# SECURED TRANSACTIONS CODE

# AND

# COMMENTARY

**Discussion Draft**

**March 2020**

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## DEFINITIONS
## of terms used in the Code

| term | defined in section |
|---|---|
| asset | 2.4 |
| asset registry | 38.5 |
| charge | 1.1 |
| chargee | 1.1 |
| charged asset | 2.4 |
| charged interest | 2.5 |
| chargor | 1.1 |
| current asset | 41.3 |
| exempt charge | 27.2 |
| financial collateral charge | 29.1 |
| fixed asset | 41.2 |
| future asset | 14.1 |
| goods | 13.1(b) |
| insolvency claw-back proceedings | 52.3(d) |
| insolvency legislation | 52.3(a) |
| insolvency officer | 52.3(c) |
| insolvency proceedings | 52.3(b) |
| intangibles | 13.1(c) |
| interest (in an asset) | 2.5 |
| land | 13.1(a) |
| obligation | 2.6 |
| outright proprietary interest | 41.4 |
| payee (of a receivable) | 17.1 |
| payer (of a receivable) | 17.1 |
| possessory charge | 28 |
| priority notice | 33.1 |
| receivable | 17.1 |
| registrable charge | 27.1 |
| registrar | 25.1 |
| secured obligation | 2.6 |
| UK business | 26.1 |

## INTRODUCTION

1 The purpose of the Code is to create a new law of secured transactions, based on the existing law but simplifying and modernising it.

2 The purpose of this Commentary is to give some context to the Code.

3 The reason we start with the existing law is that, as a general rule, it works well in practice. In particular, the principles upon which the current law is based are well suited to commercial practice, and what we have attempted to do in the Code is to state them as clearly and simply as we can.

4 But, because the law has developed over 400 years, the underlying principles have become encrusted with detailed rules which are much more complicated than they need to be and which often do not reflect current practices. What we have attempted to do here is to remove the barnacles and to create a system which is simpler and clearer than the current law and which reflects more closely what parties actually need in practice.

5 A word about the drafting. Our intention, when drafting the Code, was to make it as understandable as possible to anyone who wants to know how secured transactions work. We have therefore quite deliberately not drafted it in the form of a normal statute. The Code is not doing what most statutes do. Most statutes change the law, and their purpose is therefore to state what those changes are. The Code has a different purpose. It is intended to codify the law, as well as to change it, and we have looked as guides to the great nineteenth century codifications as examples of attempts to systematise the law in as clear and straightforward a way as possible. The intention is to make it as readable as possible not just to lawyers but also to others who want to understand how the law of secured transactions works.

6 One of the most important aspects of the current law is its flexibility. It enables the law to adapt to changing commercial practices. The intention behind the way the Code is drafted is to preserve that flexibility. As far as possible, the Code is drafted at a level of principle which should enable it to give effect to changing ways of doing business.

7 The purpose of this Commentary is to put the Code in context. By doing this, we hope to make it more readily understandable to those who read it. The Commentary puts the new law in the context of the existing law, explains why the Code says what it does and gives examples of how the law should be applied in practice.

8 Our intention is that the Code is brought into law by enabling legislation. The legislation could give the Commentary official standing as a guide to interpretation of the Code. The implementing legislation would also deal with important issues such as transitional rules, which are not dealt with in the Code itself; and it could contain a power to amend the Code by secondary legislation.

# PART 1: CHARGES

## 1 The nature of a charge

**1.1 A charge is a proprietary interest in an asset which secures the performance of an obligation and which is granted by a person (known as the chargor) over its interest in that asset in favour of another person (known as the chargee).**

**Commentary**

1 Section 1.1 describes what a charge is. There are three key aspects of a charge:

(a) it is a proprietary interest in an asset;

(b) that proprietary interest secures the performance of an obligation; and

(c) the proprietary interest is granted by the chargor to the chargee.

2 The first aspect of a charge is that it is a proprietary interest. That means that it is effective not just against the person who created the charge, but also against third parties unless they can take free of the charge under the priority rules. Crucially, it also means that a charge is effective even if the chargor goes into insolvency proceedings, subject to the terms of the insolvency legislation. This aspect of a charge is considered in more detail in s**ection 3**.

3 The second aspect of a charge is that it is security interest. It secures the performance of an obligation. The chargee does not have an outright interest in the asset. Its interest is there to secure the performance of an obligation. Once the secured obligation has been performed, the charge falls away. What distinguishes a charge from an outright proprietary interest is considered in more detail in **section 6**.

4 The third aspect of a charge is that it is granted by a person over its own interest in the asset concerned. A charge is not created if a person simply retains an interest in an asset.

## 2 The power to create a charge

**2.1 A chargor can create a charge over its interest in an asset in favour of a chargee to secure the performance of an obligation.**

**2.2 The chargor can be any person, subject to the limitations described in part 5.**

**2.3 The chargee can be the creditor or creditors to whom the obligation secured by the charge is owed or it may be another person (such as a trustee) for the benefit of those creditors (see part 5).**

**2.4 The asset can be existing or future property of any kind (see part 3). When the charge is created, the asset is referred to as a charged asset.**

**2.5 The chargor's interest in the asset can be any existing or future proprietary interest of any kind (see part 3). When the charge is created, the interest is referred to as a charged interest.**

**2.6 The obligation can be any existing or future obligation or liability of any kind (see part 4). When the charge is created, the obligation is referred to as a secured obligation.**

**Commentary**

1 **Section 2.1** contains the power to create a charge. A chargor can create a charge over its interest in an asset in favour of a chargee to secure the performance of an obligation.

2 **Sections 2.2 to 2.6** elaborate on this provision. They briefly describe what is meant by "chargor", "chargee", "charged asset", "charged interest" and "secured obligation". Each of these concepts is discussed in more detail in later parts of the Code:

(a) charged assets and charged interests in **part 3**;

(b) secured obligations in **part 4**; and

(c) chargors and chargees in **part 5**.

## 3 The effect of a charge

**3.1 Once it has been created (see part 2), a charge is effective between the chargor and the chargee.**

**3.2 Once it has been created, a charge other than a registrable charge (see part 7) is effective against:**

**(a) an insolvency officer of the chargor, subject to the insolvency legislation (see part 10); and**

**(b) any other person who obtains an interest in the charged asset unless that person takes free of the charge under the priority rules (see part 8).**

**3.3 Once it has been created and registered under part 7, a registrable charge is effective against:**

**(a) an insolvency officer of the chargor, subject to the insolvency legislation; and**

**(b) any other person who obtains an interest of any kind in the charged asset unless that person takes free of the charge under the priority rules.**

**Commentary**

1 **Section 3** describes the effect of a charge. It has been seen from **section 1** that a charge creates a proprietary interest in an asset. **Section 3** explains what this means in practice. As a proprietary interest, a charge is effective not just against the chargor, but also against an insolvency officer of the chargor (subject to the insolvency legislation) and against any other person who obtains an interest in the charged asset unless that person takes free of the charge under the priority rules which are described in **part 8**.

2 But this is subject to one important limitation. Most charges created by UK businesses require to be registered under **part 7**. If a charge is required to be registered under **part 7**, it is not effective in an insolvency of the chargor, nor is it effective against third parties, until it has been registered. It is effective between the parties once it has been created, but it is not effective in an insolvency or against third parties until it has been registered.

3 The Code therefore draws an important distinction between two types of charge – those which require registration, and those which do not:

(a) If the charge is a registrable charge, it is effective between the chargor and the chargee once it has been created, but it is only effective in an insolvency and against third parties once it has been registered.

(b) If the charge is not a registrable charge, it is fully effective as soon as it has been created.

4 The reasons for this distinction are discussed in the Commentary to **part 7**. **Part 7** also explains which types of charge are registrable charges. In essence:

(a) a charge created by a UK business is a registrable charge unless it is excluded from the requirement to register under **part 7**; and

(b) a charge created by anyone else (for instance an individual or a foreign corporation) is not registrable under part 7, and is therefore effective as soon as it has been created.

5 This is the rule of English substantive law. The law which governs a foreign person may require registration under that other law.

## 4 The attributes of a charge

**4.1 An asset may be subject to more than one charge.**

**4.2 It is not necessary for the chargee to obtain possession of the charged asset.**

**4.3 A charge can be created over an asset even if the chargor has the authority to dispose of the asset concerned free from the charge or to deal with it in any other way.**

**Commentary**

1 As under the current law, there is no limit to the number of charges which can exist concurrently over the same charged asset (**section 4.1**). It might have been thought that, once a chargor has charged an asset in favour of A, all that it can charge in favour of B is its remaining interest in the asset, and therefore that B necessarily ranks behind A. But that is not always true under the current law. Nor is it true under Code. The question is one of priorities, which is dealt with in part 8 of the Code.

2 Under the existing law, most types of security can be created without the secured creditor taking possession of the assets concerned. This is also the case under the Code (**section 4.2**). The exception to this under the existing law is the pledge, which is only effective whilst the creditor has possession of the pledged goods. Under the Code, the equivalent of a pledge is a possessory charge. The main practical distinction between pledges and other types of security is that pledges do not require to be registered at Companies House. This distinction is recognised in the registration provisions of the Code (see **part 7**). If the chargee has possession of the charged asset, there is no necessity to register the charge under **part 7**.

3 **Section 4.3** reflects one of the most important principles of English security law – that it is possible to create security over an asset even if the chargor is given the authority to deal with it free from the charge. This principle was established in the 1860s in England[1] although it took much longer in the United States[2].

4 Charges of this kind soon became known as floating charges[3]. The Code recognises the ability to create a charge of this kind. It would be described as a floating charge under the existing law, but the Code does not distinguish between fixed and floating charges.

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[1] *Re Marine Mansions Company* (1867) LR 4 Eq 601*; Re Panama, New Zealand and Australian Royal Mail Company* (1869-70) LR5 Ch App 318.
[2] As a result of *Benedict v Ratner* 268 US 353.
[3] *Re Colonial Trusts Corporation, ex parte Bradshaw* (1879) LR 15 ChD 465 at 472.

5 The distinction is important under the current law for two main reasons. In the first place, the priority rules are different depending on whether the charge is fixed or floating. And, secondly, recoveries under a floating charge are subject to certain imposts in an insolvency to which fixed charges are not subject.

6 The Code deals with priorities in a different way. Rather than distinguishing between the nature of the charge, the Code looks to the nature of the asset concerned (see **part 8**). The position on insolvency is discussed in the Commentary to **part 10**.

## 5 The duration of a charge

**5.1 Once the secured obligation has been paid or satisfied in full, the charge is automatically extinguished.**

**5.2 The secured obligation may consist of liabilities which are not yet in existence (see part 4). Accordingly, in the case of a running account, the charge is not extinguished just because the balance on the account is zero or the account enters into credit.**

**5.3 If requested to do so by the chargor after the charge has been extinguished, the chargee must execute a deed of release of the charge and assist with anything which is necessary to release the charged asset from the charge. The chargee must do these things as soon as reasonably practicable. The chargor must pay the reasonable costs of doing them unless the parties agree otherwise.**

**Commentary**

1 A charge secures the performance of an obligation (**section 1.1**). The chargor retains its proprietary interest in the charged asset, but it is now subject to the charge. It follows that once the secured obligation has been discharged, the charge is extinguished. **Section 5** explains how this works in practice.

2 **Section 21** provides that the secured obligation can be either an existing liability or a liability which is not yet in existence.

3 A charge can secure, for instance, all amounts which may from time to time be owing under a particular facility agreement. Here, the charge is securing an existing liability – the liability from time to time under the agreement. That existing liability may be present, future or contingent. It is present to the extent that it secures an amount which is now payable under the existing agreement. It is future to the extent that it secures a drawing which has been made but which is not yet repayable. And it will be contingent to the extent that it secures an amount which can be, but has not yet been, drawn down under the agreement.

4 But **section 21** goes further than this. It also enables the secured obligation to be a liability which is not yet in existence. For instance, a charge can secure all monies from time to time owing to a particular person. In this way, the charge will secure not only existing arrangements, but also new arrangements which are entered into in the future. They may never be entered into, but if they are, they will be secured. This is

elaborated on in **section 5.2**. If, for instance, the charge secures an overdraft, it is not discharged merely because the account goes into credit.

5 Although a charge is automatically extinguished once the secured obligation has been paid or satisfied in full, in practice it is often useful for a deed of release to be executed in order to make the position clear. **Section 5.3** provides for this.

## 6 Distinguishing a charge from an outright interest

**6.1 What distinguishes a charge from an outright proprietary interest is that the chargee's proprietary interest in the asset concerned secures the performance of an obligation.**

**6.2 Whether or not a proprietary interest in an asset does secure the performance of an obligation depends on the legal rights, liberties, powers and immunities of the parties to the transaction, not on the economic or functional effect of the transaction.**

**6.3 The determination of those legal rights, liberties, powers and immunities depends on the terms of the transaction concerned.**

**6.4 A proprietary interest in an asset secures the performance of an obligation if the proprietary interest is granted by a person over its interest in that asset in favour of another person (the beneficiary) and, under the terms of the transaction concerned:**

**(a) a person is owed an obligation;**

**(b) the proprietary interest is an independent interest, separate from the obligation;**

**(c) the beneficiary is entitled to obtain payment of the obligation from the proprietary interest; and**

**(d) the beneficiary cannot recover more from the proprietary interest than the amount of the obligation.**

**Commentary**

1 It has been seen from **section 1.1** that a charge is a proprietary interest in a charged asset which secures the performance of a secured obligation. The purpose of **section 6** is to explain how to distinguish a proprietary interest which secures the performance of a secured obligation from an outright proprietary interest.

2 **Section 6.1** states the principle. It derives from **section 1.1**.

3 **Section 6.2** establishes that the test of whether a proprietary interest is outright or by way of security is a legal test, not an economic one. This might be thought to be self-

evident, but for the fact that, under the influence of jurisprudence from the United States, a number of (mainly common law) jurisdictions have adopted a functional economic test of whether a proprietary interest is outright or by way of security.[4]

4 The pros and cons of that approach are discussed elsewhere. The Code does not go down this functional route. It continues the approach of the existing law, which is that whether or not a proprietary interest is an outright interest or a charge depends on the legal rights and powers of the parties to the transaction[5].

5 **Section 6.3** establishes the principle that the determination of the parties' legal rights depends on the terms of the transaction concerned. This is consistent with the basic approach of English law.

6 **Section 6.4** explains when a proprietary interest does secure the performance of an obligation. There must be two interests – a proprietary interest in an asset and an obligation. They must be separate interests, but the owner of the beneficial interest must be entitled to payment of the obligation from that interest, and it can only recover from the interest an amount equal to the obligation.

7 Security is a means, not an end. It is a means of ensuring payment of as an obligation. In order to be effective, a charge needs to be enforced, and thereby turned into money. This will normally be by sale of the charged asset, although it can be by set-off or by payment in appropriate cases. The key point is that the proprietary interest in the asset is separate from the obligation, but the payment under one will reduce the other. If the charged asset is sold and the proceeds are used to defray the obligation, that will reduce the amount of the obligation. Equally, payment in full of the secured obligation will release the charge over the asset.

8 This can be clarified by a simple example. A owes a debt to B. A transfers an asset to B. It is the terms of the transaction - which will determine whether the interest which has been created in favour of B is an outright interest or a security interest. If the objective common intention is that the asset is to secure the payment of the debt, then it will be a charge, however it is described. But, if it is an entirely separate transaction, which is not intended to secure the debt, then it will be an outright transfer.

9 The most important criterion in practice is the nature of the consideration for the transfer. If B pays for the asset, then it is likely to be an outright sale, unconnected with

[4] This is the effect of Personal Property Security Acts in jurisdictions such as Canada, New Zealand and Australia.
[5] *Lloyds and Scottish Finance v Cyril Lord Carpets Sales* [1992] BCLC 609*; Welsh Development Agency v Export Finance Company* [1992] BCLC 148*.*

the underlying debt. If B does not pay any consideration, then it is much more likely to be a charge. In a commercial setting, it is unlikely to be a gift.

10 There is another possibility, which is that the consideration for the transfer is the discharge of the debt owed to B. If that is the case, the transaction is outright, not by way of security. It is of the essence of a secured transaction that B has two rights – first, a right to payment or performance and, secondly, a proprietary interest in an asset which secures that payment or performance. If the consideration for the transfer is the discharge of the debt, then there can be no secured liability, B has only one right, and the transaction must be outright.

11 It is also important to distinguish between the creation and the retention of an interest. If A creates an interest over an asset in favour of B to secure an obligation, then a charge has been created. But if B owns an asset and creates a limited interest in favour of A (such as a leasehold interest) or if B sells an asset to A on reservation of title terms, A never obtains anything other than a limited interest in the asset and therefore cannot create a charge over it. B's rights in the asset are retained by it, not created by A. So there is no question of a charge being created by A even if, in the case of a reservation of title clause, the purpose of B retaining title is to secure the payment of the purchase price. A has not created an interest in an asset in favour of B, and so no charge has been created. This is the case under the existing law[6], and it is also true under the Code.

12 The following examples illustrate the application of **section 6**.

13 Example 1:

B leases an asset to A for the period of its useful life in consideration for the payment of rent, the amount of which approximates to the price of the asset and the cost of financing it over the period of the lease. If the terms of the transaction create a lease, then the transaction is not a charge, even if it has a similar economic effect. B has created an outright limited proprietary interest in favour of A. B has retained a residual proprietary interest. A has not created any interest.

14 Example 2:

B sells goods to A on the basis that B reserves title to the goods until their price has been paid. If the terms of the transaction are that the goods are sold on reservation of

[6] *Clough Mill v Martin* [1985] 1 WLR 111; *Armour v Thyssen Edelstahlwerke* [1991] 2 AC 339

title, the transaction is not a charge even if it has a similar economic effect. This is also the case if B transfers legal title to A, but retains beneficial title (and, to the extent that there is any existing rule to the contrary[7], it is abolished). B has created an outright limited proprietary interest in favour of A. B has retained a residual proprietary interest. A has not created any interest.

15 Example 3:

B sells its receivables to A on the basis that A has recourse to B for bad debts. If the terms of the transaction are that B has sold the receivables to A, the transaction is not a charge even if it has a similar economic effect. B has transferred a proprietary interest in the receivables to A, but the interest which it has transferred is outright, not by way of security.

16 Example 4:

A sells goods to B on the basis that B will lease them back to A. If the terms of the transaction are that B will acquire the goods and then lease them to A, the transaction is not a charge even if A remains in possession of the goods and the transaction has a similar economic effect to a charge. The transactions are outright, not by way of security.

17 Example 5:

B sells goods to A on the basis that the payment of the price is deferred, that B reserves title to the goods until they are sold and that, on sale, A holds the proceeds of sale on trust for B. The proceeds of sale belong to A, and accordingly the proprietary interest which B obtains in them is created by A; it is not retained by B. The trust over the proceeds of sale is a charge if the terms of the arrangement are that the trust secures the payment of the price.

18 *Other examples can be added to clarify the application of this section in practice, including title transfer of financial collateral, such as repos.*

[7] See *Re Bond Worth* [1980] Ch 228.

## 7 Treating other forms of security as charges

**7.1 If:**

**(a) a person transfers a proprietary interest in an asset to another person or creates a proprietary interest over an asset in favour of that other person; and**

**(b) that proprietary interest secures the performance of an obligation,**

**then it is a charge, regardless of its characterisation by the parties.**

**7.2 Accordingly mortgages, security assignments, pledges and contractual liens will be treated as charges.**

**Commentary**

1 The purpose of the Code is to simplify the law. One of the problems with the current law is that there are three main types of security interest available – mortgages, charges and pledges; and mortgages can be either equitable or legal. There is therefore a multiplicity of types of security.

2 This can be seen as an advantage – a multiplicity of types of security enables parties to exercise choice. But, in practical reality, there is little difference between the various types of security interest except in one respect – which is whether they are legal or equitable. And that is more relevant to priority issues than to anything else.

3 So the reality of the current law is that there are a variety of different ways of doing the same thing. That seems unnecessarily complicated.

4 The intention behind the Code is to take the best parts of the current law and turn them into a single form of security interest – the charge.

5 There would be no point in creating a new form of charge and then allowing the existing forms of security to continue. That would create complication, not resolve it. The intention of the Code is therefore that the charge will replace the existing forms of security.

6 As a result, if a person purports to create any other form of security interest, it will be treated as a charge, and be subject to the provisions of the Code. This is the effect of **section 7**.

7 The following examples illustrate the application of this principle.

8 Example 1:

If A purports to pledge goods to B (or to create a contractual lien over them in favour of B), B's interest will be a charge, and not a pledge (or lien).

9 Example 2:

If A purports to mortgage an asset to B, B's interest in the asset will be a charge, not a mortgage.

10 Example 3:

If A purports to assign an intangible to B in order to secure the payment of a secured obligation, B's interest in the intangible will be a charge, not an assignment.

## 8 Extent of the Code

**8.1 Part 7 of this this Code applies throughout the United Kingdom. The rest of the Code applies in England and Wales.**

**8.2 This Code does not apply to:**

**(a) international interests under the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (SI 2015/912); or**

**(b) security which arises by operation of law; or**

**(c) security created before the Code came into force.**

**Commentary**

1 The rules for the registration of charges apply throughout the United Kingdom, and it is envisaged that part 7 of the Code will do likewise – replacing the relevant provisions of the Companies Act 2006. The rest of the Code is restricted to England and Wales, though it could easily be adopted in Northern Ireland if that was thought appropriate.

2 The Code does not attempt to alter the Cape Town Convention.

3 The Code is concerned with consensual security interests, not with security which arises by operation of law. The old law will continue to govern the law concerning security which is created by operation of law (**section 8.1(a)**). The new law in the Code does, however, apply to a contractual lien.

4 It is envisaged that the Code will be brought into law by a statute which contains transitional provisions. The existing law will continue to apply to security created before the Code comes into force. **Section 8.1(b)** establishes that the Code only applies to security created after the Code has come into force.

## PART 2: CREATION

### 9 Creating a charge

**9.1 A charge is created if a chargor intends to create a charge over its interests in an asset in favour of a chargee to secure the performance of an obligation.**

**9.2 A charge is created when the chargor intends it to be created.**

**9.3 The intention of the chargor is established objectively, based on the terms of the transaction concerned.**

**Commentary**

1 **Section 9** establishes that a charge is created if and when a chargor intends to create a charge over its interest in an asset in favour of a chargee to secure the performance of an obligation. The intention of a chargor is established objectively, based on the terms of the transaction concerned.

2 Under the existing law, there are three main types of security – mortgage, pledge and charge. Mortgages can be either legal or equitable, and the choice in practice is therefore between a legal interest (under a legal mortgage or a pledge) or an equitable interest (under an equitable mortgage or a charge)

3 The advantage of an equitable interest over a legal interest is that it is easier to create, in the sense that there are fewer formalities. This is particularly true of a charge. The essence of a charge is the intention of the chargor to create the charge. That is a matter of substance, not of form. Mortgages and pledges require other formalities. A mortgage requires a transfer of legal or equitable title in the mortgaged asset. A pledge requires delivery of possession of the pledged asset.

4 The approach taken in the Code is to replace the existing forms of security interest with a new one which is based on the existing jurisprudence concerning charges and which is therefore described as a charge.

5 There are two main reasons why the charge was chosen, rather than the mortgage or the pledge. The first is that a charge can be taken over almost every type of asset of any description, including future assets[8]. That is also true of an equitable mortgage, but a pledge can only be taken over existing tangible movable assets[9] and a legal mortgage can only be taken over existing assets over which legal title can be

[8] *Holroyd v Marshall* (1861-62) 10 HLC 191.
[9] *Coggs v Bernard* (1703) 2 Ld Raym 909.

transferred[10]. The charge is therefore more all-embracing than a legal mortgage or a pledge.

6 The second reason for preferring the charge is that the key requirement for the creation of a charge is that the chargor intends to do so, and therefore that there are few formalities required.[11] (Even an equitable mortgage requires the transfer of beneficial title to the asset.) The reason why formalities are eschewed as far as possible in the Code is discussed in the Commentary to **section 11**.

7 The ease of creation of a charge does mean that it can be created without third parties necessarily being aware that it has been created. It is for this reason that most types of charge created in a corporate context require registration against the chargor under the current law.[12] The Code adopts a similar approach. The registration requirements of the Code are contained in **part 7**. A registrable charge is only effective against third parties once it has been registered (**section 31**).

8 Whether or not a charge has been created is a question of the intention of the chargor (**section 9.1**). This is part of a broader principle of equity that the creation of an equitable proprietary interest is determined by the intention of the person creating the interest. This is true of trusts (where the principle is that there must be certainty of intention to create a trust[13]), equitable assignments[14] and charges[15].

9 It is often important to know when a charge has been created, and that also depends on the intention of the chargor (**section 9.2**).

10 **Section 9** refers to the intention of the chargor, not to the intention of the parties. In practice, a charge will be created as part of a transaction entered into between the chargor and chargee and, quite possibly, others. Why does the Code not refer to the intention of parties, rather than to the intention of the chargor?

11 The reason why the Code refers to the intention of the chargor is that it reflects the basic principle that the creation of an equitable proprietary interest depends on the intention of the putative creator of that interest. A charge is invariably created in a transaction between parties other than the chargor. The chargee will be involved. In a syndicated facility, so may the lenders. And the charge document is almost invariably

[10] Land, goods and limited classes of intangible. *Lunn v Thornton* (1845) 1 CB 379.
[11] *Tailby v Official Receiver* (1888) 13 App Cas 523; *Re Kent & Sussex Sawmills* [1947] Ch 177.
[12] Companies Act 2006, s 859A. This applies to companies. Equivalent provisions apply to LLPs.
[13] *Mills v Sportsdirect* [2010] EWHC 1072 (Ch) at [52] to [55].
[14] *Tailby v Official Receiver* (1888) 13 App Cas 523 at 543.
[15] *Re Kent & Sussex Sawmills* [1947] Ch 177; *Swiss Bank v Lloyds Bank* [1982] AC 584.

drafted by the chargee's lawyers. But the question to be determined is whether, and on what basis, a person has created a proprietary interest over its asset.

12 That person's intention will reflect the commercial transaction and the agreement reached between the parties. But it is the act of the chargor which creates the charge, and it is the chargor's intention which is the ultimate requirement.

13 Intention plays a central part in English commercial law. It is the basis of contractual liability, and it is also the reason why equitable proprietary interests are created. But, in both types of case, the word "intention" has a very particular meaning. In neither case is the law generally concerned with the subjective intention of the parties to the contract or of the person purporting to create the equitable proprietary interest. There are limited circumstances in which subjective intention is relevant but, in the vast majority of cases, the law is concerned with the objective intention of the persons concerned. For the purpose of the Code, it is always the objective intention which is relevant.

14 The law looks at what the person concerned has written, said and done and, where there is more than one person concerned, at what has passed between the parties. Based on that objective evidence, the law then establishes how a reasonable person would understand the intention of the people concerned. The actual, subjective, intention of the parties is irrelevant. What is important is how a reasonable person would understand their intention based on its objective manifestations. This is as true of the creation of equitable proprietary interests[16] as it is true of the creation and interpretation of contracts[17]. It is reflected in **section 9.3**.

[16] *Re Lehman Brothers International (Europe)* [2010] EWHC 2914 (Ch) at [225(v)].
[17] *Reardon Smith Line v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 996.

## 10 Identification

**10.1 The terms of the charge must identify the charged asset and the secured obligation.**

**10.2 This requirement is satisfied if, when the charge comes to be enforced, it is possible to establish whether or not:**

**(a) a particular asset falls within the scope of the assets which are charged by the terms of the charge; and**

**(b) a particular obligation falls within the scope of the obligations which are secured by the terms of the charge.**

**Commentary**

1 One of the advantages of a charge is that the parties have a great deal of flexibility in identifying the charged asset and the secured obligation. Under the current law, all that is required is that, when the charge comes to be enforced, it is possible to establish whether or not a particular asset falls within the scope of the charged assets as defined and whether a particular obligation falls within the scope of the secured obligations as defined[18].

2 This approach is reflected in **section 10**.

[18] *Tailby v Official Receiver* (1888) 13 App Cas 523.

## 11 Formalities

**11.1 If the charged interest consists of or includes an interest in land, the charge must be created or evidenced by a document executed by the chargor.**

**11.2 If a charge is created by a consumer, all formal requirements imposed by consumer protection laws must be complied with.**

**11.3 If a charge is to be registered in an asset registry (see part 8), it must comply with the requirements of the asset registry concerned.**

**11.4 It is not necessary for any other charge to be created or evidenced in writing.**

**11.5 It is not necessary for the chargee to execute any document creating or evidencing a charge. Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 is amended accordingly.**

**11.6 It is not necessary for any document creating or evidencing a charge to be executed as a deed. Any legislation which requires a deed is amended accordingly.**

**11.7 Any power of attorney contained in a document which creates or evidences a charge will be effective if the document concerned is executed by the chargor. It does not have to be executed as a deed, and the Powers of Attorney Act 1971 is amended accordingly.**

**11.8 A document creating or evidencing a charge can be executed electronically.**

**Commentary**

1 We have had a lot of discussion about whether there should be a requirement for writing. On one side is the view that a requirement for writing would add certainty to the law and, in any event reflects best practice. Attractive though this argument is, the approach of the Code is to eschew formalities. The reason for this is that, however well-intentioned the quest for the greater certainty which formalities provide, experience suggests that the effect of formalities is the refusal to give effect to something which the parties have agreed simply because they have not complied with a technicality.

2 An example in the related area of guarantees is the Statute of Frauds of 1677. This requires a guarantee to be in writing and signed by the guarantor. It still can cause problems in practice, as the decision of the House of Lords in *Actionstrength v*

*International Glass Engineering*[19] shows. In that case, a person entered into an oral guarantee as part of an agreement. But, because it did not comply with section 4 of the Statute of Frauds, the House of Lords held that it was not binding. The parties had reached an agreement, but it was not enforced.

3 The problem with formalities of this kind is that they have the tendency to defeat the legitimate commercial expectations of the parties. There has been a long history of the courts finding ways around formalities of this kind[20]. It is therefore considered that the best approach is not to require formalities.

4 Of course, in practice, it is expected that parties will continue to do what they have always done, which is to create charges in writing and have them signed. That is clearly the best practice.

5 The Code also does away with the necessity for some of the formalities which are required under the current law.

6 Under section 2 of the law of Property (Miscellaneous Provisions) Act 1989, it is necessary for a charge over future land to be executed by the chargor and the chargee. **Section 11.5** dispenses with the requirement for the chargee to execute the document.

7 Security over land also needs to be executed as a deed under the current law. The effect of **section 11.6** is to dispense with this requirement. Where the charged asset consists of or includes an interest in land, the charge must be created or evidenced by a document executed by the chargor (**section 11.1**), but there is no necessity for it to be a deed.

8 This section does not override the formal requirements required by consumer law where the chargor is a consumer. The existing requirements will continue to apply.

9 Similarly, where a charge is to be registered in an asset registry, the charge must comply with the requirements of the asset registry concerned. So, for instance, where the charge is to be registered at the ship registry, then the requirements of the relevant legislation will have to be complied with.

10 Under the Powers of Attorney Act 1971, a power of attorney must be created by deed. The requirement for a deed is dispensed with in the case of a charge by **section 11.7**.

[19] [2003] 2 AC 541.
[20] *Rochefoucauld v Boustead* [1897] 1 Ch 196; *Bannister v Bannister* [1948] 2 All ER 133; *Yaxley v Gotts* [2000] Ch 162.

11 **Section 11.8** enables a document creating or evidencing a charge to be executed electronically.

## PART 3: CHARGED ASSETS

### 12 Charged assets in general

**12.1 The charged asset can be property of any kind. It does not have to be located in England and Wales or governed by the laws of England and Wales. It does not have to be in existence at the time the charge is created.**

**12.2 The charged interest can be any proprietary interest of any kind. It does not have to amount to ownership. It can be legal or equitable. It can be outright or by way of security. It does not have to be in existence at the time the charge is created.**

**12.3 A chargee can create a charge over the benefit of a charge (in other words, a sub-charge).**

**12.4 A chargor can create a charge in favour of a chargee over a receivable (see section 17) owing by the chargee to the chargor.**

**12.5 A company's uncalled capital is property of the company and the company's interest in it can be charged by the company.**

**Commentary**

1 The Code applies to property of all kinds – land as well as goods and intangibles.

2 This is because, in practice, one charge is frequently taken over a number of different types of asset. A common form of security interest is the debenture by which a chargor charges all of its present and future assets.

3 It is also because the basic issues of security law are the same whatever type of asset is charged – who can create the charge and how, who can be the chargee, what are the charged assets, what are the secured liabilities, how is the security to be enforced?

4 There are of course differences between land and other assets, but there are also very material differences between goods and intangibles. In neither case do they affect the basic principles of taking security. It was therefore considered that no useful purpose would be served by confining the scope of the Code to assets other than land[21].

[21] Which is what has been done in the United States and the PPSA jurisdictions which follow it.

5 The Code therefore applies to all property of all kinds; and it also applies wherever the property is located and, if it is an intangible asset, whichever law governs it. Conflict of laws rules in England or elsewhere will determine the extent to which it will be enforced over foreign property but, as a matter of English substantive law, the Code applies to all property.

6 In common parlance, we talk about a person creating a charge over land, or goods, or a contract right. There is nothing wrong with that, but it is not strictly accurate. A chargor does not create a charge over property. The chargor creates a charge over its interest in the property. In the case of land for instance, it is not the land which is charged; it is the chargor's freehold or leasehold interest which is charged. This is reflected in **sections 12.1 and 12.2**.

7 **Sections 12.1 and 12.2** are drafted widely, and are intended to cover all types of property and interests in property – including new types of property and of interests in property as they are created. It would, for instance, cover cryptoassets.

8 A chargor can charge its leasehold interest in property, or a security interest which it has in property. The only restriction is that a charge cannot be created over a purely personal right – in other words a right which cannot be transferred or over which a proprietary interest cannot be created. So if, for instance, a particular receivable is personal to its owner, it cannot be charged because it can neither be transferred and nor can a proprietary interest be created over it. A charge is a type of proprietary interest, and it cannot be created if a proprietary interest cannot be created.

9 **Section 12.3** is an illustration of **section 12.2**. A charge can be created over the benefit of a charge.

10 **Section 12.4** has been inserted for the avoidance of doubt. In *Re Charge Card Services*[22], it was decided that it was conceptually impossible for a person to have a charge over a debt which it owes to another. That decision was disapproved by the House of Lords in *Re Bank of Credit and Commerce International (No. 8)*[23]. It is therefore possible for a person to take a charge over its own debts. **Section 12.4** confirms this position.

[22] [1987] Ch 150.
[23] [1998] AC 214.

11 In *Re Russian Spratts Patent*[24], it was decided that uncalled capital is not property of a company and, as a result, a security document must specifically refer to uncalled capital if the security is to extend to it. The purpose of **section 12.5** is to reverse this decision. A reference to the property of a company will include the company's uncalled capital. This is not expected to have much effect in practice because companies rarely have uncalled capital.

[24] [1898] 2 Ch 149.

## 13 Types of asset

**13.1 In this Code, assets are, for certain purposes, divided into:**

**(a) land: which includes fixtures;**

**(b) goods: which means any tangible property which is transferable by delivery; and**

**(c) intangibles: which means any property other than land or goods.**

**Commentary**

1 The Code sometimes refers to particular types of asset. **Section 13** explains what the Code means by land, goods and intangibles.

## 14 Future assets

**14.1 A chargor can create a charge over any interest which it may subsequently have in an asset. Assets of this kind are described as future assets in this Code.**

**14.2 If the terms of a charge extend to future assets, the charge will automatically cover the chargor's interest in each future asset concerned once the chargor acquires it, without the necessity for any other act by the chargor or for any further registration under part 7.**

**14.3 A chargor can create a charge over all or part of its interest in its present and future assets.**

**14.4 A chargor's future assets include assets in which it acquires an interest after it has entered into insolvency proceedings other than assets recovered in insolvency claw-back proceedings (see part 10).**

**Commentary**

1 **Section 14** is concerned with future assets. It builds on **section 12**.

2 **Section 14** generally reflects the existing equitable position. It is not possible to create a legal mortgage over future assets. At common law, the mortgaged asset must be in existence and owned by the mortgagor at the time the mortgage is created[25]. But it is possible to create an equitable mortgage or charge over future property[26]. Once the asset comes into existence and becomes owned by the chargor, it automatically becomes subject to the equitable mortgage or charge without anything further being required to be done[27].

3 Under the existing law, a charge over future property is only effective if it is given for consideration. This is because an equitable proprietary interest is only created over future property if there is a binding contract to create it.[28] This is not a requirement under the Code. In practice there will normally be consideration for the creation of a charge but, in the interests of simplicity, it was not considered necessary to impose this additional requirement.

4 One of the questions which has created problems in practice is the extent to which a charge over future assets covers assets which are acquired by the chargor after it has

[25] *Lunn v Thorton* (1845) 1 CB 379.
[26] *Holroyd v Marshall* (1861-62) 10 HLC 191.
[27] *Collyer v Isaacs* (1881) 19 ChD 342 at 351.
[28] *Holroyd v Marshall* (1861-62) 10 HLC 191.

entered into insolvency proceedings. The Code deals with this issue by drawing a distinction between assets which are recovered as a result of the insolvency claw-back provisions (which are discussed in **part 10**), and other assets. The former are intended to be recovered for the benefit of creditors as a whole, and so they do not fall within the scope of the charge. But any other assets which are subsequently acquired by the company do fall within the scope of the charge if they fall within the description of the charged assets.

## 15 Part of an asset

**15.1 A charge can be created over part of an asset if that part which is charged is identifiable.**

**15.2 A particular percentage or proportion of goods or intangibles is identifiable. Unless the charge instrument provides to the contrary or the parties agree to the contrary, the chargee is entitled to all of the proceeds of the asset concerned until the chargee has received an amount equal to its percentage or proportion.**

**Commentary**

1 **Section 15.1** confirms that a charge can be taken over a part of an asset provided that it is identifiable.

2 Identification can be a particular problem with a part of an asset. If I charge 20 of my 100 shares in a company, would the charged assets be sufficiently identifiable? Issues of this kind have created problems in relation to the creation of trusts. The problem can be solved by the courts treating a trust of 20 per cent of an asset as if it were a trust of 100 per cent of the asset on behalf of the settlor as to 80 per cent and the beneficiary as to 20 per cent.[29] But it is more difficult to apply that logic to a charge.

3 **Section 15.2** deals with this issue by providing a rebuttable presumption that, where there is a charge over a particular percentage or proportion of an asset, the asset is identifiable and the chargee is entitled to all the proceeds to the asset until the chargee has received an amount equal to its percentage or proportion. This is a default rule. Like much else in the Code, it gives way to contrary intention.

[29] *Hunter v Moss* [1994] 1 WLR 452; *Re Lehman Brothers International (Europe)* [2010] EWHC 2914 (Ch), [232].

## 16 Extent of charged assets

**16.1 The identity and extent of the charged asset is determined by the objective intention of the chargor, based on the terms of the transaction concerned.**

**16.2 A charge over an asset extends to the proceeds of an unauthorised disposition of that asset to the extent that they are capable of being traced under the general law.**

**16.3 A charge over an asset extends to:**

**(a) the benefit of any insurance contract for the benefit of the chargor relating to that asset; and**

**(b) where the asset consists of a right to receive money, any security for that right, whether that security is proprietary (i.e. a charge) or personal (for instance a guarantee); and**

**(c) where the asset consists of the benefit of an account, the benefit of any replacement account,**

**except to the extent that:**

**(i) the charge instrument provides to the contrary or the parties agree to the contrary; or**

**(ii) the new asset concerned is an intangible asset which cannot be charged because it is prohibited by the terms on which that asset was created (see section 19).**

**16.4 A charge over land extends to fixtures on the land.**

**Commentary**

1 **Section 16.1** states the basic principle that the extent of the charged assets is a matter of the objective intention of the chargor. Where, as will usually be the case, the charge is created by a document, it therefore depends on the proper interpretation of the document concerned.

2 **Section 16.2** states the underlying law. It is a reminder that, where there is an unauthorised disposition of a charged asset, the chargee may be able to trace the

asset into its proceeds. Whether it can do so depends on the rules of tracing, normally in equity.

3 **Section 16.3** establishes three default rules, which give way to contrary intention.

4 Under the existing law, the general principle is that a charge over an asset does not extend to the proceeds of any insurance taken out in respect of the asset[30]. **Section 16.3(a)** alters this. The default rule is now that a charge over an asset will extend to the benefit of any insurance contract for the benefit of the chargor relating to the asset.

5 Where the charged asset is a right to receive money, the question that sometimes arises is whether the charge extends to any security granted for that right. A charge over a receivable will normally be expressed to extend to any security for the receivable. **Section 16.3(b)** establishes a default rule that a charge over a right to receive money does include any security for that right.

6 It is common for charges to be taken over bank accounts, and also for money standing to the credit of one account moved to a replacement account. **Section 16.3(c)** establishes a default rule that, where the asset consists of the benefit of an account, the charge extends to the benefit of any replacement account.

7 **Section 16.3** is also subject to **section 19**. If the replacement asset cannot be charged, then the charge does not extend to it.

8 **Section 16.4** states the underlying law - that a charge over land extends to fixtures on the land.

[30] *Sinnott v Bowden* [1912] 2 Ch 414 at 419; *Lees v Whiteley* (1866) LR 2 Eq 143; *Colonial Mutual v ANZ* [1995] 1 WLR 1140.

## 17 Receivables

**17.1** **A receivable is the right which one person (the payee) has to be paid money by another person (the payer). The right can arise under a contract or in any other way; and it can be present, future or contingent. It includes the right to payment of a debt and a claim for damages.**

**17.2** **If a payee creates a charge over a receivable, the chargee obtains all of the payee's rights in relation to the receivable until the charge is extinguished, subject to the terms of the charge and the provisions of this Code.**

**17.3** **It is not a requirement for the creation of a charge over a receivable that notice of the charge is given to the payer. But notice may be given.**

**17.4** **For the purpose of this section, a payer only receives notice of a charge once it is actually aware of it. No formalities are required, but constructive notice is not sufficient.**

**17.5** **Until the payer has received notice of a charge, it will obtain a good discharge by paying the payee or as the payee has directed. Once the payer has received notice of a charge, it can only obtain a good discharge by paying the chargee or as the chargee has directed.**

**17.6** **To the extent that, as a result of payment, the chargee receives more than is necessary to pay the secured obligation, it holds the balance on trust for the chargor or whoever else is entitled to it.**

**17.7** **Once the payer has received notice of a charge, the chargee can bring legal or arbitration proceedings in its own name against the payer without the involvement of the chargor, except to the extent that the parties to the charge have agreed otherwise. To the extent necessary to resolve the proceedings, the tribunal concerned will join the chargor to the proceedings; and any costs of doing so are payable by the chargee (although it may recover them from the payee if the payee has agreed to pay them or is otherwise liable for them).**

**17.8** **The chargee obtains no greater rights to the receivable than the payee has. For instance, if the payment of the receivable is subject to a condition or to a right of set-off under the contract, then the chargee is subject to them in the same way as the payee is. Accordingly, the payer cannot be required to pay a greater**

**amount than the contract provides or (except for the identity of the payee) to pay on different terms than the contract provides.**

**17.9 In addition, the payer can set off against the chargee any other cross-claim which it has against the payee if:**

**(a) the cross-claim arises under a contract or other transaction entered into before the payer has received notice of the charge (even if the cross-claim was future or contingent at the time notice was received); or**

**(b) the cross-claim is so closely connected with the chargee's claim against the payer that it would clearly be unfair for it not to be taken into account.**

**17.10 The rights, powers, liberties and immunities of the payer, the payee and the chargee under this section can be varied by agreement between the relevant parties.**

**Commentary**

1 Although the basic principles concerning charged assets are the same, whatever the nature of the asset concerned, there are particular rules which apply to particular types of asset. Where practicable, it is intended to state these rules in the Code. We start with receivables, but specific reference could be made to assets such as registered land, ships and aircraft, intellectual property and particular categories of goods and intangibles.

2 **Section 17.1** defines receivables broadly, to include any right which one person has to be paid money by another. The last two sentences of **section 17.1** show that the intention is to give the expression a broad meaning.

3 If a charge is created over a receivable, the chargee will generally obtain all of the payer's rights in relation to the receivable until the charge is extinguished. This is the subject of **section 17.2**. This principle is subject to the other provisions of the Code, particularly those set out in the rest of **section 17**. It is also subject to the provisions of the charge instrument. It is open to the parties expressly to restrict the rights of the chargee, and therefore the general principle in **section 17.2** will give way to contrary intention.

4 Under the existing law, a statutory assignment of a receivable requires notice to be given to the payer.[31] But an equitable assignment or charge can be created without any notice being given to the payer.[32] **Section 17.3** adopts the equitable rule. A valid charge can be created over a receivable without notice being given to the payer.

5 It will no longer be possible to take a statutory assignment where the interest being acquired by the assignee is a security interest (see **section 7**). A purported assignment by way of security will be treated as a charge. But the ability of the chargee to bring proceedings in its own name in certain circumstances is preserved by **section 17.7**.

6 Although notice of a charge is not a requirement of its validity, it can still be given, and it can be advantageous (for instance under the rule in *Dearle v Hall*[33]). **Section 17.4** provides that, for the purpose of **section 17**, a payer only has notice of a charge if it is actually aware of it. Constructive notice is insufficient.

7 One of the practical issues which arises where a charge has been created is whom the payer must pay in order to obtain a good discharge. Until the payer has received actual notice of the charge, it clearly has to pay the chargor. It is not aware of anyone else. If the payer pays the chargor in ignorance of the creation of a charge, it will still get a good discharge.[34]. The Code does not alter this. See **section 17.5**.

8 But, in practice, it is common for a notice to be given to the payer which directs the payer to continue to pay the chargor until it receives notice to the contrary from the chargee. **Section 17.5** also caters for this. Until the payer has received a direction to pay the chargee, it will obtain a good discharge by paying the chargor. Once the payer has received a direction to pay the chargee, it can only obtain a good discharge from the chargee.

9 **Section 17.6** deals with the situation where the chargee receives more than it is entitled to. In such a case, as with any chargee, it holds the balance on trust for the chargor or for the person otherwise entitled (for instance a second chargee).

10 **Section 17.7** is concerned with the practicalities of the chargee bringing legal proceedings against the payer. It adapts the underlying law. Once the payer has received notice of the charge, the chargee can bring proceedings in its own name

[31] Law of Property Act 1925, s 136.
[32] *Gorringe v Irwell India Rubber and Gutta Percha Works* (1886) LR 34 ChD 128.
[33] (1828) 3 Russ 1.
[34] *Stocks v Dobson* (1853) 4 De GM&G 11.

against the payer unless it has been directed to pay someone else (for instance, the chargor). If it is necessary to resolve the proceedings, the tribunal will join the chargor to the proceedings, and the costs are for the account of the chargee, although the terms of the charge may enable the chargee to be reimbursed by the chargor.

11 The rights of a chargee of a receivable derive from those of its chargor. It follows that the chargee can have no greater rights to the receivable than the chargor has. If an amount is only payable on the satisfaction of certain conditions, then those conditions apply as much to the chargee as they do the chargor. If a payment is subject to contractual right set-off, then it will apply to the chargee as much as to the chargor[35]. This principle is stated in **section 17.8**.

12 **Section 17.9** is concerned with other rights of set-off. Because a chargee of a receivable takes its interest in the receivable "subject to equities", the chargee is subject to another limitation on its rights. Even if money is payable under the contract, the chargee may find the amount to which it is entitled is reduced because the payer has a right of set-off against the chargor and it is entitled to exercise it against the chargee.

13 For instance, the payer may have entered into other dealings with the chargor as a result of which money is payable by the chargor to the payer. The payer may be able to set these amounts off against the chargee if it could have done so against the chargor. Although there would be no mutuality in such a case, set-off would be available because the assignee takes "subject to equities" and the right of set-off is an "equity".

14 Under the general law, the payer would be entitled to a set-off in a case of this kind if the payer would have had a right of set-off against the chargor at the time it received notice of the charge. It would have such a right in two circumstances. First, if the cross-claim was liquidated or of a certain amount at that time (although it need not necessarily have been payable then). And secondly if the cross-claim was so closely connected with the payer's claim against the chargor that it would clearly be unfair for it not to be taken into account.[36].

15 **Section 17.9** broadly adopts the same approach. The one change is in **section 17.9(a)**. Under the existing law, a set-off is only available of unconnected claims if the

[35] *Tooth v Hallett* (1868-69) LR 4 Ch App 242.
[36] *Business Computers v Anglo-African Leasing* [1977] 1 WLR 578; *Bank of Boston Conneticut v European Grain & Shipping* [1989] AC 1056; *Geldof Metaalconstructie v Simon Carves* [2010] 1 CLC 895.

cross-claim was liquidated and was either presently payable or must become payable in the future (i.e. if it was a present or a future claim) at the time notice was received. It does not apply where the claim was contingent at that time (i.e. it was an existing claim the payment of which was dependent on the happening of some uncertain future event). Under **section 17.9(a)**, a set-off is available even where the claim was contingent at the time the notice was given. So if, at the time the payer received notice of the charge, it had already entered into a contract with the chargor, then amounts payable under that contract can be set-off against the chargee even if they were contingent at the time notice was received. We think that this strikes a fairer balance, but it is, of course, subject to discussion.

16 One of the basic precepts of the Code is that the parties should have as much freedom to contract as possible. **Section 17.10** is an example of this approach. The parties can vary the rules contained in **section 17**.

## 18 Other assets

***Provisions relating to specific types of asset can be addressed here if required, for instance in relation to registered land, ships, intellectual property and financial collateral.***

**Commentary**

1 Receivables are covered in some detail in **section 17**. Other types of assets can also be dealt with in more detail if that would be helpful.

## 19 Prohibitions on charging certain intangible assets

**19.1 The benefit of an intangible asset (for instance, a contract) cannot be charged if it is prohibited by the terms on which the asset is created (for instance, the terms of the contract which creates it), unless it is permitted by other legislation (such as the Small Business, Enterprise and Employment Act 2015).**

**19.2 This is the case even if the prospective chargee is unaware of the prohibition.**

**19.3 Whether or not the creation of a charge is prohibited by the terms of a contract is a matter of interpretation of the contract concerned.**

**19.4 If the creation of a charge over all or any part of the benefit of an intangible asset is prohibited by terms on which the asset is created, then:**

**(a) unless it is permitted by other legislation, any purported charge is, to the extent of the prohibition, invalid; and**

**(b) if the chargor has agreed to create the charge, the invalidity of the charge may result in a personal claim by the intended chargee against the chargor.**

**19.5 In this Code, a prohibition on the creation of a charge includes any limitation of any kind on the creation of the charge (including, for instance, the requirement for a consent which has not been obtained).**

**19.6 This section does not apply to the proceeds of a receivable once they have been paid.**

**Commentary**

1 It is common for contracts to contain prohibitions on the creation of charges (and, indeed, of assignments). What is the effect of those provisions? If a charge is created in breach of such a prohibition, is the charge invalid, or is it just that the person who has breached the contract is liable in damages?

2 The Code draws a distinction between two types of case. **Section 19** is concerned with intangible assets the terms of which prohibit the creation of a charge. **Section 20** is concerned with other contractual restrictions.

3 The most obvious example of a restriction to which **section 19.1** applies is a contract right. A enters into a contract with B under which A agrees to pay money to B in

consideration for the supply of services by B. The contract prohibits B from creating a charge over the benefit of the contract. In breach of that restriction, B charges to C its rights under the contract, including the receivable owing by A. Is the charge valid?

4 The effect of **section 19.1** is that the charge is invalid unless it is validated by other legislation.

5 The Code follows the approach in the existing law. The key decision is that of the House of Lords in *Linden Gardens Trust v Lenesta Sludge Disposals*[37]. B's rights against A are created by contract. The only asset which B has is its contractual right against A. It should therefore follow that B's rights against A are determined by the terms of the contract. And if the contract says that it cannot be charged, then it cannot be charged. Any purported charge is a nullity.

6 This approach has much to commend it. A and B have entered into a contract under which A is assured that B cannot charge its rights under the contract, and therefore that A is solely responsible to B. That being the basis on which the parties have contracted, should it be open to B to deny that the clause has the effect which the parties have agreed?

7 But this approach does have its critics. The argument is that receivables are an important asset available to a company, and that it should be able to assign or charge them freely whatever the terms of the contract are between A and B. The argument is essentially one of expediency, rather than logic. The need to raise finance on receivables is so important, that the contractual arrangements between the parties should be overridden in the greater interests of the UK economy.

8 It was this idea which led the government to pass the Small Business, Enterprise and Employment Act 2015. It contains a power for regulations to be made to override contractual restrictions on assignment. The Regulations have now been made[38]. The primary legislation only applies to assignments, and it is not clear whether this will also encompass charges. **Section 19.1** is expressed to be subject to the Act, but it remains to be seen the extent to which it will affect charges.

9 The problem with the approach in the Small Business, Enterprise and Employment Act 2015 is that it overrides the contractual arrangements between the parties. If A enters into a contract with B to pay money in consideration for the receipt of services, A may

[37] [1994] 1 AC 85.
[38] The Business Contract Terms (Assignment of Receivables) Regulation 2018 (2018/1254)

have an interest in dealing only with B, and not with anyone else. And A does not want to find itself in a position where, as a result of the creation of a charge in favour of C in breach of a contractual prohibition, it has to pay more to C than it would have had to pay B. This would be a possible outcome because, although the contractual entitlement of C (as chargee) is no greater than that of B (as payee), the effect of the charge to C may be that A loses rights of set-off which it would have been able to exercise against B. Set-off is discussed in the Commentary to **section 17.9**. Although A's rights of set-off against B are available against C, it is only those in existence at the time when A received notice of the assignment. If A is dealing on running account with B, an assignment to C could prejudice A's rights.

10 The countervailing argument is that it is in the interest of the UK economy that B should be able to raise money on its receivables, and that it is therefore appropriate to override contractual restrictions.

11 It would be possible to reconcile these two imperatives if the law recognised that:

- a purported charge/assignment of a receivable is effective to give the chargee/assignee a proprietary interest in the receivable; but
- the payer has no duty to pay the chargee/assignee more than it would have had to pay its counterparty, so enabling it to take advantage of any rights of set-off which would have arisen if there had been no charge/assignment.

12 This alternative approach was explored in an Annexure to the first version of the Code (July 2015). It applied not just to charges but also assignments, although it would be possible to restrict it to charges. We would welcome views on whether this alternative approach should be explored further.

13 **Section 19.2** provides that the rule described in **section 19.1** applies even if the prospective chargee is unaware of the restriction. That follows the existing law.

14 One of the issues which has caused the most difficulty in practice has been determining whether a particular form of words does, or does not, apply to the particular transaction which has been effected. For instance, if a clause prohibits an assignment, does it also prohibit a charge or a trust? Much of the recent case law on this area has been concerned with this issue[39].

[39] *Don King Productions v Warren* [2000] Ch 291; *Barbados Trust Co v Bank of Zambia* [2007] 1 CLC 434.

15 But these cases are of limited value because they decide what a particular formulation of words meant in a particular contract. Any question of contractual interpretation depends on the precise words used in the context of the contract as a whole, any other transaction documents, and the relevant background facts at the time the transaction was entered into. The meaning of a prohibition in particular words in one transaction is not necessarily the same as the meaning of those words (or similar words) in another transaction at a different time.

16 **Section 19.3** confirms that the meaning of a particular restriction is a matter of interpretation. It would be nice if it could resolve some of these questions of interpretation, but it cannot do so. Ultimately, the only people who can do so are the draftsmen of the contracts concerned.

17 **Section 19.4** explains the effect of these provisions in a transaction and **section 19.5** gives a wide meaning to the expression "prohibition".

18 The application of **section 19** can be illustrated in the following example.

If:

(a) A has entered into a contract with B under which B is entitled to a receivable from A;

(b) the contract contains a prohibition on B creating a charge over the receivable without A's consent;

(c) A has not consented; and

(d) B purports to charge the receivable to C,

then:

(e) unless the prohibition is ineffective under other legislation, the purported charge is invalid, and C therefore obtains no proprietary interest in the receivable; and

(f) C may have a personal claim for breach of contract against B, depending on the terms of its contract with B.

## 20 Other contractual prohibitions on charging assets

**20.1 Neither the validity nor the priority of a charge over an asset is affected by any contractual prohibition on the creation of a charge by a chargor, except to the extent that it is invalidated under the preceding section.**

**20.2 This is the case even if the chargee is aware of the prohibition.**

**20.3 This does not affect any personal claim for breach of contract which the chargor may be liable for.**

**20.4 If:**

**(a) a chargor creates a charge over an asset; and**

**(b) a person with a proprietary interest in that asset has the benefit of a contractual prohibition on the creation of such a charge; and**

**(c) when taking the charge, the chargee had actual knowledge of that prohibition and deliberately encouraged the chargor to breach it,**

**then the chargee is liable in tort for the loss suffered by the person in whose favour the prohibition was given. The chargee has no other liability of any kind (for instance, in tort or in equity) if it takes a charge in breach of a contractual prohibition on its creation.**

**Commentary**

1 **Section 20** is concerned with contractual prohibitions on the creation of a charge which do not fall within **section 19**. Here, the rule is the opposite to that in **section 19**. The validity of a charge over such an asset is not affected by a contractual prohibition on the creation of a charge. And this is the case even if the chargee is aware of the prohibition (**section 20.2**).

2 The reason for this distinction is that assets of this kind exist in their own right – not merely because they have been created by a contract. There is therefore no necessary reason why a breach of the prohibition should prevent the creation of a charge.

3 The approach taken in the Code is to create one simple rule, which is that a prohibition of this kind can give rise to a personal claim for breach of contract (**section 20.3**), but

that the validity of the transaction itself cannot be called into question (**section 20.1**), even if the chargee is aware of the restriction (**section 20.2**).

4 If a chargee had actual knowledge of the prohibition at the time the charge was created, and it deliberately encouraged the chargor to breach that provision, the chargee may be liable in tort under **section 20.4**. But that is the limit of its liability. **Section 20.4** is intended to cut through much of the case law on unlawful interference with contracts and provide a simple test of liability which will only be satisfied in an extreme case. Whether this draws the line in the right place is a question we would like to discuss.

5 The effect of **section 20** can be illustrated in the following example:

6 If:

(a) B is the owner of goods and agrees with A that it will not charge the goods; and

(b) B purports to charge the goods to C,

then:

(i) the purported charge is valid;

(ii) in the limited circumstances described in **section 20.4**, A may have a personal claim against C in tort to recover any loss which A has suffered as a result of the charge being created in breach of the prohibition (and, if it finds out in time, it may be able to get an injunction);

(iii) unless those limited circumstances apply, A will have no claim against B in relation to the charge; and

(iv) A will have a personal claim against B for breach of contract for the loss which A has suffered as a result of the charge being created in breach of the prohibition.

***CONTRACTUAL RESTRICTIONS ON CHARGING ASSETS: ALTERNATIVE APPROACH***

***(This would replace sections 19 and 20)***

***19. Contractual restrictions on charging assets***

***19.1 A contractual restriction on the creation of a charge does not affect the validity of the charge. The charge is valid in spite of the restriction, even if the chargee is aware of the restriction.***

***19.2 If:***

***(a) the charged asset is a receivable arising under a contract (a contractual receivable); and***

***(b) the charge breaches a restriction in that contract on the creation of the charge,***

***the payer cannot be required to pay anyone other than is provided for in the contract until the chargee enforces the charge and notifies the payer that it has done so. Once this has happened, the payer must pay the chargee (or as it directs). In addition to the set-offs available to any payer against a chargee, the payer may also set off against the chargee any monetary claim it has against the chargor at the time payment is due which it could have set off against the chargor if the receivable had not been charged. This includes insolvency set-off if the chargor, the chargee or the payer has entered into insolvency proceedings.***

***19.3 If:***

***(a) the charged asset is an intangible arising under a contract with a third party but is not a contractual receivable; and***

***(b) the charge breaches a restriction in that contract on the creation of the charge,***

***the third party cannot be required to do anything which would put it in a worse position than the contract provides.***

***19.4 If the chargor commits a breach of a contractual restriction on the creation of a charge by entering into the charge, the chargor is liable to the person in whose favour the restriction was given for the loss suffered by that person as a result.***

***19.5 If:***

***(a) a chargor creates a charge over an asset; and***

***(b) a person with a proprietary interest in that asset has the benefit of a contractual restriction on the creation of such a charge; and***

***(c) when taking the charge, the chargee had actual knowledge of that restriction and deliberately encouraged the chargor to breach it,***

***then the chargee is liable in tort for the loss suffered by the person in whose favour the restriction was given. The chargee has no other liability of any kind (for instance, in tort or equity) to any person if it takes a charge in breach of a contractual restriction on its creation."***

**Commentary**

1 This is an alternative approach to dealing with contractual restrictions on charging assets. If it were adopted, it would replace **sections 19 and 20**.

2 The purpose of the existing **sections 19 and 20** of the Code is broadly to reflect the current law. This alternative **section 19** would alter the current law. This alternative approach is being put forward in order to see whether there is support for a change to the current law.

3 The law concerning restrictions on assignment was materially altered by The Business Contract Terms (Assignment of Receivables) Regulation 2018 (2018/1254). That is a recent change to the law, and it was not considered appropriate to attempt to alter it. But the primary focus of those regulations is the assignment of receivables, and the extent to which it applies to charges is not entirely clear. This alternative approach to contractual restrictions would only apply to charges. Outright assignments would continue to be the subject of the regulations. But charges (which, under the Code, would also include what would now be security assignments) would be governed by this new **section 19**.

4 The idea behind this proposal is to see whether it is possible to enable a charge to be created notwithstanding a restriction on charging whilst at the same time protecting the payer from any adverse effects of the charge. In essence, the intention behind this new **section 19** is to enable the charge to be created but to ensure that the payer will not suffer as a result.

5 We put this forward for discussion and would be very keen to hear whether or not there is support for this alternative approach.

## PART 4: SECURED OBLIGATIONS

### 21 Secured obligations

21.1 **The secured obligation can be any obligation or liability of any kind of any person. It can be an existing liability (whether present, future or contingent) or it may be a liability which is not yet in existence (and which may, or may not, come into existence in the future).**

21.2 **For example, a secured obligation may include a liability to pay all money from time to time owing:**

**(a) to a particular person or class of persons; or**

**(b) under a particular agreement or class of agreements.**

21.3 **The secured obligation does not have to be owed by the chargor. Nor does it have to be owed to the chargee.**

21.4 **The identity and extent of the secured obligation is determined by the objective intention of the chargor, based on the terms of the transaction concerned.**

21.5 **If the secured obligation is not an obligation to pay money, the charge secures the obligation to pay damages for breach.**

**Commentary**

1 In a secured transaction, the identification of the secured obligations is as important as the identification of the charged assets. An elaborate description of the charged assets counts for nothing if there is not an appropriate description of the secured obligations. As **section 1.1** shows, there are two key elements to a charge. First, the chargee obtains a proprietary interest in an asset. Secondly, the proprietary interest secures the performance of a secured obligation. Each of these elements is as important as the other.

2 A secured obligation can be any obligation or liability of any kind of any person (see **section 21.1**). The formulation is very wide.

3 Under the existing law, the secured obligation can be either an existing liability (whether present, future or contingent) or it may be a liability which is not yet in

existence (and which may, or may not, come into existence in the future). This is reflected in **section 21.1**.

4 In some cases, the secured obligation will be an existing liability. For instance, a charge can secure all monies from time to time owing under a particular agreement which is entered into at the same time as the charge. This charge will secure existing liabilities because they arise (or will arise) under an existing agreement. Those liabilities may be present, future or contingent:

- a present liability is an existing liability which is now payable (for instance, an amount now due under the agreement);
- a future liability is an existing liability which must become payable in the future (for instance, the obligation to repay advances which have already been made); this is sometimes referred to as *debitum in praesenti, solvendum in futuro*;
- a contingent liability is an existing liability the payment of which is dependent on the happening of some uncertain future event (for instance, the obligation under an existing agreement to repay advances which have not yet been made – and which may never be made).

5 Alternatively or in addition, the charge may secure a liability which is not yet in existence and which may or may not come into existence in the future. For instance, the charge may secure all monies from time to time owing to a particular person. That may cover existing liabilities under existing agreements, but it may also cover liabilities which are not yet in existence under agreements which have yet to be entered into, and may never be entered into.

6 **Section 21.3** establishes that the secured obligation does not have to be owed by the chargor. This is important in practice. A chargor can charge an asset in favour of a chargee not only to secure an obligation owing by the chargor to the chargee, but also an obligation owing by a third party to the chargee. A transaction of this kind is commonly referred to as a "third party charge".

7 If A owes an obligation to B, and it is intended that C should charge an asset in support of that obligation, there are two ways in which this can be done. C can guarantee the obligations of A to B, and then charge its asset to B in support of that guarantee (and the guarantee can be limited to the value of the charged asset if that is what is required). Or, alternatively, C can charge the asset in favour of B to secure A's

obligations to B. In this latter case, C owes no personal obligation to B. So B cannot bring proceedings against C for the recovery of the amount owing. Instead, C has created a proprietary interest in favour of B which secures the obligation which A owes to B. Although C is not personally liable to pay the liability, B is entitled to enforce the charge in order to recover the amount owing by A. Unlike the guarantee example, a third party charge is necessarily limited recourse – limited to the value of the asset charged.

8 **Section 21.3** also establishes that the secured obligation need not be owed to the chargee. A charge can be created in favour of someone else (for instance a trustee) on behalf of the creditor. This is very common in practice.

9 One of the great advantages of the English law of secured transactions is that the identity and extent of both the charged assets and the secured obligations is a matter for agreement between the parties. Where the charge is created by a document, it therefore depends on the interpretation of the document. The extent of the secured obligations depends on the interpretation of the particular words used in the context of the charge instrument and the other transaction documents as a whole and in the context of the relevant background facts at the time the transaction was entered into. This is the effect of **section 21.4**.

10 In practice, it is common for secured obligations to fall into one of two categories (see **section 21.2**).

11 Where there is only one lender involved (in other words, it is a bilateral facility), it is common for the secured obligations to be expressed to be all moneys from time to time owing by the chargor to the chargee. This means what it says. It will cover not just those facilities which are in place at the time the charge is created, but also subsequent facilities granted by the chargee to the chargor.

12 In a bilateral transaction, it is common for the secured obligation to be expressed to be all moneys and liabilities now or hereafter owing or incurred by the chargor to the chargee "on any account whatsoever". In *Re Quest Cae*[40], wording of this kind was held to extend only to money which had been lent or otherwise made available by the chargee to the chargor. It did not cover money which had been lent by a third party and which had subsequently been acquired by the chargee. That was because the reference to "any account whatsoever" must have been intended to cover dealings or

[40] [1985] BCLC 266.

transactions between the chargor and the chargee, but not liabilities incurred by the chargor to a third party which had subsequently been acquired by the chargee.

13 For this reason, it is common for the secured obligations clause specifically to refer to amounts acquired by the chargee as well as amounts owing to the chargee.

14 A typical "all moneys" clause would contain an undertaking by A to pay all money due or owing to B and all obligations or liabilities incurred to B, whether they are:

(a) present, future or contingent;

(b) joint or several;

(c) payable as a principal debtor or as a guarantor;

(d) sounding in debt or in damages;

(e) originally owing to B, or originally owing to a third party but which have been acquired by B.

15 All moneys clauses are common in bilateral facilities but not in syndicated facilities. Where the loan is made available by a number of lenders, all moneys wording would extend not just to the facility concerned, but also to any other facilities which any of the lenders might make available to the borrower. For that reason, it is usual for the secured obligations to be expressed to be all moneys from time to time owing under the particular facility agreement concerned.

16 This does cause practical problems. The chargor creates a charge over its assets to secure all moneys owing under a particular facility agreement. That facility agreement is then amended. Does the security cover the amended facility?

17 As would be expected, this is a question of interpretation of the secured obligations clause. The secured obligations definition will almost invariably cover all moneys owing under the facility agreement "as it may be amended from time to time". If it does, then this security will extend to an amended facility.

18 But that does not necessarily solve all the problems. There is concern in practice that the amendments may be so fundamental that, although drafted as an amendment to the existing facility, they really create a new facility. If that is the case, the secured

obligations clause will not cover what has happened. In *Triodos Bank v Dobbs*[41] a guarantee was held not to extend to an amendment to a facility agreement which was in substance a new facility, even though it was drafted as an amendment to an existing facility. The concern in practice is that this principle would be applied to security documents.

19 It is therefore quite common for a secured obligations clause to cover:

> all money from time to time owing under [a particular facility agreement], including all amounts owing under that agreement as it may be amended from time to time, even if the agreement is fundamental (for instance, by increasing the amount of the facility to any extent, by changing the purpose of the facility concerned or by changing the identity of the persons providing the facility).

20 When drafting the Code, it was considered whether wording along these lines could be inserted in the Code itself – in effect as a presumption of what the parties would intend, but subject to contrary intention. It was decided that this would be too great an intrusion, and that it is necessary to leave the question to the interpretation of the document concerned.

21 For that reason, **section 21.4** does not attempt to do anything other than to state that the extent of the secured obligations is a matter of interpretation.

22 Secured obligations normally comprise obligations to pay or repay money. If the secured obligation is an obligation to perform a non-monetary obligation, **section 21.5** provides that the amount secured is the amount of damages payable for breach of the primary obligation.

[41] [2005] 2 CLC 95.

## PART 5: PARTIES

### 22 The chargor

**22.1 A charge can be created by any person, subject to the limitations contained in this part and to any limitations contained in other legislation.**

**22.2 An individual cannot create a charge over an interest in goods in England and Wales unless:**

**(a) the goods are owned by the chargor at the time the charge is created; or**

**(b) the chargor is carrying on business as a sole trader and the goods concerned are assets of the business concerned; or**

**(c) the chargor is a member of a partnership or a limited partnership and the goods concerned are assets of the partnership concerned.**

**Commentary**

1 Who can create a charge has provoked a lot of discussion.

2 There is no disagreement on what the starting point should be – that a charge should be capable of being created by any person, whether a natural or a legal person. **Section 22** provides for this.

3 The problem comes when deciding whether there should be any exceptions from this principle and, if so, what they should be.

4 There are two distinct questions at issue, although they are often linked in practice. The first is whether there should be any limits on the ability of natural persons to create security, particularly if they are consumers. The second is whether all security created by all persons (whether legal or natural) should be registrable at a debtor registry.

5 These issues are conceptually distinct. But they have been linked historically for over a century because of the distinction which legislation has drawn between security created by companies (and now LLPs) and security created by individuals. In essence, companies can create security over all their present and future assets and, if they do so, the security must generally be registered at Companies House in order to ensure its validity. In theory, individuals can create security over all their present and future assets but, in practice, the effect of the bills of sale legislation is that non-possessory

security over goods is extremely difficult for individuals to create because of the formidable registration requirements. The effect is that individuals can create security over land and over most types of intangible (the main exception being a general assignment of book debts) but not, generally, over goods unless they create a pledge.

6 It has long been considered that the bills of sale legislation is unsatisfactory and it is intended that the legislation which implements the Code would repeal the bills of sale legislation.

7 **Section 22.2** prevents individuals from creating security over goods in England and Wales unless the security falls within one of the exceptions, contained in the section.

8 There are exceptions for natural persons who are running a business, either in partnership (**section 22.2(c)**) or as a sole trader (**section 22.2(b)**).

9 The other exception (contained in **section 22.2(a)**) is that an individual should be able to create a charge of goods if they are owned by him or her at the time the charge is created. This would prevent chargors from being able to create security over future goods.

## 23 The chargee

**23.1 A charge can be created in favour of:**

**(a) the creditor or creditors to whom the obligation secured by the charge is owed (the creditors); or**

**(b) another person (such as a trustee) for the benefit of the creditors.**

**23.2 A person can hold the benefit of a charge on behalf of any number of present, future or contingent creditors.**

**23.3 The rights, powers, liberties and immunities of that person and the creditors between themselves can be established and varied by agreement between them.**

**Commentary**

1 It is commonplace for a debtor to create security over an asset in favour of its creditor. In this type of case, the chargor creates security in favour of the chargee to secure a secured obligation owing by the chargor to the chargee. This common form of charge is the subject of **section 23.1(a)**.

2 But it is also very common, particularly in syndicated loans and capital markets transactions, for the security to be granted in favour of someone (such as a security trustee) for the benefit of the creditors from time to time under a particular transaction. This is the subject of **section 23.1(b)**.

3 The use of security trustees to hold the security on behalf of a group of creditors has a number of advantages. Where there are a number of creditors involved, granting the security to all of them is administratively inconvenient and, from the point of view of the chargor, undesirable. Even more importantly, syndicated loans are designed to be traded, so that the identity of the syndicate will change from time to time. In syndicated loans, the trading is normally effected by novation, (rather than assignment); and, if the security was granted to all of the lenders, new security would need to be granted in favour of each new lender when it joined the syndicate.

4 The advantage of the security trust structure is that the security is created at the outset of the transaction in favour of a security trustee on behalf of a group of lenders, the identity of whom can change from time to time. A change to the underlying lenders does not require any change to the security. The security continues to be granted to the same person (the security trustee) and it continues to secure what it has always

secured (the obligations of the borrower to the lenders from time to time under the facility).

5 A security trustee can hold the benefit of a charge for the benefit of any number of present or future or contingent creditors (**section 23.2**).

6 The touchstone of the Code is the ability of the parties, so far as possible, to agree things between themselves. **Section 23.3** applies this principle to the rights of the creditors between themselves.

## PART 6: TERMS

### 24 The terms

**24.1 Subject to the provisions of this Code and of any other relevant laws and regulations (such as those concerning consumers), the terms of the charge can be agreed between the parties from time to time.**

**24.2 In the absence of agreement, the chargor may not do anything which materially prejudices the existence and priority of the charge, but may otherwise deal with the charged asset in any way until the charge is enforced.**

**24.3 In the absence of agreement, the chargee has no power to deal with the charged asset until the charge is enforced.**

**24.4 The doctrine of clogs on the equity of redemption is abolished.**

**Commentary**

1 One of the purposes of the Code is to give the parties as much freedom as possible to determine the terms of their arrangement. They cannot alter the basic principles of property law (for instance the requirement for identification of the charged assets and the secured obligations), but the Code expressly acknowledges their freedom under the general law to agree the terms of the charge subject to the provisions of the Code and of any other relevant laws and regulations (for instance those dealing with consumers).

2 Section 24 contains minimal default powers. It is expected that appropriate powers will be contained in the charge document. Under **section 24.2**, the default position is that the chargor can deal with the charged asset until enforcement. Any dealing will be subject to the charge unless it is overridden by the priority rules in **part 8**.

3 It is a fundamental principle of the existing law of security that the chargor retains a proprietary interest in the charged asset and that, once the secured obligations have been discharged, the charge terminates and the chargee must take any necessary action to transfer the charged assets back to the chargor. This is preserved in the Code.

4 In a series of cases in the House of Lords at the end of the nineteenth century and the beginning of the twentieth, it was decided that “any provisions inserted to prevent redemption on payment or performance of the debt or obligation for which the security

was given is what is meant by a clog or fetter on the equity of redemption and is therefore void".[42]

5 The effect of this rule is that an undertaking by the chargor in favour of the chargee which extends beyond the period of the charge[43] and an option for the chargee to purchase the charged assets[44], are both void.

6 This extension of the principle concerning equities of redemption has been criticised[45], and seems unnecessary in a commercial transaction. Any necessary protection for consumers is already contained in the consumer legislation.

7 This doctrine is abolished in **section 24.4**.

[42] *Santley v Wilde* [1899] 2 Ch 474 at 474-475. And see *Bradley v Carritt* [1903] AC 253 and *Kreglinger v New Patagonia Meat and Cold Storage Co* [1914] AC 25.
[43] *Noakes v Rice* [1902] AC 24.
[44] *Lewis v Frank Love* [1961] 1 WLR 261.
[45] See *Bradley v Carritt* [1903] AC 253 at 262 (Lord Shand).

## PART 7: REGISTRATION

### 25 Registration of certain businesses

**25.1** **In this Code, the registrar is the Registrar of Companies.**

**25.2** **The following types of business may register at Companies House for the purposes of the Code:**

**(a)** **a company or corporation incorporated by statute or created by Royal charter in any part of the United Kingdom;**

**(b)** **a partnership or limited partnership which is created under the law of any part of the United Kingdom;**

**(c)** **an individual who is carrying on business as a sole trader wholly or partly in the United Kingdom.**

**25.3** **Businesses of this type are described in the Code as registrable businesses.**

**25.4** **The process of the registration of a registrable business will be determined by the registrar, and may be amended from time to time.**

**25.5** **Once the process of registration of a registrable business has been completed, the registrar will issue that registrable business with a registered number.**

**25.6** **A registrable business which has been registered at Companies House is described in the Code as a registered business.**

**25.7** **The only purpose of registration under this section is to enable the registration of charges by registered businesses. It has no other significance.**

### 26 UK Businesses

**26.1** **A UK business is:**

**(a)** **a UK-registered company within the meaning of section 1158 of the Companies Act 2006;**

**(b)** **a limited liability partnership registered in any part of the United Kingdom;**

**(c)** **a registered business.**

**Commentary**

1 The registration requirements of part 7 apply to "UK businesses". The expression "UK business" is defined in **section 26.1**. It extends more broadly than the existing requirement for registration under the Companies Act 2006, and the reason for this extension needs to be explained.

2 The reason why charges are registrable in a debtor registry (and, if not registered, are ineffective against third parties) is because registration is a counterbalance to the absence of any formalities for the creation of charges. The great advantage of the charge is the simplicity with which it can be created and the fact that its existence and scope generally depends on the objective intention of the chargor. But this very simplicity carries with it a concern that security can be created between a chargor and a chargee without anyone else becoming aware of it; and that this could prejudice third parties dealing with the chargor. The registration system provides the necessary transparency for the charge. So long as the registration system is cheap, easy to use and certain in its effect, its combination with the ease of creation of security produces a system which works well in practice.

3 The question is therefore how broad the registration system should be? Should it cover all charges created by anyone, or only particular types of charge created by particular types of chargor?

4 The proposition that the registration requirement should apply to all charges created by everyone is very appealing. But it proceeds on the assumption that registration provides the same benefits to all types of charges created by all types of person. And the view which has been adopted when drafting the Code is that there is a demonstrable need for registration in the commercial context, but less clarity about the real benefits which would be obtained if it were extended to consumers.

5 The Code has also been drafted against the backdrop of the current law, which provides an efficient and useful system of registration for companies, but a very inefficient system for individuals which no-one wants to retain. If we were starting from scratch with a registration system, there would be something to be said for applying it to all chargors. But the approach taken in the Code is that we already have a registration system for companies which works well in practice; and therefore that the better approach is not to require the establishment of a wholly new register but, rather, to adapt the registration system which is already available at Companies House.

6 The approach when drafting **section 26.1** has therefore been to retain the current system of registration which applies to charges created by companies and LLPs and to extend that to other business entities and to partnerships and sole traders who register under **section 25**.

7 This would seem to be a manageable extension to the current registration system. But to extend it to all consumers who create security would be greatly to extend its scope without any obvious measurable commensurate benefit. The genius of English law has always been its preference for practicality over absolute logic, and this is the approach which has been adopted when drafting the registration provisions of the Code.

8 **Section 26.1** therefore defines a UK business to include those classes of entity whose charges already require registration (UK-registered companies) and LLPs). It then extends the requirement to statutory companies, chartered companies, partnerships and sole traders who become registered businesses under **section 25**.

9 The intention is that Companies House would provide a registered number to every UK registered business and would then register charges created by it. The other requirements of the companies legislation would not apply to non-companies.

10 As with the current legislation, the registration requirement applies to UK chargors. Registration requirements for foreign chargors should depend on the law of the place they are incorporated.

11 The result is that charges created by consumers are not registrable at a debtor registry (though they might still be registrable at an asset registry - **see part 8**). We have taken the view that the costs of extending the debtor registration system to consumers are likely to outweigh its benefits.

## 27 Registrable charges

**27.1 Every charge created by a UK business is a registrable charge unless it is an exempt charge.**

**27.2 A charge is an exempt charge if it is:**

**(a) a possessory charge; or**

**(b) a financial collateral charge; or**

**(c) a rent deposit charge; or**

**(d) a Lloyd's charge; or**

**(e) a central bank charge; or**

**(f) a charge which is exempt from registration under this Code as a result of other legislation.**

**[*It may be helpful to add another exception to cover electronic bills of lading*]**

**27.3 A charge created by a registrable business is only a registrable charge if it is created after that registrable business has become a registered business.**

**27.4 A charge is not created by a UK business if:**

**(a) the charge arises by operation of law; or**

**(b) the UK business acquires an asset which is already subject to the charge; or**

**(c) the UK business is the owner of property and, in connection with a dealing with that property, it retains an interest in the property to secure the payment of a secured obligation.**

**Commentary**

1 **Section 27** describes which charges created by UK businesses are registrable charges. The starting point is that all charges created by a UK business are registrable. Those charges created by UK businesses which are not registrable are described as exempt charges in the Code.

2 Exempt charges are broadly the same as security interests which are not registrable under the Companies Act 2006.

3 Under the existing law, mortgages and charges are registrable but pledges are not. **Section 27.2(a)** therefore exempts from registration possessory charges, which are defined in **section 28**.

4 In practice, the main type of mortgage or charge which is not registrable under the current law is one which is exempted under the Financial Collateral Arrangements (No. 2) Regulations 2003, which implements the Financial Collateral Directive. A charge of this kind is referred to in the Code as a "financial collateral charge". It is exempted by **section 27.2(b)** and it is defined in **section 29**.

5 Three other types of charge are exempt from registration under the existing law. They are described as a "rent deposit charge", a "Lloyd's charge" and a "central bank charge" in the Code and are exempted from registration under the Code by **section 27.2(c), (d) and (e)**. They are defined in **section 30**.

6 **Section 27.2(f)** exempts from registration a charge which is exempted by other legislation. There is none at present which is not already exempted by the Code.

7 **Section 27.4** is not strictly necessary. It describes certain types of charge which are not "created" by a UK business, and are therefore not registrable under **section 27**. This would be the case anyway, but the purpose of the section is to confirm that transactions of the kind described do not require registration.

8 Consideration could be given to whether it is desirable to deal specifically with rentcharges, for instance by excluding them from the requirement for registration. This is an issue which has come up in the past.

9 We are also considering whether electronic bills of lading used in short-term finance should be exempt from registration.

## 28 Possessory charge

**28.1** **A charge is a possessory charge to the extent that the chargee has possession of the charged asset at the time the issue is to be determined.**

**28.2** **A person has possession of charged assets if:**

**(a)** **they are goods, and it has physical possession of them; or**

**(b)** **they are goods, and it has possession of them by attornment; or**

**(c)** **they are goods or intangibles, and it has documentary possession of them.**

**28.3** **A person (A) has possession of goods by attornment if:**

**(a)** **someone other than the chargor or the chargee (B) has physical possession of them; and**

**(b)** **with the consent of the chargor, B has acknowledged to A that B holds them on behalf of A.**

**The acknowledgement can be in writing, but does not have to be.**

**28.4** **A person has documentary possession of goods or intangibles if:**

**(a)** **it has physical possession of a document of title to them (for instance, a bill of lading, a bearer security or a negotiable instrument); and**

**(b)** **that document is either made out to bearer or made in favour of the person concerned (whether initially or by endorsement).**

**28.5** **A person who has possession of a charged asset does not cease to have a possessory charge only because:**

**(a)** **the asset is taken from it without its consent; or**

**(b)** **the asset is sub-charged by that person to someone other than the chargor with the consent of the chargor; or**

**(c)** **the asset is delivered to the chargor for the purpose of sale and on the basis that the net proceeds of sale are held on trust for the chargee.**

**Commentary**

1 Under the existing law, pledges are not registrable at Companies House. The purpose of **section 28** is broadly to replicate the current law but to clarify some existing uncertainties.

2 A pledge is a possessory security interest. Under the Code, it will be replaced by a charge which, if a "possessory charge" will not be registrable.

3 **Section 28.1** defines a possessory charge by reference to the chargee having possession of the charged assets. This has to be the case at the time the issue is to be determined. The reason is that it is not sufficient for the pledgee to have possession of the assets concerned at the time the pledge is created. The pledge has to continue, so that the pledgee has possession at the time the question arises.

4 **Section 28.2** sets out three circumstances in which a person has possession of charged assets.

5 The first case (**section 28.2(a)**) is where the person concerned has physical possession of goods. This is the straightforward example of a pledge and, for that reason, is rarely seen in commercial practice. It would include a case where the chargee is the sole controller of an area where the goods are situated[46].

6 The second case (**section 28.2(b)**) is where the person concerned has possession of goods by attornment. Attornment is described in **section 28.3**. It follows the common law concept of attornment described by Lord Wright in *Official Assignee of Madras v Mercantile Bank of India*[47].

7 The third type of case (section 28.2(c)) is where the person concerned has documentary possession of goods or intangibles. **Section 28.4** explains when a person has documentary possession of goods or intangibles. This is, again, intended to follow the common law approach. An important point to note about the documentary possession is that it applies not just to goods but also to intangibles which are the subject of a document of title. As a result, a possessory charge can be created by the chargee taking possession of a document of title to goods or intangibles which is either made out to bearer or is made in favour of the person concerned, whether initially or by endorsement.

[46] In the past, the courts have held that the creditor was in possession of the asset concerned on rather flimsy evidence. Cases include *Hilton v Tucker* (1888) LR 39 Ch D 669 and *Wrightson v McArthur and Hutchisons* [1921] 2 KB 807. It is envisaged that under the Code the Courts will be less willing to extend the meaning of "possession" in this way.
[47] [1935] AC 53 at 58-59

8 **Section 28.5** establishes that a person who has possession of charged assets does not lose that possession only because certain things happen.

9 The first type of case (**section 28.5(a)**) is where the assets are taken from that person without its consent. This reflects the common law position.[48]

10 The second type of case (**section 28.5(b)**) is where the assets are sub-charged by the person who is in possession to someone other than the chargor with the consent of the chargor. This reflects the common law position established in *Donald v Suckling*[49].

11 The third type of case (**section 28.5(c)**) is the most important in practice. This is where assets are delivered to the chargor for the purpose of sale and on the basis that the net proceeds of sale are held on trust for the chargee. This follows the position under the existing law[50]. **Section 28.5(c)** only allows this to be done where the assets are delivered for the purpose of sale and on the basis that the net proceeds of sale are held on trust for the chargee. That may be a narrower formulation than under the existing law. There are also certain cases under the existing law where a pledge was held to be created even though the goods were in the possession of the pledgor.[51] It is of the essence of a possessory charge that the asset concerned should not be in the possession of the chargor. Those cases would be decided differently under the Code.

12 **Section 28.5(c)** has been limited to cases where the purpose of re-delivery to the chargor is to sell the assets. That is thought to be a reasonable way of distinguishing between charges which require registration, and those which do not.

[48] *Bassano v Toft* [2014] CTLC 117.
[49] (1865–66) LR 1 QB 585.
[50] See, for instance, *North Western Bank v John Poynter, Son & MacDonalds* [1895] AC 56 and *Re David Allester* [1922] 2 Ch 211.
[51] See, for instance, *Martin v Reid* (1862) 11 CBNS 730; and *Reeves v Capper* (1838) 5 Bing NC 136

## 29 Financial collateral charge

**29.1 A charge is a financial collateral charge if it is created or arises under a security financial collateral arrangement.**

**29.2 Security financial collateral arrangement has the meaning given to it in The Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226) as amended from time to time.**

**Commentary**

1 The most far-reaching of the exempt charges is the financial collateral charge.

2 The Code does not attempt to improve upon the regulations which apply to financial collateral[52].

3 The scope of the regulations is unclear, particularly because of the requirement that security financial collateral is in the possession or under the control of the creditor or someone acting on its behalf. What is really needed is a wholesale review of financial collateral, and the Treasury now has the power to do this by secondary legislation.

4 There are difficult political and commercial decisions which would have to be taken before the financial collateral rules could be reformed. We will monitor developments.

[52] The Financial Collateral Arrangement (No.2) Regulations 2003, SI 2003 / 3226, as amended.

## 30 Rent deposit, Lloyds and central bank charges

**30.1 A rent deposit charge is a charge in favour of a landlord on a cash deposit given as security in connection with the lease of land.**

**30.2 A Lloyd's charge is a charge created by a member of Lloyd's (within the meaning of the Lloyd's Act 1982) to secure its obligations in connection with its underwriting business at Lloyd's.**

**30.3 A central bank charge is a charge which falls within section 252 of the Banking Act 2009, as amended from time to time.**

**Commentary**

1 These provisions are based on the other exceptions to the registration requirement contained in the Companies Act 2006. They replicate the current law, although it is worth discussing whether they could be more clearly expressed (for instance by making specific reference to tenancy agreements in **section 30.1**).

## 31 The effect of non-registration

**31.1 Until it has been registered, a registrable charge is of no effect against any person other than the parties.**

**31.2 In particular, until it has been registered, a registrable charge is of no effect against:**

**(a) an insolvency officer of the chargor (see part 10); or**

**(b) any other person who obtains an interest of any kind in the charged asset.**

**31.3 This is the case even if the person concerned was aware of the existence of the charge.**

**Commentary**

1 **Section 31** is the mirror image of **section 3.3**. That section provides that, once a registrable charge has been created and registered under **part 7**, it is effective against third parties. **Section 31** deals with the converse situation. It provides that, until a registrable charge has been registered, it is of no effect against any person other than the parties.

2 If the charge which has been created is a registrable charge, it will have contractual effect between the parties but will have no proprietary effect against third parties until it has been registered. **Section 31** simplifies the approach of the current law. If the charge is a registrable charge, it is of no effect against third parties until it has been registered.

## 32 Registration procedure

**32.1** **Where a UK business has created a charge, the chargee, the chargor or a person acting on behalf of either of them (a registrant) may deliver to the registrar:**

**(a)** **a certified copy of the instrument creating the charge (or, if there is no instrument, evidence of the creation of the charge); and**

**(b)** **a document specifying:**

**(i)** **the registered name and number of the chargor;**

**(ii)** **the name of the chargee;**

**(iii)** **the date of creation of the charge; and**

**(iv)** **whether the charge is expressed to cover all, or substantially all, of the present and future assets of the chargor.**

**32.2** **This can be done even if the charge concerned is an exempt charge.**

**32.3** **The certified copy of the charge instrument can be redacted to omit:**

**(a)** **personal information relating to an individual (other than the name of the individual);**

**(b)** **the number or other identifier of a bank or securities account;**

**(c)** **a signature.**

**32.4** **On receipt of those documents, the registrar will register them and will deliver to the registrant an electronic confirmation that the registrar has received those documents and the time of receipt.**

***[It is intended that the chargee will receive confirmation of registration automatically as soon as the documents are delivered.]***

**32.5** **The charge becomes registered on receipt by the registrant of that electronic confirmation.**

**32.6** **That confirmation is conclusive evidence that the charge has been duly registered and of the time of registration.**

**Commentary**

3 The procedure for registration of charges is contained in **section 32**. It broadly follows the approach in the regulations made under the Companies Act 2006, with certain amendments which are intended to simplify and streamline the process.

4 A charge may be registered by the chargee, the chargor or a person acting on behalf of either of them. In the Code, that person is known as the registrant (see **section 32.1**).

5 The registrant needs to deliver two documents to the registrar of companies.

6 The first is a certified copy of the instrument creating the charge (or, if there is no instrument, evidence of the creation of the charge).

7 The second is a document specifying certain particulars. The details are set out in **section 32.1(b)**. The particulars are a simplified form of those which are currently required by the Companies Act 2006. What is required under the Code is to specify three simple factual matters (the registered name and number of the chargor, the name of the chargee and the date of creation of the charge). In addition, the registrant has to state whether the charge is expressed to cover all, or substantially all of the present and future assets of the chargor. The purpose of this last requirement is so that it should be clear from the file whether the chargee can appoint an administrator or administrative receiver of the chargor.[53]

8 The thinking behind the Code is that the important thing for a person searching the register is to be able to read the charge instrument itself (assuming it is created by a document). That would be delivered under **section 32.1(a)**. It should therefore only be really key information which has to be provided under **section 32.1(b)**.

9 **Section 32.2** allows exempt charges to be registered. There may be doubt about whether a charge is exempt and this section gives the parties the flexibility to register an exempt charge if they wish.

10 There are provisions under the Companies Act 2006 for the redaction of certain information. Those provisions are followed in **section 32.3**.

11 When the registrar receives the documents, it is intended that an email confirmation will be sent to confirm the receipt of those documents at a particular time. As far as possible, it is intended that this should happen automatically at any time or day or

[53] Although, whether the chargee can do so depends on whether the charge satisfies the relevant criteria, not on whether the registrant says that they do.

night. It is crucial that the registrant receives confirmation of registration as soon as the documents are received by Companies House. See **sections 32.4 and 32.5**.

12 It has always been the case, since registration at Companies House was first required in 1900, that the *quid pro quo* for the invalidation of an unregistered charge should be that the chargee will know, at the time the transaction is entered into, that the charge has been properly registered, and is therefore valid. **Section 32.6** provides that the confirmation email from the registrar is conclusive evidence that the charge has been duly registered and the time of registration.

## 33 Priority notices

**33.1 The registrant may deliver to the registrar a notice of an intention to create a charge in advance of the charge being created. That notice is described as a priority notice in this Code. The priority notice must state the registered name and number of the chargor and the name of the chargee.**

**33.2 On receipt of a priority notice, the registrar will register it and will deliver to the registrant an electronic confirmation of the time of registration of the priority notice.**

**33.3 If a charge is created by that chargor in favour of that chargee and is registered within 30 days after the registration of the priority notice, the charge will be deemed to have been registered at the time that the priority notice was registered for the purpose of the priority rules contained in part 8.**

**Commentary**

1 The purpose of section 33 is to enable the parties to set up an arrangement in advance which will enable them to be clear that the charge, once it has been created and registered, will take priority over earlier charges. This sections draws on the process for priority searches which exists in relation to registered land.

## 34 Amendments and priority agreements

**34.1 If:**

**(a) an amendment is made to the terms of a registrable charge; and**

**(b) the amendment extends the scope of the charged asset or the secured obligation,**

**then the amendment must be registered in accordance with this part 7 because, to the extent that it does so, it creates a new charge.**

**34.2 If any other amendment is made to the terms of a registrable charge, the registrant may deliver a certified copy of the amendment to the registrar, who will register it. Whether or not this is done does not affect the validity of the charge or the conclusive nature of the existing certificate of registration.**

**34.3 If a priority agreement is entered into in relation to one or more registrable charges (see part 8), the registrant may deliver to the registrar either a certified copy of the agreement or a notice that a priority agreement has been entered into, in which event the registrar will register it with each registrable charge to which it relates. Whether or not this is done does not affect the validity or effectiveness of the priority agreement.**

**Commentary**

1 If a charge is amended to increase the scope of the charged assets or of the secured obligations, then a new charge will be created to the extent of the increase. That requires to be registered in the normal way under **section 32** (see **section 34.1**). This would only apply where there was an extension of the charged assets or secured obligations. It would not apply, for instance, where a particular class of assets was charged and a subsequent document simply identified more specifically some of the assets concerned.

2 No other amendment to a charge requires registration. The registrant may (but does not have to) notify the registrar of an amendment and, if it does, the registrar will register it. Whether or not this is done does not affect the validity of the charge or the conclusive nature of the certificate of registration. See **section 34.2**.

3 Section 34.5 permits the registration of priority agreements. Because their terms may be confidential, it enables either the terms or just the existence of the agreement to be registered.

## 35 Releases of charges

**35.1 The registrant may send to the registrar a notice that:**

**(a) the charge has been released; or**

**(b) specified assets have been released from the charge.**

**35.2 If the registrar has received confirmation from the chargee (or from a person acting on behalf of the chargee) that the notice is correct, the registrar will, as soon as reasonably practicable, register it and confirm that he has done so to the registrant.**

**[*It is sometimes impossible to get the confirmation of a chargee even where the charge has clearly been extinguished. It should be possible to tidy-up the register without confirmation from the chargee if there are appropriate safeguards.*]**

**Commentary**

1 **Section 35** contains the mechanics for the release of charges. The charge may either be released completely (for instance, on payment in full of all of the secured obligations), or specified assets may be released from the charge (for instance, because they are to be sold) but it otherwise remains in effect (**section 35.1**).

2 The existing rules enable the registrar to register a notice of this kind if it has been received from the chargor. **Section 35.2** alters this approach. The registrar will only register the notice once he has received confirmation from the chargee (or from the person acting on behalf of the chargee) that the notice is correct.

3 It is important that the chargor should not be able to amend the registration without the consent of the chargee, but this does mean that it may not be easy for chargors to tidy up their registers when charges have actually been released, but the chargee can no longer be tracked down. Consideration should be given to a mechanism which would enable the chargor to deal with this in some way – perhaps through the court.

# PART 8: PRIORITIES

## General commentary

1 The priority rules under the existing law are extremely complicated. Where there is a priority dispute between two people who have proprietary interests in a debtor's assets, the result may depend on the dates on which the respective interests were created[54], or on the dates on which they were registered in an asset registry[55], or on the date on which a third party received notice of the interests concerned[56]. The date of registration at Companies House can have a bearing[57], as can the conduct of the parties[58]. The outcome can also depend on the nature of the asset (whether it is land, goods or intangibles[59]) or on the nature of the claimant's interest in the asset (whether it is legal or equitable[60] and, if equitable, whether it is fixed or floating[61]). There are many possible permutations.

2 But, in spite of that, there have been very few priority disputes between secured creditors or between a secured creditor and a person claiming an outright interest in the last century. There are two main reasons for this. The first is that priority disputes generally arise where a person has fraudulently created two interests over the same asset and, thankfully, that is not an everyday occurrence. And the second reason is that the requirement for the registration of most corporate charges at Companies House has meant that the chance of a company being able to perpetrate such a fraud is much less likely.

3 There is nevertheless much sense in attempting to simplify the priority rules, and this is what the Code tries to do. But, because the Code only deals with security interests - not with outright transactions - it is not able completely to rewrite the priority rules. It cannot, for instance, entirely abolish the distinction between legal and equitable interests for the purpose of priorities because they may continue to be relevant where an outright interest is involved to which the Code does not apply. But what the Code can do is to simplify the priority rules between chargees.

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[54] At common law, this is the result of the maxim *nemo dat quod non habet*. In equity, see *Phillips v Phillips* (1861) 4 De GF & J 208 at 215 (Lord Westbury LC),

[55] This is the rule for land, ships, aircraft and certain types of intellectual property. For example, see Land Registration Act 2002, ss 28-30 and 48, and Sch 3,

[56] In the case of contract rights and equitable interests, under the rule in *Dearle v Hall* (1828) 3 Russ 1.

[57] It can provide constructive notice and therefore override the *bona fide* purchaser rule and the rule in *Dearle v Hall* and it can also affect priorities between fixed and floating charges.

[58] If, as a result, the equities are not equal. See *Rice v Rice* (1853) 2 Drew 73.

[59] Which priority rules apply often depends on the type of asset charged.

[60] The *bona fide* purchaser rule can give a legal mortgagee or pledgee of goods priority over an earlier equitable charge. See *Joseph Lyons* (1884) 15 QBD 280. And, in some cases, it is still possible to tack *tabula in naufragio*. See *Macmillan v Bishopsgate Investment Trust* (No 3) [1995] 1 WLR 978 at 999-1005.

[61] The rules applied to the priority of a floating charge are different from those for a fixed charge. See *Wheatley v Silkstone and Haigh Moor Coal Co* (1885) 29 ChD 715.

4 Priority issues are not confined to disputes between chargees. They can also arise between a chargee and a purchaser. The Code therefore also deals with the circumstances in which a purchaser can (and cannot) take priority over an existing charge.[62]

[62] In the PPSA jurisdictions, this is described as "taking free".

## 36 The scope of this part

**36.1 This part deals with the following priority issues:**

**(a) priorities between charges;**

**(b) priorities between a charge and a subsequent outright disposition of assets subject to the charge.**

**36.2 These priority issues are determined in accordance with this Code, which overrides any priority rule which would otherwise have applied under the general law.**

**36.3 If a registrable charge has not been registered in accordance with part 7, it is of no effect against third parties. Accordingly, references to charges in this part are to:**

**(a) registrable charges which have been registered under part 7; and**

**(b) charges other than registrable charges.**

**Commentary**

1 **Section 36.1** explains the scope of **part 8**.

2 Where the Code applies, priority issues are determined in accordance with the Code, and not with the general law (**section 36.2**). But all other priority issues are determined under the general law (**section 44**).

3 Under **section 31**, a registrable charge is of no effect against third parties until it has been registered under **part 7**. It follows that there can be no priority dispute with a chargee who has an unregistered registrable charge. **Section 36.3** makes this point.

## 37 Agreement

**37.1** **The provisions contained in this part can be varied by agreement between the parties concerned. That agreement can be made and varied at any time.**

**37.2** **If the charged interest or the charged asset is registrable in an asset registry, this is subject to the rules of the relevant asset registry.**

## 38 Priorities between charges

**38.1** **If more than one charge has been created over the same charged asset, the priority of the charges between themselves is determined by the following Rules.**

**38.2** **Rule 1: If a charged asset is registrable in an asset registry, priority between charges over the asset concerned is determined by the rules of the relevant asset registry, to the extent that those rules resolve the priority issue concerned.**

**38.3** **Rule 2: [If a charged asset is financial collateral and a chargee obtains control over the asset concerned, that chargee will take priority over any other chargees of that asset.]**

**38.4** **Rule 3: In any other case, the priority of charges between themselves depends on the times they are created or (in the case of a registrable charge) registered under part 7. The first to be created or (in the case of a registrable charge) registered takes priority.**

**38.5** **When applying these rules to a charge, it makes no difference that the chargee has authorised the chargor to dispose of charged assets free of the charge.**

**38.6** **The asset registries are:**

**(a)** **Her Majesty's Land Registry;**

**(b)** **the register of British ships;**

**(c)** **the register of aircraft mortgages maintained by the Civil Aviation Authority;**

**(d)** **the registers of patents and of trade marks maintained by the Comptroller-General of Patents, Designs and Trade Marks.**

**Commentary**

1 Priority rules are normally seen as rules of law which can, sometimes, be varied by agreement between the parties. The approach of the Code is different. In the Code, the very first rule establishes party autonomy. If the parties (ie the chargor and the chargees concerned) have agreed the priority of their charges, then that is the end of the matter (subject to the rules of the relevant asset registry if the charged asset is registrable in an asset registry). Except to the extent that any asset registry requires particular formalities, the agreement can be made at any time and without formality. That is the effect of **section 37**.

2 The starting point is therefore to establish what the parties have agreed. It is only if the relevant parties have not reached an agreement (or, if the asset is registrable in an asset registry, an agreement which complies with its rules), that we need to look any further.

3 Rule 1 in **section 38.2** applies if the asset is registrable in an asset registry. Here, the Code follows the rules of the asset registry. The asset registries are described in **section 38.6**. They extend to land, ships, aircraft, patents and trademarks. The purpose of those registers is to establish with (a fair degree of) certainty the ownership of registered assets and the priority of encumbrances over them. In many cases, priority is established by reference to the date of registration, even if the first to be registered was aware if an earlier encumbrance which was registered later. The Code does not purport to override the priority rules set out in the asset registries.

4 **Section 38.6** does not refer to the International Registry set up under the Cape Town Convention. That is because international interests fall outside the scope of the Code (see **section 8.2(a)**).

5 So, where there is a question as to the priority of two charges over registered land, it is the Land Registration Act and Rules which will determine that matter. Generally speaking, the asset registries determine the priority of charges by reference to the date of registration in the asset registry concerned.

6 Rule 2 is contained in **section 38.3**. It is concerned with financial collateral. The proposal here is that, if a chargee obtains control of the financial collateral, then that chargee will take priority over any other chargee of the same collateral, even if that other charge was created or registered earlier. If this Rule is adopted, it will require both a clear definition of what is meant by financial collateral (that contained in the

current Regulations being inadequate) and also a definition of what is meant by control (there being at present no clear definition of it). We would welcome views on these issues.

7 The drafting assumes that only one person can have control. If that was not the case, it would need to be amended.

8 Rule 3 is contained in **section 38.4**. If Rules 1 and 2 do not apply, the priority of charges between themselves depends on the times they are created or, in the case of a registrable charge, registered. If there is a priority notice, for the purpose of priorities the charge is deemed to have been registered at the time the priority notice was registered. For instance, between two registrable charges, the first to be registered will take priority. If one charge is a registrable charge and one is not, the non-registrable charge will take priority if it is created before the registrable charge is registered.

9 Under the existing law, the priority rules for floating charges are different from those for fixed charges.[63] The Code does not distinguish between fixed and floating charges and it does not treat the priority of a floating charge any differently from the priority of a fixed charge. This is provided for in **section 38.5**.

[63] See, for instance, *Re Castell & Brown* [1898] 1 Ch 315 and *The English and Scottish Mercantile Investment Company v Brunton* [1892] 2 QB 700.

## 39 Tacking further advances

**39.1 If a charge has priority over another proprietary interest (whether outright or by way of security), that priority extends to the entire secured obligation secured by the charge, regardless of the time advances were made.**

**39.2 All restrictions on tacking further advances are abolished.**

**Commentary**

1 The extent to which a charge has priority depends on the scope of the charged assets and the identity of the secured obligation. If A and B both have a charge over a particular asset, and A's charge takes priority over B's charge, it follows that A's charge ranks ahead of B's charge to the extent of the obligations which are secured under A's charge. A has priority over B to the extent of the secured obligations, but not further. So if A has lent 100 to the chargor, but only 60 is secured, then A will rank in priority to B for 60, but not for the remaining 40.

2 That gives effect to the basic principle behind the Code that a charge is a matter of intention, and that the scope of the charged assets and of the secured obligations depend on the objective intention of the chargor.

3 Under the existing law, the rules concerning tacking further advances restrict the priority of A over B. The rules are different depending on whether the charged asset is registered land, unregistered land or other assets. But, in all cases, the rules restrict A's ability to apply the charged assets in discharge of the secured obligations.

4 This was not always the case. In the eighteenth century, the law recognised that, if A had priority over B, then that priority extended to the totality of the secured obligations[64] but, in *Hopkinson v Rolt* in 1861[65], the House of Lords decided to limit A's priority. Once A had received notice of B's charge, then it was no longer able to take priority for any further advances.

5 The particular rules concerned depend on the nature of the asset – whether they are registered land[66], unregistered land[67] or other assets[68]. But, whatever the nature of the asset, the effect of the rules is to prevent A from having the priority for the secured

[64] *Gordon v Graham* (1716) 2 Eq Cas Abr 598.
[65] (1861) 9 HLC 514.
[66] Land Registration Act 2002, s49 and Land Registration Rules 2003 r 107.
[67] Law of Property Act 1925, s 94.
[68] *West v Williams* [1899] 1 Ch 132.

obligations which were agreed between it and the chargor when the charge was executed.

6 The Code abolishes all these restrictions on tacking further advances (**section 39.2**). Under the Code, therefore, the extent of the obligations which are secured in priority to a subsequent charge depends on the interpretation of the terms of the first charge (**section 39.1**).

## 40 Transactions for which no value is given

**40.1 If a person purports to acquire a proprietary interest in a charged asset from a chargor for no consideration (for instance as a gift), that person takes its proprietary interest subject to the charge.**

**40.2 If a person obtains execution of any kind over a charged asset, the execution is subject to the charge.**

**40.3 This section is subject to regulation 35 of the Uncertificated Securities Regulations 2001 (2001/3755) and the rules or specifications contemplated by paragraphs 5(3) to (5) of Schedule 1 to those Regulations.**

**Commentary**

1 **Section 40** is concerned with transactions for no consideration. This includes gifts, but also commercial transactions for which there is no consideration, such as the levying of execution.

2 It is one thing for a person who gives value to take priority over an earlier charge, but a person who has not given value should be in no better position than the chargor. A donee should take subject to any proprietary interests over the asset concerned. And the same to true of an execution creditor[69].

3 This is subject to one particular rule concerning CREST (see **section 40.3**)

[69] See *United Bank of Kuwait v Sahib* [1997] Ch 107 at 119.

## 41 Outright dispositions of assets

**41.1 If a person (the acquirer) purports to acquire an outright proprietary interest in a charged asset from a chargor which is not in insolvency proceedings (see part 10), the acquirer will only obtain its interest in the asset free from the charge if:**

**(a) the chargor had the actual or apparent authority from the chargee to effect the transaction; or**

**(b) in the case of a fixed asset, the following section applies; or**

**(c) in the case of a current asset, the next section but one applies.**

**41.2 A charged asset is a current asset if it is:**

**(a) [financial collateral]; or**

**(b) goods other than ships or aircraft objects which, in the transaction concerned, a reasonable acquirer would expect the chargor to be able to sell free from a charge without the acquirer having to check whether the chargor has the actual or apparent authority from the chargee to effect the transaction.**

**41.3 A charged asset is a fixed asset if it is not a current asset.**

**41.4 An outright proprietary interest is any proprietary interest other than a charge.**

## 42 Outright dispositions of fixed assets

**42.1 If a person (the acquirer) purports to acquire an outright proprietary interest in a fixed asset from a chargor which is not in insolvency proceedings, the acquirer will obtain its interest free from the charge unless, at the time of the purported acquisition:**

**(a) the charge was on the register at Companies House or at an asset registry; or**

**(b) the acquirer actually knew the asset was subject to a charge; or**

**(c) the acquirer had constructive notice that the asset was subject to a charge.**

**42.2 A person will only have constructive notice that an asset is subject to a charge if that person would have discovered the existence of the charge if it had made all those enquiries which it ought reasonably to have made before entering into the transaction concerned. What is reasonable depends on all the circumstances relating to the transaction (for instance, the identity of the parties, the nature of the assets concerned and the size of the transaction).**

## 43 Outright dispositions of current assets

**43.1 If a person (the acquirer) purports to acquire an outright proprietary interest in a current asset from a chargor which is not in insolvency proceedings, the acquirer will obtain its interest free from the charge unless:**

**(a) the acquisition is prohibited in a contract entered into between the chargor and the chargee (a restriction on disposal); and**

**(b) the acquirer actually knew of the restriction on disposal at the time of the purported acquisition.**

**43.2 Nothing in this section absolves the chargor from the consequences of any breach of contract which it commits as a result of breaching a restriction on disposal.**

**43.3 In the absence of fraud (in the sense of dishonesty), the acquirer is not liable to any person for any breach of a restriction on disposal of a current asset by the chargor (whether in tort, in equity or in any other manner).**

**Commentary**

1 **Sections 41 to 43** are concerned with outright dispositions of assets. In what circumstances will a person who buys an asset which is subject to a charge take free from the charge?

2 English law has generally applied the same priority rules to purchasers as it applies to subsequent secured creditors. It does not generally matter whether the person who is trying to take priority over a charge has obtained an outright interest or a security interest. So, for instance, the *bona fide* purchaser rule applies as much to a mortgagee or a pledgee as it does a purchaser[70]. The rule in *Dearle v Hall*[71] applies to all dealings in receivables, whether they are outright or by way of security. And the priority rules of

[70] *Joseph v Lyons* (1884) 15 QBD 280.
[71] (1828) 3 Russ 1.

the asset registries generally distinguish between registered and unregistered interests, not between security interests and outright interests.[72]

3 In practice, the main exception concerns constructive notice. Constructive notice is of little relevance to transactions which are registered at an asset registry[73] but, it does still have an important part to play in security taken over assets which are not the subject of asset registries, which includes most types of goods (except ships and aircraft) and most types of intangible assets (other than intellectual property). The starting point for a priority issue in relation to these types of asset is that the first to be created take priority over a later interest.[74] But there are a large number of exceptions to that basic principle.

4 One exception is the *bona fide* purchaser rule, by which a *bona fide* purchaser of the legal title to an asset for value and without notice of a prior equitable interest will take free of that interest.[75]. There is also the rule in *Dearle v Hall*[76] which establishes that, in relation to receivables, the relevant date for priority is not the date of creation but the date on which notice is given to the person who owes the receivable.

5 In theory, therefore, both rules override the rule that the first interest to be created takes priority. But in practice, the most important point about both of these rules is that neither give priority to a subsequent encumbrancer if that person knew or ought to have known of the existence of the earlier interest at the time the subsequent interest was acquired[77].

6 In both cases, it is not just actual notice which prevents the subsequent encumbrancer from taking priority. Constructive notice is sufficient. The practical importance of this is that most security created by companies is registrable, and the question is therefore whether registration at Companies House constitutes constructive notice.

7 There is little authority on this point but in principle the question is whether the person who acquired the subsequent interest ought to have searched the register. This is a question of fact depending on what a reasonable person ought to have done in similar circumstances[78]. This requires an analysis of the whole transaction – the nature of the

[72] See, for instance, the Land Registration Act 2002, ss 28-30 and 48 and Sch 3.
[73] Although it is relevant to mortgages over patents and patent applications. See Patents Act 1977, s33.
[74] This is the foundation of the principle *nemo dat quod non habet* at common law, and it is also relevant in equity: *Phillips v Phillips* (1861) 4 De GF & J 208 at 215.
[75] *Pilcher v Rawlins* (1872) LR 7 Ch App 259.
[76] (1828) 3 Russ 1.
[77] In relation to the *bona fide* purchaser rule, see, for instance the comments of Lord Browne – Wilkinson in *Barclays Bank v O'Brien* [1994] 1 AC 180 at 195-196 and *Macmillan v Bishopsgate Investment Trust* (No.3) [1995] 1 WLR 978. In relation to the rule in *Dearle v Hall*, see *Spencer v Clarke* (1878) 9 Ch D 137.
[78] *Bailey v Barnes* [1894] 1 Ch 25 at 34-35.

asset, the type of the transactions, the amount involved, the parties concerned. The principle is described in **section 42.2**.

8 A chargee would normally be expected to search the register. The same is true of a factor, even though the factor is acquiring an outright interest in the asset concerned. But a normal purchaser may well be in a different position, particularly if the transaction is for a relatively small consideration.

9 The one area where the existing law does take a different approach between chargees and outright purchasers is therefore in relation to constructive notice.

10 The Code takes this further. It draws a distinction between, on the one hand, priority disputes between chargees and, on the other hand, priorities between chargees and subsequent purchasers.

11 The rules for priority between charges are contained in **section 38**. Priorities between a chargee and a subsequent purchaser are determined by **sections 41 to 43**.

12 **Section 41.1** sets out the circumstances in which a purchaser will take free of an existing charge.

13 It applies where a person purports to acquire an outright proprietary interest in a charged asset by contract. It does not apply where the chargor is in insolvency proceedings. The efficacy of the transaction in such a case would depend on insolvency law.

14 If **section 41.1** does apply, it sets out three circumstances in which the acquirer takes free of the charge. The first (under **section 41.1(a)**) is where the chargor has the actual or apparent authority of the chargee to effect the transaction. This gives effect to the normal rules of agency law. The chargor may have the actual authority from the chargee to sell the asset concerned. This would be the case, under the existing law, in many floating charges. But even if the chargor does not have actual authority, it might have apparent (or as it is sometimes known, ostensible) authority to dispose of the asset. This would be the case if, under the principles of agency law, the chargee has held out the chargor as having the authority concerned. Under the existing law,

apparent authority is important in relation to floating charges[79], and it can also be relevant in other types of case[80].

15 The other two circumstances in which a person will take free of a charge under **section 41.1** depends on whether the asset over which the charge has been created is a current asset or a fixed asset. A fixed asset is defined in **section 41.3**, and a current asset in **section 41.2**.

16 Why has the Code drawn this distinction between fixed and current assets?

17 The starting point is that the powers of the chargor to dispose of the charged assets is something which should be dealt with in the terms of the charge. If the chargee has given the chargor the authority to dispose of the asset free from the charge then, of course, the purchaser will take free from the charge. And what is true of actual authority, must also be true of apparent authority. That is the effect of **section 41.1(a)**.

18 But that cannot be the only circumstance in which a purchaser can take free from the charge. There are likely to be cases where the charge is drafted or agreed in such a way that it restricts the chargor's ability to dispose of assets which it would be expected to have the authority to dispose of. If the chargor disposes of an asset in breach of a restriction, then it is liable for the consequences. But it does not necessarily follow that the purported purchaser should lose the asset. What if the asset is of a kind which the purchaser would expect the chargor to be able to dispose of, and it is not appropriate for the purchaser to carry out an investigation?

19 Under the current law, this issue is dealt with by distinguishing between types of charge. Where the charge is a fixed charge, the purchaser will only take free of the fixed charge if it can rely on one of the priority rules which overrides the first in time rule. But where the charge is a floating charge, the purchaser will obtain the asset concerned free from the floating charge unless it had (actual or constructive) notice of a restriction in the charge.

20 The problem with this approach is that a person dealing with the chargor may not necessarily be able to establish very easily whether the charge is fixed or floating[81]. The one thing which the purchaser does know is the nature of the asset concerned.

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[79] *Re Castell & Brown* [1898] 1 Ch 315 and *The English and Scottish Mercantile Investment Company v Brunton* [1892] 2 QB 700.
[80] See, for instance, *Perry Herrick v. Attwood* (1857) 2 De G & J 21; *Brocklesby v Temperance Permanent Building Society* [1895] AC 173 and *Rimmer v Webster* [1902] 2 Ch 163.
[81] It is notoriously difficult to distinguish between fixed and floating charges in practice.

Rather than drawing a distinction between types of charge, the Code therefore draws a distinction between types of asset.

21 If the asset is of a kind which the seller would normally be expected to dispose of in the ordinary course of its business, then it should be easier for the purchaser to take free than where it is acquiring an asset which would not normally be disposed of in the ordinary course of business.

22 We considered using the accounting distinction between fixed assets and current assets, but decided that this would prove too difficult to apply in practice. The concern is to establish those types of asset which a purchaser would expect to be able to acquire without searching the register. We have taken the view that any purchaser of land would expect to search the register, and that it would also be likely to do if it were acquiring large assets such as ships or aircraft and also intangible assets other than financial collateral. Assets of these kinds are described as fixed assets, and the purchaser will be expected to search the register.

23 Where the asset concerned consists of goods other than ships or aircraft, the priority rule will depend on whether or not the chargor would be expected to be able to dispose of its interests in the goods without the acquirer having to check whether it was charged. If the purchaser would be expected to check, then it would be a fixed asset. If not, then it is a current asset. That test may produce uncertainty in some cases. But issues of this kind do not occur frequently in practice, and it is considered better to base the outcome on the reasonable expectations of the parties.

24 We have also applied the same rule to financial collateral, which still needs to be defined.

25 **Section 42** is concerned with the outright disposal of a fixed asset. Clearly, if the acquirer actually knew the asset was subject to a charge, then it should be subject to it (**section 42.1(a)**). But it will also take subject to the charge if the charge was registered at Companies House or at an asset registry (**section 42.1(b)**) or if the acquirer had constructive notice that the asset was subject to a charge (**section 42.1(c)**). This last provision is necessary to deal with non-registrable charges.

26 **Section 42.2** contains a definition of constructive notice which is based on the existing law. The essence of **section 42** is that, if a person is acquiring a fixed asset, then it ought to carry out the necessary searches.

27 **Section 43** is concerned with outright dispositions of current assets. The principle in **section 43.1** is that the acquirer will only take its interest subject to the charge if there is a restriction on disposal under the terms of the charge or in a related document and the acquirer actually knew of that restriction at the time of the purported acquisition.

28 The important point here is that, where the asset is a current asset, the acquirer will only be bound by a restriction if it had actual notice of the restriction at the time of the purported acquisition. Constructive notice is irrelevant. The only thing that matters is whether the acquirer actually knew of the restriction at the relevant time.

29 The purpose of **section 43.3** is to prevent the acquirer being liable in any other way as a result of the acquisition – for instance in tort. In the absence of fraud (in its common law sense of dishonesty) the acquirer is not otherwise liable for having acquired the asset.

30 If the chargor acts in breach of the restriction, it will be liable to the chargee for breach of contract, and this is made clear by **section 43.2**. If the chargee knew that the chargor was intending to sell an asset in breach of a restriction, it may be able to obtain an injunction to prevent the sale. Nothing in **section 43** alters the circumstances in which such an injunction would be available.

## 44 Other priority issues

**44.1 Any priority issues which are not determined by the Code will be determined under the general law.**

**44.2 For this purpose, to the extent that it is relevant, a charge will be treated as a legal interest.**

***[We could try to codify the law further if there is a consensus as to how to do it.]***

**Commentary**

1 The Code deals with priorities between charges and also priorities between a charge and a subsequent outright interest. It does not deal with other priority issues which arise, and they therefore need to be dealt with under the existing law. That is the effect of **section 44.1**.

2 For instance, the Code deals with the priority between a chargee and a subsequent purchaser, but not with the priority between a purchaser and a subsequent chargee.

3 For this purpose, it may be necessary to decide whether a charge is a legal or an equitable interest. **Section 44.2** contains rules to establish this point. It will only be necessary to determine a priority question which is not catered for in the Code and which, under the general law, requires a distinction to be drawn between legal and equitable interests. For all other purposes, there is no distinction in the Code between legal and equitable interests.

## PART 9: ENFORCEMENT

### 45 The scope of this part

**45.1 This part applies to the enforcement of charges, except to the extent that other laws (for example those concerning financial collateral, financial markets or settlement finality) provide to the contrary.**

**45.2 Where the chargor is an individual, this part is subject to all laws concerning consumers.**

**Commentary**

1 **Part 9** concerns the enforcement of charges. It applies generally to the enforcement of all charges, but it is subject to other specific legislation (**section 45**).

2 For instance, there are specific provisions concerning enforcement in the Financial Collateral Arrangements (No.2) Regulations 2003. And, of course, where the chargor is a consumer, any relevant restrictions contained in the consumer credit legislation will apply.

## 46 Time for enforcement

**46.1 A chargee can enforce a charge at the time provided for it in the charge instrument, or as otherwise agreed by the chargor.**

**46.2 If there is no such provision or agreement, the chargee can enforce the charge as soon as:**

**(a) all or any part of the secured obligation is to be performed; and**

**(b) the person liable to perform the secured obligation has received notice requiring it to be performed; and**

**(c) unless the chargor is insolvent or admits it is unable to perform the secured obligation in full, two business days have elapsed from the receipt of that notice, and the secured obligation has not been performed in full.**

**Commentary**

1 **Section 46** is concerned with the time for enforcement of a charge.

2 A charge will almost invariably provide for when it can be enforced, and **section 46.1** gives effect to what the parties have agreed. This agreement will normally be contained in the charge instrument itself, but it may be contained elsewhere, or it may be supplemented or amended by agreement between the parties. **Section 46.1** gives effect to that agreement wherever it is contained.

3 It would be surprising to find a charge without enforcement provisions. But **section 46.2** sets out default rules in the event that the charge does not do so. This section only applies if the parties have not otherwise agreed when the security should be enforceable.

4 The default power applies once the person who is required to pay the secured obligations (it may not be the chargor) has received a demand for money which is payable. If the chargor is insolvent or it admits that it is unable to pay the secured obligations in full, the security can be enforced immediately. If not, the chargee must wait two business days to see whether the amount is paid. If it has not been paid in full at the end of two business days, then the chargee may enforce the charge from the beginning of the third business day.

5 The notice period under **section 46.2** is much shorter than that contained in section 103 of the Law of Property Act 1925, but that provision is invariably contracted out off.

6 Where the chargee relies on an express power of enforcement, the time for enforcement depends on the interpretation of the charge document (or if elsewhere, the other agreement reached between the parties). The Code is not intended to alter the conclusion in cases such as *Massey v Sladen*[82] that, even if the words require immediate payment, the parties are likely to have intended the debtor to have sufficient time to effect the payment. But this only gives the debtor sufficient time to enable it to pay the money from a source already available to it (for instance a bank account in credit), and even that is unnecessary if the debtor clearly cannot pay[83].

[82] (1868) LR 4 Exch 13.
[83] *Cripps v Wickenden* [1973] 1 WLR 944; *Bank of Baroda v Panessar* [1987] Ch 335.

## 47 Enforcement powers

**47.1 A chargee can enforce a charge in the manner provided for in the charge instrument, or as otherwise agreed by the chargor.**

**47.2 If there is no such provision or agreement, a chargee has the following powers:**

**(a) to the extent permitted by the insolvency legislation (see part 10), to appoint an administrator or administrative receiver of the chargor; and**

**(b) to appoint a receiver over all or any part of the charged interest in the charged assets; and**

**(c) to apply to court for the sale of the charged assets; and**

**(d) to take all such other actions (or to refrain from doing so) in relation to all or any part of the charged assets as the chargor could have done if they were not charged (for instance by taking possession of them, selling them or leasing them; exercising a power of netting; in the case of receivables, demanding and receiving payment; and, in the case of cross-claims, setting them off).**

**47.3 These powers do not apply to the extent that they are inconsistent with the terms of the charge or the agreement of the parties. They can be increased, reduced, disapplied or amended in any other way in the terms of the charge or by agreement between the parties.**

**47.4 For the purpose of enforcing a charge, the chargee can:**

**(a) transfer or procure the transfer of the legal title to a charged asset if the entire beneficial interest in the asset concerned has been charged; and**

**(b) execute a deed even if the charge was not created by a deed.**

**47.5 To the extent that the charge is a financial collateral charge (see part 7), the chargee also has the powers (for instance, the power of appropriation) conferred on it by the Financial Collateral Arrangements (No 2) Regulations 2003 (SI 2003/3226) as amended from time to time.**

**47.6 The power to take possession of a dwelling-house is subject to the restrictions contained in section 36 of the Administration of Justice Act 1970, as amended by section 8 of the Administration of Justice Act 1973.**

**47.7 Foreclosure is abolished.**

**Commentary**

1 The Code enables the parties to determine what the powers of enforcement should be. This can be done in the charge instrument itself or elsewhere (see **section 47.1**).

2 This continues the existing principle under the current law that the parties are free to decide what the powers of enforcement should be. The parties to a charge almost invariably take up this offer, and it is almost unheard of to see a charge which does not contain enforcement powers. This is partly because the parties can then shape the powers of enforcement to the particular transaction concerned. It is also because the underlying default powers of enforcement under the existing law are inadequate.

3 It is envisaged that the current practice of setting out the powers of enforcement in the charge will continue. But the Code also takes the opportunity to update the default powers of enforcement. They are set out in **section 47.2**.

4 Where the charge consists of a debenture, the normal practice is to appoint an administrator to enforce the security. The power to do this is contained in the insolvency legislation. The Code also gives the chargee the power to appoint an administrative receiver where this is permitted under section 74A-H of the Insolvency Act 1986. See **section 47.2(a)**.

5 Under **section 47.2(b)** the chargee can appoint a receiver over charged assets.

6 The power to apply to court under **section 47.2(c)** might be used (for instance) to enable a ship to be sold through the court.

7 The Code does away with all the very specific powers - and their limitations – contained in the general law as it is at the present. The problem with the current default powers of enforcement is that they are both complicated and incomplete, and do not reflect current practice.

8 Under **section 47.2(d)**, the chargee is given the power to do anything with the charged assets which the chargor could have done if they were not charged. The approach of the Code, here, is to give the chargee a general power rather than to set out a long list

of specific powers. The intention is to give the chargee the ability to do anything with the assets which the chargor could have done. It is intended that this should be given a broad interpretation.

9 The default powers only apply to the extent that they are consistent with the parties' agreement (**section 47.3**).

10 The purpose of **section 47.4** is to deal with two technical issues. A chargee will need to transfer the legal title to the charged asset on enforcement even though it only has a charge. **Section 47.4(a)** enables it to do so.

11 Similarly, **section 47.4(b)** gives a chargee power to execute a deed even if the charge was not created by a deed.

12 The powers of enforcement contained in the Code can be increased by other legislation. Where the charge concerned is a financial collateral charge, the chargee therefore also has the powers conferred on it by the Financial Collateral Arrangements (No.2) Regulations 2003 (**section 47.5**). This includes the power of appropriation and the right of use.

13 In the same way as other legislation can increase powers of enforcement, it may also reduce them. The power to take possession of a dwelling house is subject to restrictions contained in section 36 of the Administration of Justice Act 1970, as amended by section 8 of the Administration of Justice Act 1873. The Code does not affect these restrictions (**section 47.6**).

14 Foreclosure is abolished by **section 47.7**. Because it is such a complicated legal process, it is not used in practice.

## 48 Powers of administrators and receivers

**48.1 Administrators have the powers conferred on them by the insolvency legislation.**

**48.2 Administrative receivers and receivers each have the powers conferred on them by the terms of the charge or by agreement with the chargor.**

**48.3 Except to the extent that they are amended by the terms of the charge or by agreement with the chargor:**

**(a) administrative receivers and receivers each have the power to take all such actions (or refrain from doing so) in relation to all or any part of the assets over which they are appointed as the chargor could have done if they were not charged (for instance by taking possession of them, selling them or leasing them; exercising a power of netting; in the case of receivables, demanding and receiving payment; and, in the case of cross-claims, setting them off); and**

**(b) (without limitation) administrative receivers have the powers conferred on them by the insolvency legislation (see part 10).**

**48.4 An administrator, an administrative receiver and a receiver can:**

**(a) transfer legal title to a charged asset if the entire beneficial interest in the asset concerned has been charged; and**

**(b) execute a deed even if the charge was not created by a deed.**

**48.5 The power to take possession of a dwelling house is subject to the restrictions contained in section 36 of the Administration of Justice Act 1970, as amended by section 8 of the Administration of Justice Act 1973.**

**Commentary**

1 **Section 48** deals with the specific powers of administrators and receivers. It follows the approach of **section 47**.

2 Administrators' powers are conferred by the insolvency legislation (**section 48.1**).

3 On the other hand, the powers of an administrative receiver or a receiver are conferred by the charge or by agreement with the chargor (**section 48.2**).

4 **Section 48.3** then goes on to deal with default powers of administrative receivers and receivers. An administrative receiver has the powers conferred by Schedule 1 to the Insolvency Act 1986. Administrative receivers and receivers each have the powers of the chargor in relation to the assets over which they are appointed. This is intended to be a broad power.

5 The other provisions of **section 48** replicate those in **section 47**.

## 49 More than one charge

**49.1 Where there is more than one charge over the same charged asset, the charged asset can be sold free from any charges which rank behind the charge concerned. If this happens, the rights of the subsequent chargees are transferred from the charged asset to its proceeds of sale.**

**49.2 Where there is more than one charge over the same charged asset, the charged asset can be sold under a second or subsequent charge subject to any charges which rank in priority.**

**49.3 This section is subject to any agreement to the contrary between the relevant parties.**

**Commentary**

1 Under **section 49.1**, a first chargee (or someone on its behalf) is able to sell the charged assets free from any second or subsequent charge. Similarly, a second chargee (or someone on its behalf) can sell subject to a third or subsequent charges. The rights of the subsequent chargees are overreached into the proceeds of sale.

2 A chargee cannot overreach prior charges. So, if a second chargee (or someone on its behalf) sells, it can only do so subject to the first charge (**section 49.2**). In many cases, this will make it very difficult to sell the asset concerned without the agreement of the first chargee.

3 The parties will frequently agree their respective powers in an intercreditor agreement. **Section 49.3** establishes that **section 49** is subject to any contrary agreement between the parties.

## 50 Effect on third parties

**50.1 An administrative receiver of a chargor and a receiver of charged assets is the agent of the chargor (even if the chargor enters into insolvency proceedings).**

**50.2 A person dealing with a chargee, or with a receiver or administrative receiver, is entitled to assume, unless it has actual knowledge to the contrary, that:**

**(a) those persons have the power to do those things which they are purporting to do; and**

**(b) they are exercising their powers properly.**

**Commentary**

1 Security documents normally provide that administrative receivers and receivers act as the agent of the chargor. Although that agency determines on the chargor entering into insolvency proceedings, this does not affect the ability of the receiver concerned to sell the charged assets[84]. **Section 50.1** simplifies the position. It makes an administrative receiver and a receiver the agent of the chargor, and that agency is not terminated by the chargor entering into insolvency proceedings.

2 It is common in security documents for a provision to be inserted to protect third parties such as purchasers of assets from a receiver or administrative receiver. The purpose of **section 50.2** is to deal with this under the general law – in order to ensure its effectiveness.

[84] *Sowman v David Samuel Trust* [1978] 1 WLR 22.

## 51 Duties on enforcement

**51.1 When enforcing a charge over charged assets, the person doing so (the enforcer) owes a duty to each interested person to take reasonable care of the charged assets which are the subject of the enforcement.**

**51.2 An interested person is:**

**(a) the chargor (where it is in insolvency proceedings, acting through its insolvency officer – see part 10); and**

**(b) any chargee of the charged assets other than the enforcer; and**

**(c) any person (such as a guarantor) who is liable for all or part of the secured obligations concerned.**

**51.3 When selling charged assets, the enforcer owes a duty to each interested person to obtain the best price reasonably obtainable for the charged assets at the time of sale.**

**51.4 The enforcer can sell the charged assets when it decides to do so. It has no duty to accelerate or delay a sale even if to do so might increase the sale proceeds.**

**51.5 Any claim for breach of these duties by the enforcer must be brought by or on behalf of an interested person for the amount of loss suffered by that person as a result of the breach of duty. For this purpose, loss suffered by an insolvent chargor includes loss suffered by its creditors (except to the extent that they are themselves interested persons and bring their own claim).**

**51.6 An enforcer can sell charged assets to a person connected with the chargee or with anyone else with an interest in the charge. If it does so, it must have contemporaneous evidence from an independent person qualified to give it that, in that person's opinion, it has obtained the best price reasonably obtainable for the charged assets at the time of sale.**

**51.7 Where the charged assets consist of financial collateral, this section is subject to the rules concerning enforcement contained in the legislation concerning financial collateral. It is also subject to Part VII of the Companies Act 1989 and to the Financial Markets and Insolvency (Settlement Finality) Regulations 1999.**

**51.8 This section is subject to any agreement to the contrary between the relevant parties**

***[Add a power for the chargee to "appropriate" the charged assets, subject to proper safeguards for the chargor.]***

**Commentary**

1 Under the existing law, the duties of a chargee when enforcing the security are relatively clear, but there are areas of uncertainty, particularly where administrative receivers or receivers become involved.[85]

2 The purpose of **section 51** is to set out the duties on enforcement broadly in line with the existing law, but to simplify and clarify them where necessary.

3 The duty is owed by the person enforcing the security. This may be the chargee, or it may an administrator, administrative receiver or receiver. In the Code, this person is described as the enforcer (see **section 51.1**).

4 The enforcer's duties are owed to those who are described as interested persons. This means the chargor, other chargees and guarantors or other persons who are liable for all or part of the secured obligations concerned (see **section 51.2**).

5 The general duty of the enforcer to the interested persons is set out in **section 51.1**. When enforcing a charge, the enforcer must take reasonable care of the charged assets which are the subject of the enforcement. Under the current law, it is not clear the extent to which a general duty of this kind does apply in all cases of enforcement. The purpose of the Code is to put it beyond doubt that an enforcer does owe this general duty of care.

6 There is also a specific duty, when selling charged assets, to obtain the best price reasonably obtainable for the charged assets at the time of sale. This is provided for in **section 51.3**, and it broadly follows the approach taken in *Cuckmere Brick v Mutual Finance*[86].

7 **Section 51.4** contains an important limitation on the enforcer's duty. The enforcer can sell the charged assets when it decides to do so. It does not have to delay the sale even if to delay might increase the sale proceeds. In other words, it is up to the enforcer to decide when to sell. This is broadly the effect of the current law.

[85] Largely as a result of *Downsview Nominees v First City Corporation* [1993] AC 295
[86] [1971] Ch 949.

8 **Section 51.5** is concerned with the claim to be brought against the enforcer. Only an interested person can bring a claim. So for instance, a shareholder or a creditor is unable to do so. Where a chargor is insolvent, loss suffered by its creditors can constitute loss suffered by the company itself.

9 Under the existing law, there are particular rules where the sale is made to a connected person. In such a case, the enforcer has an affirmative duty to establish that the sale is made at the best price reasonable attainable. This is because of the obvious risk of collusion. **Section 51.6** gives effect of this principle by establishing that the enforcer must have contemporaneous evidence from a qualified independent person that it has obtained the best price reasonably obtainable. The Code has not attempted to define who is connected. The intention is that this should be given a common-sense interpretation.

10 **Section 51.7** reminds the reader that there are particular rules concerning enforcement contained in the legislation concerning financial collateral and financial markets.

11 The duties contained in **section 51** can be increased or limited by agreement. See **section 51.8**.

12 Under the current law, a chargee cannot sell charged assets to itself. But there is significant support for allowing a chargee to retain the charged asset, free from the equity of redemption, by reaching agreement at the time with all interested persons. This needs to be explored further.

# PART 10: INSOLVENCY PROCEEDINGS

## General commentary

1 It is impossible to understand the law of security except in the context of insolvency law. The reason for taking security is to obtain a proprietary interest in assets which will survive the chargor's insolvency. It is therefore important that any Secured Transactions Code should deal with the interplay between the law of security and the law of insolvency.

2 But, equally, insolvency law is a large subject with detailed rules, and it is not practicable to reflect them all in the Code.

3 The approach taken in the Code is therefore a compromise. The purpose of part 10 is to explain why charges remain effective in an insolvency and then to explain in broad terms what limits insolvency law imposes on the effectiveness and enforceability of charges. It was considered helpful for the reader to know what the main limitations are which insolvency law places on charges; but the reader will need to go to the insolvency legislation and case law for the detail.

## 52 Effectiveness of charges

**52.1 A charge creates a proprietary interest in the charged asset and it remains effective until it is extinguished, even if the chargor is in insolvency proceedings.**

**52.2 If the chargor does enter into insolvency proceedings, the rights of the chargee in relation to the charge are subject to the insolvency legislation.**

**52.3 In this Code:**

**(a) insolvency legislation means:**

**(i) the Insolvency Act 1986 and secondary legislation made under it;**

**(ii) the European Insolvency Regulation (Regulation (EU) 2015/848 of 20 May 2015) as it may be amended from time to time; and**

**(iii) any other primary or secondary legislation in force in England from time to time relating to, or affecting, insolvency or reorganisation.**

**(b) insolvency proceedings means:**

**(i) where the chargor is a natural person, bankruptcy; and**

**(ii) in any other case, liquidation or administration;**

**(c) insolvency officer means a trustee in bankruptcy, liquidator or administrator of a chargor;**

**(d) insolvency claw-back proceedings means the proceedings described in section 53.**

**Commentary**

1 It is best to start with the definitions in **section 52.3**. This defines:

- insolvency legislation;
- insolvency proceedings;
- insolvency officer; and
- insolvency claw-back proceedings.

2 **Sections 52.1 and 52.2** set out the two basic principles which establish the relationship between the law of security and insolvency law.

3 The starting point is that a charge is a proprietary interest in the charged asset. It therefore remains effective in the chargor's insolvency proceedings (**section 52.1**). This follows from the basic principle that a charge is a proprietary interest and that a proprietary interest binds an insolvency officer of the chargor. Personal claims against the chargor abate *pari passu*. But proprietary rights continue to be effective and enforceable.

4 Although this is this basic principle, insolvency law does place certain restrictions on the effectiveness and enforceability of a charge in insolvency proceedings. If the chargor does enter into insolvency proceedings, the rights of the chargee are therefore subject to the insolvency legislation (**section 52.2**).

## 53 Insolvency claw-back proceedings

**53.1 Under the insolvency legislation, a charge may be set aside in whole or in part (and other remedies may be available) if:**

**(a) the charge is a voidable preference (see Insolvency Act 1986, sections 239 and 340); or**

**(b) [*the charge secures old money – perhaps limited to a charge over all or substantially all of the chargor's assets*]; or**

**(c) the charge is a transaction at an undervalue (see Insolvency Act 1986, sections 238 and 339); or**

**(d) the charge is part of a transaction defrauding creditors (see Insolvency Act 1986, section 423).**

***[Time limits for claw-back will need to start on the date of registration for registrable charges.]***

**Commentary**

1 Charges entered into in the period running up to the commencement of insolvency proceedings may be set aside under the claw-back provisions in the insolvency legislation. The purpose of **section 53** is to explain what the principal claw-back procedures are. It is intended to make the reader better able to understand how the claw-back procedures can impinge upon a charge. The detail is contained in the insolvency legislation.

2 Section 245 of the Insolvency Act 1986 applies to floating charges which secure money which has already been lent. The Code does not distinguish between fixed and floating charges. Consideration therefore needs to be given to a replacement to cover charges given to secure old money.

## 54 Limitations of enforcement

**54.1 If the chargor is a company which goes into administration, there are limitations on the chargee's power to enforce the charge (see Insolvency Act 1986, paras 43 and 44 of Schedule B1).**

**54.2 There are similar limitations where a small company proposes to enter into a voluntary arrangement (see Insolvency Act 1986, Schedule A1).**

**54.3 [*Bank resolution proceedings*]**

**Commentary**

1 In practice, one of the important limitations on charges in an insolvency is the moratorium on enforcement contained in the insolvency legislation. Its main application is when the chargor goes into administration. It does not apply in a liquidation.

## 55 Use of charged assets by a liquidator or administrator

***55.1*** ***It is envisaged that section 55 will contain a power for an administration (and possibly a liquidator) to use a certain amount of charged assets in certain limited circumstances. As an interim measure, we may need to draft a provision which broadly replicates the way in which floating charge assets are dealt with on an insolvency.***

### *Note: Cross-border transactions*

*Cross-border transactions are so important in practice that it is considered desirable to add a further part to the Code – Part 11: Cross-Border Transactions – to deal with the conflict of laws. There are difficult issues here – not least its relationship with EU law – and it has been decided not to propose drafting at this stage but first to see if it is possible to reach a consensus on what is both feasible and desirable.*

**Commentary**

1 Under the existing law, certain persons who have claims against the chargor rank in priority to a floating chargee (but not to a fixed chargee). In two of these cases, priority is given to unsecured creditors of the chargor whose claims were owed before the insolvency proceedings. In the other case, priority is given to claims which are created after the debtor has entered into insolvency proceedings. The three categories of case are:

- preferential creditors;
- the prescribed part payable to unsecured creditors;
- expenses of administration and, in certain circumstances, liquidation.

2 The Code does not distinguish between fixed and floating charges. One of the reasons it does not do so is that experience demonstrates that many of the problems caused by the current law stem from the requirement to draw a distinction between fixed and floating charges on an insolvency, and the uncertainties and difficulties which result from that.

3 It is therefore envisaged that the legislation which will bring the Code into force will repeal the statutory provisions which give priority to preferential creditors, unsecured creditors and insolvency practitioners over floating charges.

4 This issue was discussed in the second discussion paper on Secured Transaction Reform published by the Financial Law Committee of the City of London Law Society in February 2014. That paper raises a number of issues which need to be discussed. They may result in a decision that nothing is needed to replace the existing provisions. Alternatively, it may be necessary to replace the current provisions with a limited power to use charged assets in limited circumstances and subject to safeguards. The Code will be updated when those discussions have become more advanced.