.
- (2) The definition of “disposition” (clause 34) is discussed alongside the third party provisions in Chapter 6.

11.8 There are further definitions in clause 30, which relate only to Part 4 of the draft Bill (dealing with the rights of mortgagors and mortgagees). We set out this clause below.

### 30 Interpretation of Part 4

- (1) This section has effect for the interpretation of this Part.
- (2) “Registered”, in relation to a goods mortgage, means—
  - (a) if or to the extent that the goods mortgage relates to goods other than qualifying vehicles as defined in section 8(4), registered under section 9;
  - (b) if or to the extent that the goods mortgage relates to one or more qualifying vehicles as so defined, registered under section 10.
- (3) In relation to a goods mortgage—
  - (a) “mortgagor” includes a person to whom the original mortgagor’s rights and duties under the goods mortgage have passed by operation of law;
  - (b) “mortgagee” includes a person to whom the original mortgagee’s rights and duties under the goods mortgage have passed by assignment or operation of law.
- (4) In relation to a goods mortgage over an undivided share in goods, references to goods are to be read, unless the context requires otherwise, as references to the undivided share.

11.9 Clause 30 defines four terms:

- (1) “*Registered*” is defined in line with the registration procedure in Part 3. In Part 4 the term is used in two contexts. These are:
  - (a) clause 25(3) and (4) (dealing with a lender’s power of sale in relation to other lenders with registered mortgages); and
  - (b) clause 27(4) (dealing with the right to terminate when other lenders have registered mortgages),
- (2) “*Mortagor*” includes not only the original borrower who grants the mortgage, but also a person to whom their rights and duties “have passed by operation of law”. This would include an executor, after the borrower’s death.
- (3) “*Mortgagee*” is defined more widely to include anyone who has assumed the lender’s duties either by operation of law or assignment. This covers the situation where one lender sells their loan book to another lender.
- (4) “*Undivided share*”: clause 3(2) permits an owner in common to create a goods mortgage over their undivided share in the goods. Where this occurs, references to goods are to be read as references to an undivided share in the goods.

11.10 The draft Bill is designed to work with mortgages over undivided shares in goods (for example, a share in a racehorse), including in relation to taking possession. A lender with a mortgage over a share in goods owned in common would have the same rights and obligations as any other lender with a goods mortgage. They would still need to establish a right to take possession (under one of the grounds in clause 18) before they can do anything with the share or the goods. Once the right to possession is established, they may not need to take physical possession in order to sell the goods: they could simply sell the share or agree with the other owners in common to sell the goods in their entirety and split the proceeds of sale. Otherwise, a lender with a mortgage of a share can apply to court to be permitted to sell the share or the goods in their entirety (in order to obtain the value of the share).<sup>164</sup>

**Consultation Question 25.**

11.11 Do consultees agree that the draft Bill works for shares in goods?

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<sup>164</sup> In *The James W Elwell* [1921] P 351, the court held (in relation to a ship) that “there is no doubt that at common law an undivided share in a chattel can be taken in execution by seizure of the chattel and sale of the share”.

## REPEALING BILLS OF SALE LEGISLATION: EFFECT ON ABSOLUTE BILLS

11.12 Clause 31 implements our recommendation to repeal the Bills of Sale Acts in their entirety.

11.13 Under the Acts the term “bill of sale” refers to a document which transfers owners of goods from one person to another, while allowing the former owner to retain possession of the goods. Bills of sale come in two types: “security bills” and “absolute bills”. Under section 3 of the 1882 Act, a “security bill” is a bill of sale which is used as “security for the payment of money”. An “absolute bill” is a bill of sale which is used for any other purpose. At present, both security bills and absolute bills must be registered, though the procedure differs between the two types.<sup>165</sup>

11.14 In our 2016 report we recommended that the requirement to register absolute bills should be abolished.<sup>166</sup> It was not clear why absolute bills were ever used, or why registration was necessary. Nor did we find any contemporary examples of absolute bills being registered. The case law on absolute bills suggests that the main use of the legislation has been to enable creditors to seize goods even though the debtor had purported to sell the goods to another.<sup>167</sup> However, creditors are now protected by the “clawback” provisions in the Insolvency Act 1986,<sup>168</sup> while purchasers are protected by section 24 of the Sale of Goods Act.<sup>169</sup>

11.15 Under the draft Bill, security bills will be replaced by goods mortgages, while the kinds of transactions which currently fall within the definition of “absolute bills” will mostly be deregulated. Absolute bills which are in effect security bills for obligations other than a loan will be abolished. We expect that the kinds of transactions which will be merely deregulated will no longer be called “absolute bills”: they will be sales, assignments etc. The term “absolute bill of sale” refers to the documentary requirements that one has to satisfy in order to validate a substantive transaction which already has a name (that is why the bills of sale definition is a vast list of different types of transactions).<sup>170</sup>

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<sup>165</sup> For a full discussion of the difference, see Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 3.35 to 3.41.

<sup>166</sup> Bills of Sale (2016) Law Com No 369, para 10.27.

<sup>167</sup> *Youngs v Youngs* [1940] 1 KB 760; *Koppel v Koppel* [1966] 1 WLR 802 and *Halberstam v Gladstar Ltd* [2015] EWHC 179 (QB). For an account of these cases, see Bills of Sale (2015) Law Commission Consultation Paper No 225, paras 14.13 to 14.20.

<sup>168</sup> Insolvency Act 1986, ss 339 and 340, discussed in Bills of Sale (2016) Law Com No 369, paras 10.13 to 10.18.

<sup>169</sup> Bills of Sale (2016) Law Com No 369, paras 10.19 to 10.20.

<sup>170</sup> Bills of Sale Act 1878, s 4: “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”.

## FINAL PROVISIONS

11.16 The final provisions of the draft Bill include a regulation making power and commencement provisions.

### Regulation making power (clause 32)

11.17 The draft Bill refers to a variety of prescribed requirements, persons, manners and periods. Examples include the document requirements in clause 5; the possession notice requirements in clause 21; and the conditions for an exempt agreement in clause 28. Clause 32 gives a power to the Treasury to prescribe these various details by regulation.

### Commencement (clause 37)

11.18 Before commencement, the Treasury will need to make regulations about the prescribed requirements. Clause 37 allows the Treasury to make the necessary regulations and then bring the Act into force “on such day as the Treasury may by regulations appoint”.

## GENERAL ASSIGNMENTS OF BOOK DEBTS (SCHEDULE 2, PARAGRAPH 9)

11.19 Under insolvency law, a general assignment of book debts made by an unincorporated business must be registered “as if it were” an absolute bill of sale. If not, it will not be valid in the event of bankruptcy.

11.20 The obligation arises under section 344(2) which states:

The assignment is void against the trustee of the bankrupt’s estate as regards book debts which were not paid before the presentation of the bankruptcy petition, unless the assignment has been registered under the Bills of Sale Act 1878.

11.21 Section 344(4) continues:

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.

11.22 In the consultation paper we argued that, in principle, registration of general assignment of book debts serves a useful purpose. However, we said that the current procedures for registration are unnecessarily complex, time consuming and expensive. Consultees agreed. In our 2016 report, we recommended that general assignments of book debts should continue to be registered, but using the simpler procedures which we recommended for goods mortgages on goods other than vehicles.

11.23 This change is enacted in paragraph 9 of schedule 2, which amends section 344. Following enactment, section 344(2) would read as follows:

The assignment is void against the trustee of the bankrupt’s estate as regards book debts which were not paid before the presentation of the bankruptcy petition, unless

the assignment has been registered ***under section 9 of the Goods Mortgages Act 2017.***

11.24 Meanwhile, section 344(4) would be amended to:

For the purposes of section 9 of the Goods Mortgages Act 2017, an assignment of book debts is to be treated as if it were a general goods mortgage as defined by section 8(2) of that Act.

## Chapter 12: List of consultation questions

### **Consultation Question 1.**

Do consultees agree that high net worth individuals should be able to opt out of protections even if the loan does not exceed £60,260?

### **Consultation Question 2.**

Do consultees agree that it is right to characterise a goods mortgage as a “charge”, in accordance with all other commonly-used modern security interests?

### **Consultation Question 3.**

Do consultees agree that beneficiaries under trusts should not be able to grant goods mortgages?

### **Consultation Question 4.**

Do consultees agree with our proposed scheme of priority between a goods mortgage over fixtures and growing crops and a land mortgage?

### **Consultation Question 5.**

If not, would it be preferable to take out fixtures and growing crops from our definition of “goods” so that they could not be made subject to a goods mortgage at all?

**Consultation Question 6.**

Do consultees consider that ship mortgages which are not covered by the specialist ship mortgage regime could be brought within the scope of the draft Bill without causing difficulty to the existing regime for ship mortgages?

**Consultation Question 7.**

Do consultees agree that only high net worth individuals should be able to use goods mortgages to secure guarantees?

**Consultation Question 8.**

Do consultees agree that only high net worth individuals and businesses borrowing over £25,000 should be able to use goods mortgages to secure running-account credit?

**Consultation Question 9.**

We welcome views about whether it is necessary to prevent goods mortgages from being used to secure the performances of services.

**Consultation Question 10.**

We welcome comments on any disadvantages of a restriction which prevents goods mortgages being used to secure non-monetary obligations (such as an obligation to return shares in stock lending), either in a consumer or business context.

**Consultation Question 11.**

Do consultees agree that pledges and other possessory security arrangements should become void if the borrower is given custody of the goods?

**Consultation Question 12.**

Do you consider the wording of these warnings to be appropriate?

**Consultation Question 13.**

Do you think it is necessary to include a prominent warning for borrowers that they should not seek a second loan on the vehicle without disclosing the existence of a first loan?

**Consultation Question 14.**

Do you agree that it is unnecessary for the mortgage document to require the occupation of the witness?

**Consultation Question 15.**

If you have particular concerns about the practical consequences of dividing goods mortgages between the High Court register and private asset finance registers, we would welcome your comments.

**Consultation Question 16.**

Do consultees have experience of registering a vehicle which has been registered at the DVLA but does not have a VIN or other unique identifier?

**Consultation Question 17.**

Do consultees agree that the definition of “vehicle mortgage” is sufficiently clear and wide to cover the types of vehicles over which a goods mortgage is likely to be granted?

**Consultation Question 18.**

We welcome comments on how often lenders and registers are faced with multiple registrations of interests over the same vehicle within a short timeframe, and the impact of this.

**Consultation Question 19.**

We welcome consultees' views on the different options for ensuring adequate data-sharing.

**Consultation Question 20.**

Do consultees agree with our proposed provisions on tacking? If not, do consultees think that our Bill should forbid tacking for goods mortgages?

**Consultation Question 21.**

Do consultees think that clause 34 clearly expresses the concept of a contract to transfer ownership of goods for value?

**Consultation Question 22.**

Do consultees think that the draft Bill should specify whose consent is needed for clause 19?

**Consultation Question 23.**

Do consultees agree that the occupier of the premises (rather than the borrower) should be the person required to consent to the lender entering premises to repossess the goods?

**Consultation Question 24.**

Do consultees think that it is desirable to prevent lenders from selling goods for five working days after taking possession without a court order? If so, is this protection necessary in all such circumstances?

**Consultation Question 25.**

Do consultees agree that the draft Bill works for shares in goods?



# Appendix 1: Exempt agreements

1.1 The discussion which follows is split into three parts. We start with the contents of clause 28, which defines an “exempt” goods mortgage. We then provide a short introduction to both the “high net worth” and “business credit” conditions, before looking in more detail at how they have been applied in a consumer credit context.

## CLAUSE 28: EXEMPT GOODS MORTGAGES

1.2 The draft Bill divides goods mortgages into two types: “exempt” goods mortgages, and other goods mortgages – which we refer to here as “non-exempt” goods mortgages. Exempt goods mortgages will be subject to fewer protections than non-exempt mortgages. As a result, the draft Bill imposes certain restrictions on the circumstances in which individuals can enter into exempt mortgages. Clause 28 contains the relevant provision.

### 28 Exempt goods mortgage

- (1) A goods mortgage is an “exempt goods mortgage” for the purposes of this Act in the following cases.
  - (2) A goods mortgage is an exempt goods mortgage if the obligation secured by it is—
    - (a) a guarantee (see section 7(2) for the cases in which a goods mortgage may secure a guarantee), or
    - (b) the obligation of the borrower under an agreement for running-account credit as defined by Schedule 1 (see section 7(3) for the cases in which a goods mortgage may secure such an obligation).
  - (3) A goods mortgage is also an exempt goods mortgage if—
    - (a) the high net worth conditions (see subsection (4)) or the business credit conditions (see subsection (5)) are met, and
    - (b) the goods mortgage includes a declaration by the mortgagor which—
      - (i) states that the mortgagor agrees to forgo the protection and remedies given by sections 20(1) and 27(2), and
      - (ii) complies with prescribed requirements.
  - (4) The high net worth conditions are—
    - (a) that a statement complying with prescribed requirements has been made in relation to the income or assets of the mortgagor,

- (b) that the connection between the statement and the goods mortgage complies with prescribed requirements, and
- (c) that a copy of the statement was provided to the mortgagee before the goods mortgage was created.

(5) The business credit conditions are—

- (a) that the obligation to which the goods mortgage relates arises from the provision of credit exceeding the prescribed amount, and
- (b) that the agreement under which that obligation is owed was entered into wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the mortgagor.

1.3 A goods mortgage counts as an “exempt” goods mortgage for the purposes of the draft Bill in any of the following cases (clause 28(1)):

- (1) where the obligation secured by it is a guarantee (clause 28(2)(a));
- (2) where the obligation secured by it is an agreement for running-account credit (clause 28(2)(b));
- (3) where the high net worth conditions, and associated conditions, are met (clauses 28(3)(a) and 28(3)(b)); or
- (4) where the obligation secured is a business loan above a prescribed amount (intended to be £25,000) and other associated conditions are met (clauses 28(3)(a) and 28(3)(b)).

1.4 As we discuss from paragraph 3.77 above, under clause 7, guarantees and running-account credit obligations are “excluded obligations”. The effect of clause 7 is that only high net worth individuals can secure running-account credit obligations with a goods mortgage. Schedule 1 gives further explanation of how running-account credit facilities are intended to operate. Goods mortgages can only be used to secure guarantees by high net worth individuals or in the above business-lending context.

1.5 A goods mortgage securing a guarantee or agreement for running-account credit must be accompanied by a statement from the borrower acknowledging that they will not have the benefit of certain protections which would otherwise apply. The goods mortgage must also meet other prescribed requirements.

1.6 Clause 28 sets out the high net worth conditions and the business credit conditions.

1.7 Here we start by examining the “high net worth conditions” and the “business credit conditions”. We then look in more detail at how they have been applied in the Financial Conduct Authority handbook.

## THE “HIGH NET WORTH” CONDITIONS

1.8 The high net worth conditions follow the approach currently used to exclude certain borrowers from aspects of consumer credit regulation. These are set out in article 60H of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (“RAO”).<sup>1</sup> In broad terms, individuals are of “high net worth” if they have a net annual income of £150,000 or more, or assets of £500,000 or more (not including a home or pension). The borrower must provide two prescribed documents:

- (1) *A declaration in which the borrower agrees to forego the protections which would be available to them in a regulated consumer credit agreement.* Under article 60H, this declaration must comply with rules made by the Financial Conduct Authority (“FCA”).<sup>2</sup>
- (2) *A statement from an accountant showing the borrower’s income or assets.* Again, article 60H states that the statement must comply with rules made by the FCA.<sup>3</sup> It goes on to say that it must also comply with any FCA rules relating to the connection between the statement and the agreement.<sup>4</sup> Finally, it requires a copy of the statement to be provided to the lender.<sup>5</sup>

1.9 Clause 7 takes the same approach. The intention is that the Treasury will make regulations which mirror those for consumer credit, as set out in the FCA Handbook. The regulations may either refer to these provisions (with necessary amendments) or reproduce them in amended form.

## THE “BUSINESS CREDIT” CONDITIONS

1.10 The business credit conditions are modelled on article 60C(3) of the RAO, which states that a credit agreement is an exempt agreement if:

- (1) the lender provides the borrower with credit exceeding £25,000; and
- (2) the agreement is entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

1.11 We intend that the “prescribed amount” will be £25,000, as specified in RAO.

### Calculating whether running account credit exceeds £25,000

1.12 For fixed-sum credit, it is easy to calculate whether the loans exceeds £25,000. However, this is more difficult for running account credit, where the amount of the loan may vary from day to day. The issue is dealt with in section 10 of the Consumer Credit

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<sup>1</sup> Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001 no 544. We refer to this order throughout this Appendix as the “RAO”.

<sup>2</sup> RAO, art 60(1)(c). The FCA rules are currently found in CONC App 1.4.2R and 1.4.6R.

<sup>3</sup> RAO, art 60H(1)(d). The FCA rules are currently found in CONC App 1.4.3R, 1.4.4R and 1.4.7R.

<sup>4</sup> RAO, art 60H(1)(e). The FCA rules are currently found in CONC App 1.4.1R.

<sup>5</sup> RAO, art 60H(1)(f).

Act 1974 (“CCA”). Very broadly, section 10 provides that running-account credit does not exceed £25,000 if:

- (1) the credit limit does not exceed £25,000;
- (2) the business cannot borrow more than £25,000 at any one time;
- (3) more onerous conditions apply for the borrower if the balance rises above a specific sum of £25,000 or less; or
- (4) it is probable that the borrower will not borrow more than £25,000 at any one time.

1.13 Most of these provisions are self-explanatory. However, the second of these conditions (which is set out in the draft Bill at paragraph 4(1)(b)(i) of schedule 1) is not.

1.14 This provision replicates section 10(3)(b)(i) of the CCA. The operation of this section is then explained in an example given in schedule 2 to the CCA. This example reads as follows (we made the amendments in square brackets to reflect the current monetary threshold under the CCA).

#### **EXAMPLE 19**

*Facts.* H (a finance house) agrees with J (a partnership of individuals) to open an unsecured loan account in J's name on which the debit balance is not to exceed [£27,000] (having regard to payments into the account made from time to time by J). Interest is to be payable in advance on this sum, with provision for yearly adjustments. H is entitled to debit the account with interest, a “setting-up” charge, and other charges. Before J has an opportunity to draw on the account it is initially debited with £2,250 for advance interest and other charges.

*Analysis.* This is a personal running-account credit agreement (see sections 8(1) and 10(1)(a), and definition of “individual” in section 189(1)). By section 10(2) the credit limit is [£27,000]. By section 9(4) however the initial debit of £2,250, and any other charges later debited to the account by H, are not to be treated as credit even though time is allowed for their payment. Effect is given to this by section 10(3). Although the credit limit of [£27,000] exceeds the amount ([£25,000]) specified in section 8(2) as the maximum for a consumer credit agreement, so that the agreement is not within section 10(3)(a), it is caught by section 10(3)(b)(i). At the beginning J can effectively draw (as credit) no more than [£24,750], so the agreement is a consumer credit agreement.

1.15 We intend that the same reading will apply to the provision in schedule 1 to the draft Bill.

## HIGH NET WORTH CONDITIONS IN DETAIL

### Statements of high net worth

1.16 All high net worth individuals seeking to secure excluded obligations will require a “statement” of high net worth (clause 28(4)(a)). We propose that this statement (subject to minor adjustments) be identical to the form of statement required under current legislation and FCA rules.

1.17 These rules are referred to in article 60H of the RAO, which sets out a “high net worth” exemption – otherwise described as an exemption “relating to the nature of the borrower”. The consequence of getting such an exemption is that any associated credit agreement is not subject to a number of consumer protection measures (such as most CCA controls, FCA oversight etc). Article 60H, in full, reads:

(1) Subject to article 60HA, a credit agreement is an exempt agreement for the purposes of this Chapter if—

- (a) the borrower is an individual,
- (b) the agreement is either—
  - (i) secured on land, or
  - (ii) for credit which exceeds £60,260 and, if entered into on or after 21st March 2016, is for a purpose other than—
    - (aa) the renovation of residential property, or
    - (bb) to acquire or retain property rights in land or in an existing or projected building,
- (c) the agreement includes a declaration made by the borrower which provides that the borrower agrees to forgo the protection and remedies that would be available to the borrower if the agreement were a regulated credit agreement and which complies with rules made by the FCA for the purposes of this paragraph,
- (d) a statement has been made in relation to the income or assets of the borrower which complies with rules made by the FCA for the purposes of this paragraph,
- (e) the connection between the statement and the agreement complies with any rules made by the FCA for the purposes of this paragraph (including as to the period of time between the making of the statement and the agreement being entered into), and
- (f) a copy of the statement was provided to the lender before the agreement was entered into.

(2) Where a credit agreement would be an exempt agreement pursuant to this article but for paragraph (1)(b)(ii)(bb) or article 60HA, the FCA may treat the agreement as an exempt agreement except for the purpose of the application of the requirements of the mortgages directive.

- 1.18 Article 60H(1)(d) requires a statement to be made, which complies with FCA rules made for the purposes of that paragraph. These rules are set out in the appendix to the Consumer Credit sourcebook – the part of the FCA Handbook which deals with various aspects of consumer credit regulation.
- 1.19 The rules relating to statements in that part of the FCA Handbook are:

#### **CONC App 1.4.1R**

- (1) For the purposes of articles 60H(1)(c) and 60Q(b) of the Regulated Activities Order and of CONC 1.2.10R(2), a declaration made by the borrower or hirer which provides that the borrower or hirer agrees to forgo the protection and remedies that would be available to the borrower or hirer if the agreement were a regulated credit agreement or a regulated consumer hire agreement must comply with CONC App 1.4.2R and either CONC App 1.4.6R or, in the case of an MCD article 3(1)(b) credit agreement, CONC App 1.4.6AR.
- (2) For the purposes of articles 60H(1)(d) and 60Q(c) of the Regulated Activities Order and of CONC 1.2.10R(2), a statement in relation to the income or assets of the borrower or hirer (referred to in this section as a statement of high net worth) must comply with CONC App 1.4.3 R, CONC App 1.4.4 R and CONC App 1.4.7 R.
- (3) For the purposes of articles 60H(1)(e) and 60Q(d) of the Regulated Activities Order and of CONC 1.2.10R(2), the statement in (2) must be made during the period of one year ending with the day on which the agreement was made.

### **CONC App 1.4.3R**

(1) Subject to CONC App 1.4.4 R, a statement of high net worth shall be signed by

- (a) the lender or owner; or
- (b) an accountant who is a member of any of the bodies listed in (2).

(2) The bodies referred to in (1)(b) are:

- (a) the Institute of Chartered Accountants in England and Wales;
- (b) the Institute of Chartered Accountants of Scotland;
- (c) the Institute of Chartered Accounts in Ireland;
- (d) the Association of Chartered Certified Accountants;
- (e) the Chartered Institute of Management Accountants;
- (f) the Chartered Institute of Public Finance and Accountancy;
- (fa) the Association of International Accountants; and
- (g) a professional body for accountants established in a jurisdiction outside the United Kingdom.

### **CONC App 1.4.4R**

A person who is

- (1) the lender or owner;
- (2) an employee or agent of the lender or owner or a person who otherwise acts on behalf of the lender or owner in relation to the credit agreement or consumer hire agreement; or
- (3) an associate of the lender or owner,

may only make a statement of high net worth if the lender or owner is a person who has Part 4A permission to accept deposits.

## CONC App 1.4.7R

### Statement of High Net Worth

A statement of high net worth for the purposes of articles 60H(1)(d) and 60Q(c) of the Regulated Activities Order must have the following form and content:

#### “Statement of High Net Worth

#### **(articles 60H(1) and 60Q of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001)**

I/We\* (insert full name) ..... of (insert address and postcode)..... confirm that I am/we\* are a person qualified to make a statement of high net worth under rules made by the Financial Conduct Authority, by virtue of the fact that .....

In my/our\* opinion (insert full name of borrower or hirer) ..... of (insert address and post code of borrower or hirer) ..... is an individual of high net worth because he/she\*

(a) received during the previous financial year net income totalling an amount of not less than £150,000\*; and/or

(b) had throughout that year net assets with a total value of not less than £500,000\*.

(insert one of the following declarations as appropriate)

I/We\* declare that I am/we are\* not connected to [insert name of the lender(s)/owner(s)][any person who is a lender/owner offering credit agreements/consumer hire agreements\*].

I/We\* declare that I am/we are\* [connected to] [insert name of lender(s)/owner(s)] as I am/we are\* [the lender(s)/owner(s)/an employee of/an agent of the lender(s)/owner(s)/a person who otherwise acts on behalf of the lender(s)/owner(s) in relation to the credit agreement/consumer hire agreement/an associate of the lender(s)/owner(s)].\*

I/We declare that I am/we are\*/[a/an] lender(s)/owner(s) offering credit agreements/consumer hire agreements/ an employee of/an agent of/a person who otherwise acts on behalf of/ an associate of lender(s)/owner(s) offering credit agreements/ consumer hire agreements.\*

In this statement-

(a) “associate” shall be construed in accordance with article 60L of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;

(b) “financial year” means a period of one year ending with 31st March;

(c) “net assets” shall not include –

- (i) the value of the borrower's or hirer's primary residence or any loan secured on that residence;
- (ii) any rights of the borrower or hirer under a qualifying contract of insurance within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001; and
- (iii) any benefits (in the form of pensions or otherwise) which are payable on the termination of the service of the borrower or hirer or on his retirement and to which he is (or his dependents are), or may be, entitled.

(d) "net income" means the total income of the borrower or hirer from all sources reduced by the amount of income tax and national insurance contributions payable in respect of it; and

(e) "previous financial year" means the financial year immediately preceding the financial year during which the statement is made".

### **Statements in the Goods Mortgages Bill and associated regulations**

- 1.20 Clause 28(4)(a) requires that, to make use of the high net worth exemption, it must be the case that a statement complying with prescribed requirements has been made in relation to the income or assets of the mortgagor. Among these prescribed requirements will be those relating to the "connection between the statement and the goods mortgage" (clause 28(4)(b)).
- 1.21 Those prescribed requirements will be set out in regulations. For the most part, they will mirror the relevant provisions of CONC (set out above). Only minor changes will be made: for example, to relate the statement to the rules in the draft Bill, rather than to the RAO.
- 1.22 One substantive addition will relate to the re-use of pre-existing statements of high net worth. We recognise that in many cases, a statement of high net worth will already have been made in accordance with FCA rules. Commonly, this will be done at the request of a lender, who will offer better terms of lending if the underlying agreement is non-regulated.
- 1.23 As a result, if a statement has already been made within the 12 months prior to the granting of a goods mortgage, and it complies with the criteria set out above, we consider that statement sufficient for the purposes of the draft Bill. It may be reused for the purposes of the goods mortgage, without amendments or the additional expense of a new statement. The 12 month period is the same as the current validity period prescribed by FCA rules.
- 1.24 Clause 28(4)(c) replicates article 60H(1)(f) of the RAO, and provides that a copy of the statement must have been provided to the mortgagor. This provision applies to the relevant statement – whether made specifically for the purposes of the goods mortgage, or in relation to the underlying credit agreement.

## DECLARATIONS

1.25 FCA rules also provide for a “declaration” of high net worth to be made by the borrower within the relevant credit agreement (RAO 60H(1)(c)). By this statement, the borrower acknowledges that they will lack certain protections otherwise provided to regulated agreements. The provisions relevant to declarations are:

### **CONC App 1.4.2R**

A declaration for the purposes of articles 60H(1)(c) and 60Q(b) of the Regulated Activities Order and of CONC 1.2.10R(2) shall

- (1) be set out in the credit agreement or consumer hire agreement no less prominently than other information in the agreement and be readily distinguishable from the background medium; and
- (2) be signed by the borrower or hirer, unless the agreement is so signed.

### **CONC App 1.4.6R**

The declaration for the purposes of articles 60H(1)(c) and 60Q(b) of the Regulated Activities Order must have the following form and content-

“Declaration by high net worth borrower or hirer (articles 60H(1) and 60Q of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001)

I confirm that I have received a copy of the statement of high net worth made in relation to me for the purposes of article 60H(1)(d) or article 60Q(c) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

I understand that by making this declaration I will not have the benefit of the protection and remedies that would be available to me under the Financial Services and Markets Act 2000 or the Consumer Credit Act 1974 if this agreement were a regulated agreement under those Acts.

I understand that this declaration does not affect the powers of the court to make an order under section 140B of the Consumer Credit Act 1974 in relation to a credit agreement where it determines that the relationship between the lender and the borrower is unfair to the borrower.\*

I am aware that if I am in any doubt as to the consequences of making this declaration then I should seek independent legal advice”.

\*This section should be omitted in the case of a consumer hire agreement

## **Declarations in the Goods Mortgages Bill and associated regulations**

1.26 Clauses 7(2)(b) and 7(3)(b) provide that high net worth individuals, to secure guarantees or running-account credit facilities, must make an appropriate declaration in the goods mortgage document.

1.27 The draft Bill itself specifies certain criteria relating to this statement. It is said in 7(2)(b)(i) and 7(3)(b)(i) that the statement must:

acknowledge that the mortgagor will not have available the protection and remedies that would be available to the mortgagor under sections 20(1) and 27(2) in the case of a non-exempt goods mortgage.

1.28 In 7(2)(b)(ii) and 7(3)(b)(ii) it is further stated that the declaration must comply with additional requirements as prescribed in regulations.

1.29 We intend that the additional prescribed requirements will be similar to those set out in CONC. These will include a template declaration which should be inserted into the goods mortgage – amended as appropriate to fit the context of the draft Bill.



# Appendix 2: Goods mortgages as charges

## INTRODUCTION

### Background

2.1 In our 2016 report we recommended that:

a goods mortgage should continue to take effect by transferring ownership to the lender unless the parties agree that it should take effect as a charge.<sup>1</sup>

2.2 A transfer of ownership is the distinctive feature of a “true mortgage”. Such a transfer does not take place where the security is a charge. An explanation of the difference between a “true mortgage” and a “charge” can be found in the report,<sup>2</sup> and is discussed further below.

2.3 We said in the report that it did not matter that the common law applied differently to true mortgages and to charges because our Goods Mortgages Bill would make clear rules applicable to both, which would derogate from the common law.<sup>3</sup> In order to implement our recommendation, however, we would need to have a dual system in the draft Bill: clauses that would apply where the goods mortgage is a true mortgage and clauses that would apply where the goods mortgage is a charge.

2.4 As the distinction between true mortgages and charges permeates most aspects of the draft Bill, the legislation would be made substantially longer and more complex. On further consideration, we consider it preferable that all goods mortgages take effect as charges. This makes the draft Bill simpler and clearer, and should not disadvantage lenders or borrowers.

### Main reasons for favouring charges over mortgages

2.5 As we explain in more detail below, we think the main arguments for the mortgage operating as a charge are that:

- (1) transfers of ownership by way of security have now become mostly obsolete – aircraft, ship and land “mortgages” are all charges, and bills of sale are the only surviving example of true mortgages provided for by statute;
- (2) it fits better with the possibility of creating first and subsequent mortgages; and
- (3) it creates the right relationship between the mortgagee and third party purchasers in the context of our recommendations relating to innocent purchasers.

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<sup>1</sup> Bills of Sale (2016) Law Com No 369, para 4.42.

<sup>2</sup> Bills of Sale (2016) Law Com No 369, paras 4.41 to 4.51.

<sup>3</sup> Bills of Sale (2016) Law Com No 369, para 4.43.

2.6 Where the distinction matters, the draft Bill provides additional rights to lenders. We think that retaining title is good for borrowers, particularly consumer borrowers. It accords better with their understanding of “mortgages”, which are not generally understood as taking title from the borrower because of the land mortgage model. As for borrowers understanding that they might still lose their goods, the draft Bill requires prominent statements and warnings to be put on the face of the goods mortgage document.

2.7 Nevertheless, we think that it remains desirable to retain the label of “mortgage” – even in the absence of a transfer of title. Calling the charge a “goods mortgage” will emphasise to consumers the seriousness and potential consequences of the transaction, and is a less confusing term than “charge”.<sup>4</sup>

## THE CURRENT POSITION FOR SECURITY BILLS OF SALE

2.8 Security bills of sale are true mortgages. The statutory form of a security bill of sale imposes a requirement that the grantor “assign … chattels and things<sup>5</sup>… by way of security”.<sup>6</sup> This has been interpreted to exclude charges, licences, declarations of trust etc from the types of transactions that can constitute security bills of sale<sup>7</sup> (although they are comprised in the general definition of bills of sale).

2.9 The Bills of Sale Acts do not stipulate that legal title has to be transferred to the grantee (lender). The relevant assignment can be equitable as well. The only express requirement is for the grantor of the bill of sale be the “true owner” of the goods at the time of entering into the bill of sale.<sup>8</sup> An individual has been held to be the “true owner”<sup>9</sup> if:

- (1) they hold the legal title to the goods, although beneficial ownership is in another;<sup>10</sup>
- (2) they are beneficially entitled to the goods, although legal title is in another;<sup>11</sup> or

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<sup>4</sup> We were told that consumers tend to think of a “charge” as a “fee”.

<sup>5</sup> “Things” were held to also mean “chattels”, not choses in action or land: *Cochrane v Entwistle* (1890) 25 QBD 116. The use of “things” might be explained by the fact that fixtures and growing crops (not usually perceived as chattels) are also included in the Bills of Sale Acts.

<sup>6</sup> The 1882 Act, s 9 and the Schedule.

<sup>7</sup> Halsbury’s Laws of England *Financial instruments and transactions* vol 49 (2015), para 508.

<sup>8</sup> The 1882 Act, s 5.

<sup>9</sup> Halsbury’s Laws of England *Financial instruments and transactions* vol 49 (2015), para 481.

<sup>10</sup> *Re Sarl, ex p Williams* [1892] 2 QB 591 (a trustee is a true owner of goods).

<sup>11</sup> *Thomas v Searles* [1891] 2 QB 408, CA (mortgagor held true owner by reason of his equity of redemption); *Re Feild, ex p Pratt* (1890) 63 LT 289 (husband settling goods on himself and wife during joint lives and after death to survivor absolutely held owner by reason of his prospective rights by survivorship); *Usher v Martin v Hall* (1889) 24 QBD 272 (grantee of the bill of sale, who had been assigned rights over the equity of redemption, could take the goods out of the hands of execution creditors of the grantor).

(3) the real owner, though not the grantor himself, has held out the grantor to be the true owner and is thus estopped from denying the validity of the bill.<sup>12</sup>

2.10 The grantor of the bill of sale usually holds legal title to the assets in question. In the standard case, the grantor will assign this legal title to the grantee (mortgagee). Grantees of subsequent bills of sale over the same goods are assigned rights over the “equity of redemption”. This is the name given to the bundle of rights the grantor still retains over the goods (such as the right to demand a re-conveyance of the goods on discharge of the secured obligation).

## CHARGES

2.11 Charges are non-possessory security interests whereby the charged property is appropriated to the discharge of an obligation without transfer of legal title. Charges create new proprietary rights in the creditor (chargee), the extent of which depends on the agreement between chargor and chargee.

2.12 Examples of charges created by statute include: land mortgages,<sup>13</sup> aircraft mortgages,<sup>14</sup> and ship mortgages.<sup>15</sup> Charges are the dominant form of security over personal property in commercial life.<sup>16</sup> We have not identified any other statutory securities which operate as true mortgages.

2.13 Chargees are able to draft security agreements with such comprehensive remedial provisions operating on the chargor’s (or debtor’s) default that the theoretical distinction between the remedies under a true mortgage and under a charge can often be illusory.<sup>17</sup>

## THE DIFFERENCE BETWEEN CHARGES AND SECURITY BILLS OF SALE

2.14 As we are now proposing that the goods mortgage take the form of a charge, it is important to be clear about the difference this would make in practice, as compared to security bills of sale.

### Multiple securities over the same goods

2.15 We recommended in our report that individuals should be allowed to grant multiple securities over the same goods.<sup>18</sup> This would be possible regardless of whether the goods mortgage is a true mortgage or a charge.

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<sup>12</sup> *Westen v Fairbridge* [1923] 1 KB 667 (wife making declaration that husband true owner held estopped from denying such ownership).

<sup>13</sup> A legal mortgage of land is “a charge by deed expressed to be by way of legal mortgage”. See, for example, the Law of Property Act 1925, s 87.

<sup>14</sup> Beale, Bridge, Gullifer, Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 14.51.

<sup>15</sup> It is not entirely clear whether ship mortgages are statutory charges but this is the prevailing view: see Beale, Bridge, Gullifer, Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 14.40. In any event, there is no statutory requirement to transfer title to the first ship mortgagee.

<sup>16</sup> Bridge, Gullifer, McMeel, Worthington, *The Law of Personal Property* (1st ed 2013) 7-019.

<sup>17</sup> Bridge, Gullifer, McMeel, Worthington, *The Law of Personal Property* (1st ed 2013) 7-019.

<sup>18</sup> Bills of Sale (2016) Law Com No 369, para 4.49.

- 2.16 In the case of true mortgages (bills of sale), the mortgagor transfers the legal title to the goods to the first mortgagee (subject to an implied or express right to have the title transferred back on full satisfaction of the obligation secured) and can give rights over the equity of redemption to subsequent mortgagees. The first mortgagee has legal title and the subsequent mortgagees have equitable rights, which are subject to the fulfilment of the obligation owed to the first mortgagee.
- 2.17 Under our proposed approach, each mortgagee would have a legal charge created by statute. This would simplify the conceptual framework for goods mortgages. On this model, all mortgagees have rights of the same type over the goods, which rank in priority according to the time at which each mortgagee registered the mortgage.

### **Effect on the rights of the first mortgagee**

#### **Right to take possession without a court order**

- 2.18 In terms of legal theory, the main difference between a first mortgagee who has title to the goods and a first chargee is that the former has the right to possession at any time, as the legal owner, whether the mortgagor is in default or not.<sup>19</sup>
- 2.19 This right to take possession immediately has been qualified by the Bills of Sale Acts, which do not allow mortgagees (whether first or subsequent) under a bill of sale to take possession, other than on a limited number of grounds listed in section 7 of the 1882 Act (we replicate these grounds of possession in the draft Bill). All these grounds for taking possession involve default or a clear risk of default (such as bankruptcy).
- 2.20 At common law, chargees do not have the right to take possession without express provision either in contract or statute to this effect.<sup>20</sup> In the absence of express provision, a chargee must apply to the court for an order for sale or for the appointment of a receiver who will then take possession and sell the charged assets.<sup>21</sup>
- 2.21 Having legal title makes a difference to the bills of sale mortgagor under the current law as, by virtue of their title, they can take possession without a court order once they have the right to do so under section 7 of the 1882 Act.

#### **Court orders required in any event for most goods mortgages**

- 2.22 Irrespective of transfer of title, the recommendations in our report mean that, unlike in the case of security bills of sale, mortgagees who wish to repossess will need court orders in the vast majority of cases. The only situations in which mortgagees will not have to go to court will be:
  - (1) where the goods mortgage is “exempt”; or

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<sup>19</sup> Beale, Bridge, Gullifer, Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 18.33. The mortgagee may go into possession “before the ink is dry on the mortgage” unless the contract provides otherwise: *Four-maids Ltd v Dudley Marshall (Properties) Ltd* [1957] Ch 317, [1957] 2 All ER 35.

<sup>20</sup> For example, chargees under a charge by deed are given the same powers as legal mortgagees under the Law of Property Act 1925, s 101(1).

<sup>21</sup> See the Law of Property Act 1925, s 101(1).

- (2) where the goods mortgage is non-exempt, the amount due is quantifiable from the outset and the mortgagor has paid back less than one third.
- 2.23 Even in the two cases above, if the goods are on “premises” (anywhere not on the public road) and the mortgagor or occupier does not consent to the mortgagee taking them from those premises, the mortgagee will have to get a court order.<sup>22</sup>

#### **Statutory right to take possession**

- 2.24 First mortgagees have a right to take possession under the draft Bill where:
  - (1) one of the grounds of possession arises,<sup>23</sup> and
  - (2) they are not otherwise required under the draft Bill to seek a court order.
- 2.25 As regards taking possession, this would put them in the same position they would have been in had they had legal title under a “true mortgage”.

#### **Right to sell the mortgaged goods**

- 2.26 It has been held that mortgagees under security bills of sale have an implied power of sale, as a legal incident of their security.<sup>24</sup> The power of sale is not implied by virtue of the mortgagee’s legal title to the goods. Rather, it applies to any bill of sale or chattel mortgagee.
- 2.27 For the sake of clarity, we are including an express provision in the draft Bill giving goods mortgagees the power to sell the mortgaged goods out of court.<sup>25</sup> We also intend to include an express provision stating that subsequent mortgagees cannot sell without a court order unless they have the permission of all prior mortgagees.<sup>26</sup>

#### **Insolvency**

- 2.28 We have considered whether the first mortgagee would be in a significantly better position in the event of the mortgagor’s insolvency if they had legal title (rather than having a charge). The goods mortgagor will always be an individual under the draft Bill, so we are only concerned with personal insolvency.

#### **Individual voluntary arrangements**

- 2.29 An individual voluntary arrangement (“IVA”) is an agreement entered into by a debtor with their creditors to pay their debts over a set period of time. An IVA must be set up by a qualified insolvency practitioner, who will deal with the creditors throughout the life of the IVA. IVAs are formal insolvency arrangements which are entered on the Insolvency Register.

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<sup>22</sup> See clause 19.

<sup>23</sup> See clause 18.

<sup>24</sup> *Re Morritt, ex p Official Receiver* (1886) 18 QBD 222; this is also the case for ship mortgagees. See Falcon Chambers and P Morgan (eds), *Fisher and Lightwood’s Law of Mortgage* (14th ed 2014) 30.8.

<sup>25</sup> Clause 25.

<sup>26</sup> This is modelled on the Merchant Shipping Act 1995, Sch 1 para 9(2).

2.30 In general terms, IVAs work as follows. The debtor and the insolvency practitioner submit a repayment proposal to the creditors, who have to approve it by a majority of 75%. The majority is calculated on the basis of the value of the debts owed to the creditors participating in the vote. If the proposal is accepted, the IVA becomes effective and the debtor will start making monthly repayments to the insolvency creditor, who distributes the money to the creditors. At the end of the IVA, if the debtor's payments into the IVA are not enough to pay all the debts in full, the rest will usually be written off.

2.31 Secured creditors fall outside the IVA process as regards their security. The vote of a secured creditor in respect of the part of the debt that is secured is not counted towards the majority required for the approval of the IVA. This is because an IVA does not affect the rights of secured creditor to realise their security in the usual way.<sup>27</sup> No proposal or modification of an IVA may be approved which affects the right of a secured creditor of the debtor to enforce his security, unless the creditor concerned actively concurs in this.<sup>28</sup> The IVA is binding on secured creditors only insofar as there may be a shortfall due to them and it will be necessary to continue to make payments.

2.32 “Secured creditor”, for the purposes of the Insolvency Act 1986 (“IA 1986”) and related regulations, is a creditor who has a security, whether that is a mortgage, charge, lien or other security.<sup>29</sup> Therefore, the goods mortgagee will be in the same position in an IVA, regardless of whether goods mortgages are charges or true mortgages.

### Bankruptcy

2.33 After an individual is declared bankrupt, their secured creditors have the following options:

- (1) realise the security and prove for the balance of the debt (if any);
- (2) realise the security but abandon the balance of the debt; or
- (3) surrender the security and prove for the full debt.

2.34 On the grantor's bankruptcy, the grantee under a bill of sale has the usual rights of a secured creditor.<sup>30</sup> An example of a recent case in which grantees of bills of sale were treated as any other secured creditors in a bankruptcy is *Evans v Finance-U-Ltd*.<sup>31</sup>

2.35 Whether or not title is transferred to the secured creditor, section 283(5) of the IA 1986 provides explicitly that the vesting of the bankrupt's assets in the estate is subject to the rights of secured creditors. Further, section 285(4) states that the making of a bankruptcy order does not affect the right of a secured creditor of the bankrupt to

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<sup>27</sup> Insolvency Act 1986, s 258(4).

<sup>28</sup> *Khan v Permayer* [2001] BPIR 95. See also I Fletcher, *The Law of Insolvency* (4th ed 2014) 4-026.

<sup>29</sup> Insolvency Act 1986, s 383(2); see also Halsbury's Laws of England, *Bankruptcy and Individual Insolvency* vol 5 (2013), para 574.

<sup>30</sup> See Halsbury's Laws of England, *Financial Instruments and Transactions* vol 49 (2015), para 595.

<sup>31</sup> *Evans v Finance-U-Ltd* [2013] EWCA Civ 869, [2013] BPIR 1001.

enforce his security. The effect of these sections is that a secured creditor, be it a true mortgagee or a chargee, can enforce their security in the usual way, outside the distribution of assets in the bankruptcy.

2.36 As soon as the bankruptcy order is made, the bankrupt's estate vests in the trustee in bankruptcy. We have considered whether the fact that the first mortgagee of a bill of sale has title would take the mortgaged asset entirely out of the estate of the bankrupt. This is not the case. The title to the asset is not transferred to the mortgagee absolutely, but subject to the equity of redemption. The equity of redemption forms part of the estate which is vested in the trustee.<sup>32</sup> The trustee in bankruptcy can redeem the bill of sale, just as they can redeem any other security over goods belonging to the bankrupt.

### Debt relief orders

2.37 An individual who is unable to discharge their debts may apply for an order under Part VIIA of the IA 1986.<sup>33</sup> This is known as a "debt relief order" ("DRO"). The order may be made in relation to the debtor's "qualifying debts".<sup>34</sup> The debtor must make their application in accordance with the provisions of Part VIIA of the Insolvency Act 1986 and associated regulations.<sup>35</sup>

2.38 If the Official Receiver decides to make an order, a moratorium commences in relation to the debts specified in the order on the "effective date".<sup>36</sup> During the moratorium the creditor to whom a specified qualifying debt is owed has no remedy in respect of it, and may only seek to realise it with the permission of the court.

2.39 With certain exceptions, if the debtor complies with the terms of the DRO and any associated order, the specified debts will be discharged at the end of the moratorium period.<sup>37</sup>

2.40 As with IVAs and bankruptcy, there is no significant disadvantage to chargees as opposed to mortgagees, where a DRO is made in relation to the debtor. Section 251A(3) of the IA 1986 states that all secured debts are excluded from the definition of "qualifying debts" for the purposes of a DRO: and in turn, "secured debts" include both mortgages and charges.<sup>38</sup>

### Effect on the rights of subsequent mortgagees

#### The equity of redemption

2.41 The equity of redemption is an equitable interest in the mortgaged goods. Its economic value is the value of the mortgaged good less the amount required to

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<sup>32</sup> See Halsbury's Laws of England, *Mortgage* vol 77 (2016), para 317.

<sup>33</sup> Insolvency Act 1986, s 251A.

<sup>34</sup> Insolvency Act 1986, s 251A.

<sup>35</sup> Insolvency (England and Wales) Rules SI 2016 No 1024, Pt 9.

<sup>36</sup> Insolvency Act 1986, s 251G.

<sup>37</sup> Insolvency Act 1986, s 251I.

<sup>38</sup> Insolvency Act 1986 s 383.

discharge the underlying debt or obligation.<sup>39</sup> This value fluctuates according to how much of the underlying debt or obligation remains unsatisfied and also according to the market value of the good at any one time.<sup>40</sup> The equity of redemption is always present: even if at any particular moment it may be lacking in value, it can always revive.<sup>41</sup>

### Current position for subsequent mortgagees

- 2.42 The bills of sale mortgagor and those who claim under the mortgagor (such as subsequent mortgagees with rights over the equity of redemption) have the right to redeem the mortgage (ie pay off the first mortgagee). The right to redeem survives seizure by the first mortgagee and subsists for as long as the first mortgagee is in possession.<sup>42</sup> It is extinguished on the sale of the asset by the first mortgagee under their power of sale.
- 2.43 Once the mortgaged asset is sold under the power of sale, the rights of mortgagor and subsequent mortgagees are against the proceeds of sale.<sup>43</sup> If there is any surplus, it is held on trust by the first mortgagee,<sup>44</sup> who has to account for it to the mortgagor and subsequent mortgagees.
- 2.44 A subsequent mortgagee can only sell subject to the first mortgage, unless it agrees with the first mortgagee for the indebtedness due to it to be discharged out of the proceeds of sale, in which case the subsequent mortgagee can sell free of the prior mortgage.<sup>45</sup>

### Rights of subsequent mortgagees under the draft Goods Mortgages Bill

- 2.45 Our view is that the status quo would not change much for subsequent mortgagees if we make the security a charge rather than an equitable interest.
- 2.46 We are envisaging a “first in time” priority rule between mortgagees, so the subsequent mortgagees’ right to recover will still be subject to satisfying the prior mortgagee’s claim.

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<sup>39</sup> *Cukurova Finance International Limited v Alfa Telecom Turkey Ltd* [2013] UKPC 2, [2015] 2 WLR 875 at [94]. In the subsequent decision in the same case, *Cukurova Finance International Limited v Alfa Telecom Turkey Ltd* [2013] UKPC 20, [2015] 2 WLR 875 Lord Neuberger stated at para [81]: “... the right to redeem, like the rest of the law relating to mortgages, was developed by the Chancery Courts in relation to mortgages of land. However, as explained in the Board’s judgment in [2013] UKPC 2, there is no reason why the same principles should not apply to mortgages of chattels or of choses in action.”

<sup>40</sup> Although most goods depreciate in time, the contrary is true of antiques, fine wines, art etc.

<sup>41</sup> See Beale, Bridge, Gullifer, Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 6.02.

<sup>42</sup> *Johnson v Diprose* [1893] 1 QB 512.

<sup>43</sup> See Beale, Bridge, Gullifer, Lomnicka, *The law of security and title-based finance* (2nd ed 2012) 18.53 to 18.54.

<sup>44</sup> *Banner v Bridge* (1880) LR 18 Ch D 254 (constructive trust imposed by law if no express trust in the contract).

<sup>45</sup> Falcon Chambers and P Morgan (eds), *Fisher and Lightwood’s Law of Mortgage* (14th ed 2014) 30.10.

2.47 There will be no right to redeem as such, but if a subsequent mortgagee wishes to become the first mortgagee (in order to sell the asset themselves), they can pay off the prior mortgagees and be subrogated to their rights against the asset.

### **Effect on the mortgagor**

2.48 Conceptualising goods mortgages as charges will correspond better with the understanding that consumers have of “mortgages”. Consumers are likely to be familiar with land mortgages, where ownership is not transferred to the bank pending repayment of the loan.

2.49 Money Advice Trust told us that the term “goods mortgage” is, in any event, likely to make a borrower think that “they still own their car but that the lender has a charge or security in relation to it”.

### **Effect on third party purchasers**

2.50 We recommended in our 2016 report that innocent private purchasers take free of the goods mortgage, while private purchasers with actual knowledge of the goods mortgage and trade purchasers (regardless of their knowledge) take subject to the goods mortgage.<sup>46</sup>

2.51 These recommendations do not square with the nature of “true” mortgages. No purchaser, trade or private, innocent or otherwise, can take title from the mortgagor where the mortgagor has already transferred the title to the mortgagee as security. If title were to transfer, we would need to provide express exceptions to the “nemo dat” (“you cannot give what you do not have”) principle in the draft Bill in order to achieve our recommendations.

2.52 In contrast, the framework we recommended for third party purchasers accords well with goods mortgages, which are charges. The mortgagor retains the title to the goods, which they can transfer validly. Trade purchasers and private purchasers with actual knowledge take title burdened by charges, which they can redeem in order to have unencumbered title.

## **CONCLUSION**

2.53 As a result of the above, our view is that, if goods mortgages were to operate as transfers of title, it would give rise to a number of conceptual and practical difficulties. It is likely to confuse consumers, and does not give mortgagees better protection.

2.54 Although this would be a move away from our recommendations as stated in the report, we consider that providing for goods mortgages to take effect as charges will better achieve our overall aim of modernising the law, and making it simpler and fairer – particularly for consumers taking logbook loans.

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<sup>46</sup> Bills of Sale (2016) Law Com No 369, para 8.33.

## Appendix 3: Goods mortgages on fixtures

3.1 Goods that can become fixtures pose particular difficulty for the draft Bill, as they can exist both attached and separate from land. When separate from land, they are goods. When they are attached to land in such a way as to become “fixtures”, they form part of the land (and cease to be goods).

### **The distinction between “fixtures” and “goods”**

3.2 A physical object will usually be either land or a good, but its nature may change according to the use made of it. Whether a particular item is a “fixture” or just a good present on the land is an issue of law – it is not affected by the subjective intention of any interested party at any point in time. The classic test has two limbs:

- (1) the degree of annexation test (the degree test); and
- (2) the purpose of annexation test (the purpose test).

3.3 The degree test determines whether an item is a fixture by looking at whether the item has some substantial connection with the land or a building on it. There is a rebuttable presumption that:

- (1) an item which merely rests on the ground by its own weight (such as a cistern<sup>1</sup> or a freestanding greenhouse<sup>2</sup>) is not a fixture; and
- (2) an item which is attached to the land or a building in some substantial manner, such as by nails or screws, is a fixture.

3.4 The purpose test relies on determining the objective purpose for which the item was annexed. Broadly speaking, there are two situations here:

- (1) some goods remain goods even after annexation if the purpose of the annexation was for the better enjoyment of the object as a good rather than to improve the land permanently; and
- (2) goods which are fixtures through annexation can be severed from the land if they are “tenant’s fixtures”.

3.5 The line between the two cases above is often blurred. For example, in a case concerning tapestries which had been fixed on the wall by a tenant, the Court of Appeal held that the tapestries were a tenant’s fixtures and could be removed.<sup>3</sup>

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<sup>1</sup> *Mather v Fraser* (1856) 2 K & J 536.

<sup>2</sup> *Deen v Andrews* (1985) 52 P & CR 17.

<sup>3</sup> *Re De Falbe* [1901] 1 Ch 523.

Whereas the House of Lords held that the tapestries had never become fixtures and therefore could be removed.<sup>4</sup>

3.6 The authoritative formulation of the distinction between goods and fixtures has been stated as follows:

Perhaps the true rule is, that articles not otherwise attached to the land than by their own weight are not to be considered as part of the land, unless the circumstances are such as to show that they were intended to be part of the land, the onus of showing that they were so intended lying on those who assert that they have ceased to be chattels, and that, on the contrary, an article which is affixed to the land even slightly is to be considered as part of the land, unless the circumstances are such as to show that it was intended all along to continue a chattel, the onus lying on those who contend that it is a chattel.<sup>5</sup>

### Examples of fixtures and goods

3.7 In practice, the distinction between goods and fixtures is not clearly identifiable in advance, and courts have reached inconsistent conclusions on broadly similar factual scenarios.

3.8 The following are examples of items that have been held to be fixtures:

- (1) looms in a worsted mill, fixed by nails to wooden beams and plugs in the floor (*Holland v Hodgson* (1872) LR 7 CP 328);
- (2) machines fixed to a factory's floor by bolts and nuts (*Reynolds v Ashby & Son* [1904] AC 466);
- (3) engine fixed by bolts, but not its batteries which were connected by wires (*Jordan v May* [1947] KB 427);
- (4) tapestries, panelled pictures, statues, figures, vases and stone garden-seats (*D'Eyncourt v Gregory* (1866) LR 3 Eq 382);
- (5) carillon clock which rested on its own weight, with the reasoning that it was part of the design of a historic house (*Kennedy v Secretary of State for Wales* [1996] EGCS 17);
- (6) bathroom fittings (including mirror, towel rails, soap dishes, toilet roll holders) and kitchen units (*TSB Bank Plc v Botham* (1996) 73 P & CR D1);
- (7) moveable dog grates (*Monti v Barnes* [1901] 1 QB 205).

3.9 The following are examples of items that have been held to be goods:

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<sup>4</sup> *Leigh v Taylor* [1902] AC 157.

<sup>5</sup> *Holland v Hodgson* (1872) LR 7 CP 328 at 335 per Blackburn J, cited with approval in *Elitestone Ltd v Morris* [1997] 1 WLR 687 at 692, [1997] 2 All ER 513 at 524. *Bradshaw v Davey* [1952] 1 All ER 350, [1952] 1 Lloyd's Rep 65 also applied this dictum.

- (1) printing machines standing by their own weight (*Hulme v Brigham* [1943] KB 152);
- (2) “white goods” – oven, refrigerator, dishwasher etc (*TSB Bank Plc v Botham* (1996) 73 P & CR D1);
- (3) fitted carpets and curtains (*TSB Bank Plc v Botham* (1996) 73 P & CR D1);
- (4) mock coal gas fires (*TSB Bank Plc v Botham* (1996) 73 P & CR D1);
- (5) pictures in the recess of the panelling, statues and sun dials (*Berkley v Poulett* [1977] 1 EGLR 86); and
- (6) house boats, even when attached by wooden platforms (*Mew v Tristmire Ltd* [2011] EWCA Civ 912).

### Right to remove fixtures

- 3.10 If the item is a fixture, the general rule is that it cannot be lawfully removed and it must be left to the “fee simple” owner of the land. There is a notable exception for tenant’s fixtures (such as trade fixtures, ornamental and domestic fixtures), which can be removed during the term of the tenancy. However, even with tenant’s fixtures, the fixtures belong to the landlord up to the point when they are severed and removed.<sup>6</sup>
- 3.11 The “tenant’s fixtures” exception does not apply if the land is mortgaged.<sup>7</sup> A mortgage of land comprises, without the need for specific mention, all fixtures which are annexed to the land at the time of the mortgage or which become annexed any time afterwards during the continuance of the land mortgage.<sup>8</sup> The mortgagor is not even entitled to remove fixtures which he has attached after the date of the land mortgage.<sup>9</sup>
- 3.12 Lenders in hire-purchase agreements may be able to protect their interests to some extent from the consequences of the law of fixtures. *Megarry and Wade* explain it as follows:

If A hires machinery from B and fixes it to the floor of A’s factory, and the factory is mortgaged (whether before or after the machinery is fixed), the machinery will become subject to the mortgage as against B. But if the agreement between A and B entitles B to enter and retake the machinery if A fails to pay the hire instalments, this creates an equitable interest in A’s land (apparently a right of entry). Where title to A’s land is registered, this equitable right of entry can be protected by B’s registration of a notice. Where title to A’s land is not registered, the equitable right of

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<sup>6</sup> *Megarry & Wade: The Law of Real Property* (8th ed 2012) ch 23.

<sup>7</sup> *Monti v Barnes* [1901] 1 QB 205, *Climie v Wood* (1869) LR 4 Ex 328 at 330; cf *Lyon & Co v London City & Midland Bank* [1903] 2 KB 135.

<sup>8</sup> See Halsbury’s Laws of England, *Mortgage* vol 77 (2016), para 169; see also the Law of Property Act 1925 (“LPA”), s 62(1) – however, s 205(1)(ix) LPA does not include “fixtures” in the definition of “land”.

<sup>9</sup> *Reynolds v Ashby & Son* [1904] AC 466.

entry, which does not appear to be registrable as a land charge, will bind all later takers except a bona fide purchaser of a legal estate for value without notice.<sup>10</sup>

3.13 B's equitable interest will prevail over a subsequent equitable mortgage even if the mortgagee has no notice of B's interest. It will not prevail against a subsequent legal mortgagee without notice. If the land mortgage pre-dates the time the hire purchase item becomes a fixture, the item will pass to the land mortgagee at that time.<sup>11</sup>

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<sup>10</sup> *Megarry & Wade: The Law of Real Property* (8th ed 2012) 23-024.

<sup>11</sup> *Palmer's Company Law* (April 2017) 13.199.86.

## Appendix 4: Extra time afforded to the borrower to prevent repossession and sale of the goods

	Possession notice required under the draft Bill	Possession notice not required under the draft Bill	Delays after default but before taking possession
<b>Underlying agreement is a regulated agreement (under the CCA)</b>	<p>14 days from the time the default notice (under s 87 CCA) is served</p> <p>+ 14 days from the time the possession notice is served</p> <p>+ (if borrower asks for time) 28 days to seek debt advice</p> <p>+ (if borrower opts in) the time to list the case</p> <p><i>also includes (unless the mortgagee takes possession under a court order):</i></p> <p>5 working days after mortgagee enters into possession (in order to prevent sale)</p>	<p>14 days from the time the default notice (under s 87 CCA) is served</p>	Delay after possession but before taking possession
<b>Underlying agreement is a non-regulated agreement (under the CCA)</b>	<p>14 days from the time the possession notice is served</p> <p>+ (if borrower asks for time) 28 days to seek debt advice</p> <p>+ (if borrower opts in) the time to list the case</p> <p><i>also includes (unless the mortgagee takes possession under a court order):</i></p> <p>5 working days after mortgagee enters into possession (in order to prevent sale)</p>		<p>Delays after default but before taking possession</p> <p>Delay after possession but before sale</p>

4.1 A possession notice is required under the draft Bill where:

- (1) the goods mortgage is non-exempt; and
- (2) either:
  - (a) the borrower has paid back at least a third of the loan; or
  - (b) the obligation cannot be quantified in monetary terms.

4.2 A possession notice is not required under the draft Bill where:

- (1) the goods mortgage is exempt; or
- (2) the goods mortgage is non-exempt, the obligation can be quantified in monetary terms and the borrower has paid back less than a third.