CHANCERY BAR

Response to Law Commission Consultation Paper on Bills of Sale (Law Comm CP no 225 2015)

Introduction and general comments

1. This is the response of the Chancery Bar Association ("the ChBA") to the Law Commission's consultation on Bills of Sale.

2. The ChBA is one of the longest established Specialist Bar Associations and represents the interests of some 1200 members handling the full breadth of Chancery work, both in London and throughout the country. Membership of the Association is restricted to those barristers whose practice consists primarily of Chancery work. It is recognised by the Bar Council as a Specialist Bar Association.

3. The ChBA operates through a committee of some 17 members, covering all levels of seniority. It is also represented on the Bar Council and on various other bodies including the Chancery Division Court Users' Committee and various Bar Council committees.

4. This response has been prepared for the Chancery Bar Association by Duncan Sheehan, an academic member of the association, who is Professor of Commercial Law at the University of East Anglia (joining the University of Leeds as Professor of Business Law in January 2016) and currently teaches trusts, restitution and commercial law and has written in the personal property area, including on bills of sale.

5. Input has also been provided by Edward Cumming, a chancery and commercial barrister practising from XXIV Old Buildings, Lincoln's Inn. Edward appeared as junior counsel in *Chapman v Wilson & ors* [2010] EWHC 1746 (Ch), one of the rare cases involving the Bills of Sale Act 1878 and the Bills of Sale Act 1878 Amendment Act 1882, in which Vos J (as he then was) observed that "*The twists and turns of the Bills of Sale Acts have already been the subject of much judicial and academic comment (including a recent Law Commission report of July 2005 (number 296) on Company Security Interests). The issues raised in these proceedings have been complicated by their outdated provisions. One cannot help but think that the introduction of a modern system of registration offering protection and clarity to creditors, consumers and chattel-owners alike, is long overdue.*"

6. We agree with this assessment. The area is such a mess that reform is urgently required. A note of caution is needed in that there are multiple different initiatives of different scopes and aims in the area of secured transactions with for example the Secured Transactions Law Reform Project and the City of London Law Society both developing more general proposals. This is beyond your current remit we appreciate. You do, however, accept at para 6.64 that another project may yet be required to

enable unincorporated businesses to create floating charges. You state that in para 6.63 there are three main reasons why you do recommend such a move as part of this project. First you raise the need for in-depth consideration of whether unincorporated businesses should be able to create such charges, the need for a review of insolvency law and the requirement for a register of such floating charges. We see little reason why unincorporated businesses should not be able to create such charges, although we accept that there will be a need to keep personal (non-business) property separate (appendix D para 8), although there are definitions of consumer goods in the UCC article 9 that may be of assistance. We hope that you will be able to include this project in your next programme of work. Aside from this, there is little new in the criticisms that have been made of the existing bills of sale legislation, and you summarise the issues well at para 7.1.

7. The legislation applies to documents not transactions. Duncan Sheehan says in his book,

   "A legal mortgage of goods or chattels may be oral in the same way that passage of legal title to goods may be oral and done by delivery alone… If the mortgage is given by an individual and is in writing it must be by deed. It is then covered by the Bills of Sales Acts. Section 9 and Schedule 1 of the Bills of Sale Act (1878) Amendment Act 1882 provide the form that a security bill must take to be valid. If it is not in this form it is void even between the parties."[1]

8. To modern eyes, as you suggest, the legislation is very anachronistic in the way it goes about its protective aim and given the anachronistic language is unlikely to achieve its aim of being easy to understand. That in itself provides a sufficient reason to update the legislation, but it is also worth pointing out the lack of consumer protection. Sheehan argues,

   "The lender may take possession of the asset under section 7 of the Bills of Sale Act (1878) Amendment Act 1882 which allows seizure of the assets on default. Normally, a lender must go to court for an order for possession, but the bills of sale legislation allows for immediate possession of the chattel after any missed payment. The asset will then be auctioned. Rather than granting the power to take possession, the legislation assumes it and provides for where it can or cannot be exercised. In *Re Morritt* the question came up whether there was a power of sale. The bill explicitly gave a power to seize goods, and Cotton LJ said that section 7 of the Act gave a power to sell after a reasonable time had been left to the debtor to pay.[2] Once property is seized, it cannot be sold for five days under the legislation.[3] This allows the borrower to apply to court to restrain sale if a payment can be made. It is unlikely that consumers will be aware of this, meaning the protection given is in practice worthless. Where the contract is a regulated agreement under the Consumer Credit Act 1974, no security can be enforced without first serving a default notice under section 87 of the Act 14 days before seizing the asset. That notice must contain information on the nature of the breach and the action needed

[1] D Sheehan *The Principles of Personal Property Law* (Hart Oxford 2011) 362-363
[2] *Re Morritt* (1886) 18 QBD 222, 233
[3] ibid 241 (Lopes LJ); Bills of Sale Act (1878) Amendment Act 1882 s 13.

to remedy it or, if it is un-remediable, the compensation required by the lender.[4] This requirement is reinforced by section 7A of the Bills of Sale Act (1878) Amendment Act 1882 which provides that seizure under section 7 on default of an obligation secured by a bill of sale is not permitted if the period of grace in the default notice has not expired or the debtor takes the required action. This provides significantly less protection than is available under, say, a hire purchase agreement or other similar facilities."[5]

9. We therefore agree that bills of sale need reform, and we also agree that the only way to do this is to repeal the legislation and start again. To engage in piecemeal reform would risk worsening the lack of clarity that already exists due to the mechanics of the interaction between the existing Acts.

10. The reform must be done in a way that helps third parties to discover what rights a lender has in the borrower's assets. The current system is at best difficult because of the inadequate nature of the High Court registry (notwithstanding that many lenders register voluntarily with an asset finance registry, as required under the (non-legally binding) Consumer Credit Trade Association (CCTA) Code).[6]

We agree that bills of sale should not be "*banned*" or "*abolished*"

11. We agree that bills of sale should not simply be banned. Notwithstanding the consumer protection concerns raised in support of a ban, we do not consider – as noted in the Law Quarterly Review by Sheehan – that consumers have any difficulty in comprehending the idea of mortgaging their car (and the basic principles underpinning that transaction); rather their real difficulties arise with comprehending the documentation that comprises bills of sale.[7]

Scope of a "*goods mortgage*" – and consequences for new terminology

12. We agree that the new legislation should relate to non-possessory security over goods created by individuals, and that there is no reason not to include security for non-monetary obligations within the regime.

13. We would point out that there are different types of possession in English law, and that the borrower does not therefore need to be in actual possession. You give the example (para 8.28) of security bills over wine held in a specialist store. In such circumstances the owner may be in possession of the wine – albeit constructive possession – having attorned to the storeholder. On the basis of current understandings of possession this would be covered and we see no reason for special provision to make this clear.

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[4] Consumer Credit Act 1974 s 88; see H Beale, M Bridge, L Gullifer and E Lomnicka (eds) *The Law of Security and Title Based Financing* (2nd edn OUP Oxford 2012) paras 18.35–18.36.
[5] Sheehan (n 1) 378
[6] CCTA Code (2015) para 3.14
[7] D Sheehan 'Abolishing Bills of Sale in Consumer Lending" (2010) 126 LQR 356, 360

14. We agree that ships, aircraft and agricultural charges, which have their own specialist rules should be excluded.

15. We are not sure we understand the rationale for excluding intangible assets. It is possible that an individual – probably one of high net worth – may wish to secure a loan on the shares or other intangibles he owns, as much as (if not more so than) over his car. In the interests of simplification we would consider including such security in a new regime. There should be no issues with financial collateral because security & title transfer financial collateral arrangements require the parties to be non-natural.[8]

How the "goods mortgage" might take effect

16. Under the bills of sale legislation the bill of sale acts in effect as a mortgage – it transfers ownership of the goods to the lender. You argue in para 8.35 that the borrower who grants a security bill can only transfer ownership once. One would think so, but we note the ambiguity contemplated by section 10 of the Bills of Sale Act 1878, which provides for priority by date order of registration (or stamp) between two holders of bills of sale. We do not read this as applying only to absolute bills. The 1878 Act applies to both types of bill and the 1882 Act has no priority provision. This suggests that two bills of sale can co-exist in the same asset.

17. You suggest at para 8.36 that the parties be free to agree that the goods mortgage operate as a charge instead. We find the thinking and terminology used here somewhat confusing. If the new terminology is to include the word "*mortgage*" (especially if it is to do so, as suggested at para 8.10, to avoid "*the potential to be misunderstood*") we think clarity of thought requires use of the words "mortgage" and "charge" – and references to the remedies available in each case – in the technical sense. If the justification for a power to agree that a goods mortgage should take effect as a charge would allow the borrower to charge the asset a second time, we think such a power to be unnecessary. A charge does not allow for possession as a remedy, although it does allow for the sale of the asset. Should repossession of the asset be considered an appropriate remedy, however, then it would be preferable to say that the goods mortgage operates as a mortgage with ownership transferred to the mortgagee subject to an equity of redemption. This would allow for a second goods mortgage but would mean that a second goods mortgagee would be unable – at least as against the first – to take possession; we would be happy to provide that the second mortgagee has the power as against the debtor-grantor to take possession in order to provide the more flexible possibilities to some unincorporated businesses that are contemplated at para 8.36.

18. In general we agree that the lender should only be able to repossess in the circumstances laid out in Question 8. Importantly this makes it extremely important

[8] Regulation 3 of the Financial Collateral Arrangements (No. 2) Regulations 2003

that the process not be as random as you describe in paras 5.31-5.32.[9] An electronic register would make this easier, and we return to this below.

19. Goods mortgages may well be used to obtain the goods (just as land mortgages are), but we are not convinced this requires that future goods be used as security (paras 8.49-8.51). This is not how it works with land mortgages after all. I do not grant a mortgage before the acquisition of a house, but simultaneously with its acquisition; see *Abbey National BS v Cann*.[10] This type of security over future assets would be of most use in a different setting – where I borrow £x to buy inventory stock and draw upon a revolving facility as I purchase the stock. This in fact is impossible because the bills of sale legislation, as you point out, requires that the loan be repayable on a defined and certain date and also because I do not want a fixed charge over inventory, leaving me to ask permission every time I wish to sell some stock. This is precisely the reason why unincorporated businesses need to be able to create floating charges. If you are leaving that issue for now, then I would either leave the requirement that the assets be present assets, or alternatively ban future security over consumer goods, and leave businesses to make their own mind up whether they wish to create such (fixed) future security or not.

20. We think your three aims in para 9.3 are appropriate.

21. We also agree, as suggested at paras 9.10-9.11, that goods mortgages should be in writing and that the credit agreement should be separate. Beyond this we have reservations as to the extent to which your proposals beyond this will provide much, if any, effective consumer protection. We would accordingly suggest that consideration might be given to loosening those proposals by not requiring the borrower's signature to be witnessed. In circumstances where there would be no restrictions on who the witness should be or their independence we see little value in the requirement (for example we see no point in a system whereby an employee signing on behalf of the lender also acts as witness to the borrower's signature and think the circumstances likely to be limited where a friend, partner, or other companion of someone considering transferring ownership of a vehicle "*late at night or while drunk*" will dissuade that person from entering into the transaction upon being asked to witness their signature). We note further that the credit agreement would also be subject to regulation under the consumer credit legislation. The proposal for a witness to the goods mortgage would seem to add little to the consumer protection in place in that legislation (and if we thought that legislation inadequate our answer would be to reform that not to introduce a witness requirement). With that caveat we agree with the points raised in questions 12-13 about what the document should – and need not – contain, and with your points about prominent statements. We are also content with nullifying the mortgage (but not the separate loan) if the formality requirements are not met.

[9] An observation based, in part, on experience of the mistakes that are unavoidably made in the stamping of court documents.
[10] [1991] 1 AC 56

Registration

22. We agree that the main reasons for registration are false wealth, notice to third parties and priority. We also agree that for consumers the false wealth issue is unlikely to be a problem (para 10.25). For serial numbered goods (and we prefer this to just vehicles so that other uniquely identifiable assets can be included) we therefore agree that registration with an asset registry such as HPI is appropriate as a perfection requirement. Dating priority from the point that the mortgage becomes searchable also seems appropriate (para 10.40).

23. For other goods, the High Court Registry remains. Again we agree that as a perfection requirement registration is appropriate (para 10.64) and that the lender would not be able to enforce against third parties who acquired a right prior to the date of registration (para 10.76); your list of requirements (Q21) appears reasonable.

24. In terms of searching the register, if the goods are serial numbered the search will be against the serial number; if, however, it is a goods mortgage over chattels other than a vehicle, you have not identified how the search will be conducted. If relatively small numbers of goods mortgages are registered this question might be unimportant (or could be made to be), but the approachshould be determined on the assumption that the new regime could be widely adopted. One can imagine problems if I enter two goods mortgages one with my name as Duncan Sheehan and the other with my name as Duncan Kenneth Sheehan. The High Court staff searching could return a search certificate with both names – but they might not. Whilst with small numbers of registrations this might be feasibly managed, but over time if the market develops the question becomes more important. Other difficult examples that might arise include goods mortgages granted by many people with similar names and a goods mortgage created by an unincorporated business – do we search against the owners or the trading name of the business?

25. In terms of the protection provided in the proposed new legislation to consumers in default of a regulated agreement, you propose to track the rules in hire purchase agreements. You raise the one third rule, which requires the hire purchase lender to seek a court order for repossession where the purchaser has paid one third of the total cost. A number of disadvantages raise their head in this regard.

26. The first is cost. You suggest at para 11.33 that the lender should be able to pass the court fee – but not other legal costs – on. It is true that the prospect of a hefty costs order might make the requirement of a court order less of a protection, but a balance needs to be struck as you say. The expenses incurred in enforcement will be covered by the borrower; this will be done either directly by making the defaulting borrower pay, subject to review as to whether the costs are reasonable, or by the costs simply being factored into the interest rate and other charges payable by all borrowers, including those who do not default. We agree (paras 11.37-11.41) that, once a return of goods order has been made, the lender should have a quick way to enforce that order via its own employees or debt collectors. We also agree that the borrower needs to continue to be liable for any shortfall.

27. We would suggest, however, that on a voluntary termination the borrower be liable for the shortfall over the value of the depreciated asset. You point out at para 11.68 that the logbook lender is less concerned about that than the hire purchase lender, but there might be cases in goods (rather than vehicle) mortgages where depreciation becomes an issue.

28. There are also significant problems with third party buyers of goods subject to a security bill of sale. The third party (TP) only obtains good title in two cases.

    a. The first is that purely equitable title is transferred to the grantee (G); in that case TP is a bona fide purchaser for value without notice. This is possible because the registration of the bill does not provide constructive notice to third parties.[11] If by contrast the grantee acquires legal title (subject to the grantor's equity of redemption) the seller only has his equity of redemption to sell and a bona fide purchaser of the equity cannot defeat the lender's legal title. This is a straightforward application of *nemo dat quod non habet* (i.e. that a party cannot give a better title than he has).

    b. The second possibility is that G is estopped from denying TP's title, because he has represented to TP that the latter will gain good title.[12] It is unclear that estoppel provides good title against anyone other than the grantee of the bill.[13]

29. Other than these two exceptions third party purchaser of a car subject to a logbook loan with no knowledge of the bill will be bound by it. Analysed from the perspective of *nemo dat quod non habet*, we can treat these cases as cases for the application of "taking free" rules. You quote Sheehan at para 12.28, but the quotation really needs to be put into context. What he says (with that context) is

    > "Consumers cannot be expected to search registers, and when a third party purchases an asset subject to security, he should not find himself bound by a security about which they knew nothing. Section 54 NZ PPSA 1999 solves this problem by providing that third party purchasers of consumer goods worth less than NZ$2000 who do not know of the security interest take free of it. This type of provision would need to be enacted."[14]

30. The point then is that non-consumers who purchase the goods or the vehicle can be expected to search a register – indeed a car dealer purchasing second hand will be used to searching HPI and other registries. This is the importance of perfection by registration. Once perfected the interest binds third parties, unless they fall into a taking free exception. Section 54 of the NZ Personal Property Security Act 1999 is an example of the "taking free" provisions, which when they bite permit a third party to

[11] *Joseph v Lyons* (1884) 15 QBD 280
[12] L Sealy and R Hooley *Commercial Law: Text and Materials* (4th edn OUP Oxford 2008) 1141
[13] *Re London Wines* [1986] PCC 121
[14] Sheehan (n 6) 360

take legal title unencumbered by the security – i.e. they improve the purchaser's position. You make some recommendations, which we come to later, equating goods (and vehicle) mortgagees to hire purchasers. In his book Sheehan says

> "Section 27 Hire Purchase Act 1964 states that if the third party purchaser of a car or other motor vehicle from a hire purchaser is a private purchaser in good faith and without notice of the seller's interest the sale has effect as if title had vested in the hire purchaser, even if the private purchaser bought from a trade purchaser (who would not get good title under the section). The sale must be complete while the vehicle is still on hire purchase and a debt is outstanding on that contract. These two categories of purchaser are mutually exclusive; if you carry on a business trading in vehicles or lending on the security of such vehicles, you can never be treated for the purposes of the section as a private purchaser. The reason for the distinction is likely to be the ability of trade purchasers to protect themselves."[15]

31. The position here seems to be that your proposals track the type of *nemo dat* provision found in the Hire Purchase Act 1964. This is explicitly your aim (para 12.26). We agree with your assessment that private purchasers cannot be expected to carry out searches or provenance checks, and that the danger of collusion is a non-problem. Fraud is always a possibility, but if you prove fraud then the transaction will be capable of being unwound. We are not certain, however, why someone purchasing other than in good faith should be protected by repossession only being possible with a court order. In fairness this type of dispute will almost always end in court because the purchaser will almost inevitably claim to be a purchaser in good faith (perhaps especially when they are not!), but once it is established that the lender's goods mortgage binds the purchaser we see no reason for a separate application to repossess to be required. We are not sure about the proposed regulation-making power either. It seems to us that this is a chicken and egg situation. If consumers do not have to search, they will not (even if only for £3). Why then would you think that they will? The industry could mount the type of advertising campaign you mention (para 12.45) – but it simply won't be true that it is necessary to search the register. Consumers won't need to search; they would get good title anyway, because the Act says so.

32. In chapter 13 you discuss assignments of book debts. From the perspective of the NZ Personal Property Security Act system these would be deemed security interests. Deemed security interests are different to "in substance" interests. Essentially they are re-characterised for perfection and priority purposes, but left alone for enforcement purposes. They are not therefore devices that would be understood as having a security function even if in some cases they can be used a financing tool. There are two main arguments deployed to justify inclusion of such interests in the scheme; the first is the ostensible ownership argument, and the second the "too hard to tell the difference" argument. Assignments of receivables are typically included[16]

[15] Sheehan (n 1) 80
[16] Eg Personal Property Securities Act 2009 (Cth) s 12(3)(a), where it is referred to as a "transfer of accounts"

on the grounds of ostensible ownership. If the assignment is registered it becomes clear to those searching and looking to see what collateral is available that the book debts or other receivables will not be available to a later creditor. It is for this reason that we think registration serves a valuable purpose, but it only serves this purpose if the registration regime is workable. Currently it is not. You are correct that setting up an entirely new register would require significant work, but we would hope that the improved system of High Court registration would be at least a staging post on the way to a register of assignments for both corporate and unincorporated businesses of the type that ABFA favour (para 13.20-13.21). As a member of the Secured Transactions Law Reform Project, Sheehan shares their desire for a unified online register. The streamlined system you propose for the High Court is one we largely agree with. You will remember that we queried the need for a witness to the goods mortgage earlier in this response. We would also query the need for a witness here (para 13.17). Nothing in section 136 Law of Property Act 1925 dictates that an assignment of choses in action (which book debts are) requires a witness, and a company (or someone on its behalf) need not sign in the presence of a witness. We would also suggest that perhaps you have still over-complicated the documentation required. We agree that the full factoring or invoice discounting need not be registered. The information you require – name of the financier and the business making the assignment, duration and the description of the book debts assigned (and going to be in the future assigned) (para 13.25) – could be included in the registration form. Effectively this would be a form of notice-filing if the factors did not need to send in the invoice factoring or discount agreement. We agree that many of the more extreme formalities such as the sworn affidavit are unnecessary (not least to try to avoid the formalistic arguments that failed, but caused consternation, in *Chapman v Wilson & ors*).[17]

33. On absolute bills of sale we agree that there really is no reason to regulate them. If there are no registered absolute bills, and lack of registration (pace *Halberstam v Gladstar*[18]) provides little or no protection that would not have been available anyway, we see no benefit.

[17] Ibid.
[18] [2015] EWHC 179