Security Rights and the European Insolvency Regulation

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1. The following report is drafted from the perspective of the Common Law. It focuses on the law in England though incidental references are made to the law in the Republic of Ireland where the law is fundamentally the same though some statutory differences do exist. The report does not consider specifically the law in Scotland where there is a mixed Common Law/Civil Law heritage though the statutory provisions in respect of insolvency are largely the same as those in England.

Introduction

2. There is no universally recognised definition of security rights under the common law but 'security' in this context is generally taken as signifying a right over property to ensure the payment of money or the performance of some other obligation[1] and the property over which security is taken is referred to as 'secured' or 'collateralised'.

3. It is widely understood among the international lending community that a modern law of security rights or interests/secured transactions should conform to certain key elements. These key elements are reflected in the 'Core principles for a secured transactions law' drawn up by the European Bank for Reconstruction and Development (EBRD).[2] In summary these principles are as follows -

- the security right should constitute a property right (right in rem) that is effective in the event of the debtor's insolvency
- the law should provide for the granting of security in the widest possible range of circumstances.
- the existence of a security right over property must be effectively publicised.
- there should be a rapid and cost-effective means of recovering the debt from the secured asset
- the cost of creating, maintaining and exercising the right should be kept at a reasonable level.[3]

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[1] See Browne-Wilkinson VC in Re Paramount Airways Ltd [1990] BCC 130 at 149.

[2] http://www.ebrd.com/what-we-do/legal-reform/access-to-finance/transactions.html/ Important work has also been done in this area by the United Nations Commission on International Trade Law (UNCITRAL) with is Legislative Guide on Secured Transactions available at www.uncitral.org and the World Bank Group - http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/publications/secured+transactions+and+collateral+registries/ and see generally G McCormack Secured Transactions and the Harmonisation of Law (Cheltenham, Edward Elgar, 2011).

[3] See also the Preface to the Model Law on Secured Transactions (1994) published by the European Bank for Reconstruction and Development (EBRD).

4. In essence, the common law implements these principles.[4] Firstly, security rights under the common law are rights in rem. In other words, they are enforceable against third parties including the debtor's insolvency representative and not just inter partes i.e. between debtor and creditor.

5. Secondly, the common law does provides for the granting of security in the widest possible range of circumstances. Through the 'floating charge' it is possible to create security over the entirety of a company's business operations by simply 'charging' – creating a security over – what is referred to as the company's undertaking. It is also possible to create a fixed charge over almost any asset provided that the debtor (charge giver) is restricted in the manner that it can deal with the assets that form the subject matter of the security. For instance, the courts have acknowledged the possibility of creating a 'fixed charge' over receivables that may come into existence in the future provided that the charge giver pays the proceeds of the receivables into a special bank account under the control of the charge taker.[5]

6. It is in this area of extensiveness of possible security interests that the common law scores earns a reputation for being favourably disposed towards the secured creditor.[6] In the 19th century legal practitioners and the courts responded to the growing needs of commerce by recognising the validity of fixed forms of security on the debtor's after-acquired property[7] and also by recognising an all-encompassing form of security - the floating charge. A floating charge is essentially a charge on a class of assets, both present and future, which permits the company creating the charge to dispose of a clean title to the assets which form the subject-matter of the charge until some event occurs which causes the charge taker to intervene. Such an event is called a 'crystallising' event. Put another way, the corporate debtor has management autonomy with respect to the category of assets covered by the floating charge. The centrality of the floating charge was acknowledged in Agnew v Commissioner of Inland Revenue[8] where Lord Millett said:[9]

'The floating charge is capable of affording the creditor, by a single instrument, an effective and comprehensive security upon the entire undertaking of the debtor company and its assets from time

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[4] See for a comparison between the Model Law and English Law G McCormack and F Dahan [1999] *Company, Financial and Insolvency Law Review* 65 and more generally J Norton and M Andenas ed. *Emerging Financial Markets and Secured Transactions* (1998).
[5] Siebe Gorman v Barclays Bank [1979] 2 Lloyd's Rep 142; Re Brightlife Ltd [1987] Ch 200; Agnew v Commissioner of Inland Revenue [2001] 2 AC 710.
[6] See generally on the history and development of the floating charge RR Pennington, "The Genesis of the Floating Charge" (1960) 23 *Modern Law Review* 630.
[7] Holroyd v Marshall (1862) 10 HL Cas 191.
[8] [2001] 2 AC 710.
[9] [2001] 2 AC 710 at para 8.

to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder. Such a form of security is particularly attractive to banks, and it rapidly acquired an importance in English commercial life which … should not be underestimated.' [10]

7. Thirdly, in England (and also in Ireland) statute has supplemented the common law by publicising the existence of security interests over property through the registration of company charges regime. There is general hostility to the recognition and enforcement of secret security interests and this hostility is based on the avoidance of detriment to other creditors. Such creditors may advance credit to a company on the basis that its assets are unencumbered and are prejudiced if it later emerges that the company has in fact given security for some or all of its existing debts. The register is open to public inspection and, in this way, third parties are alerted to the scope of a company's secured borrowings.

8. The registration regime does not apply to possessory security interests - pledges and common law liens - but the fact that the creditor has possession of the items used as security may be taken as the functional equivalent of notice. There are also no notification or registration requirements in the case of security interests arising by operation of law i.e. equitable liens. This is a gap in the system and is, perhaps, the main reason why the judiciary have set their face against any extension of the category of equitable liens.

9. The registration regime applies to 'charges' and not to legal instruments that might in economic terms be regarded as the functional equivalent of security i.e. title based mechanisms such as finance leases, factoring of receivables and retention of title clauses in sale of goods contracts. In economic terms, there are many strategies for taking what would be regarded as the functional equivalent of security but which do not, in a legal sense, involve the creation of a charge or a security interest. These alternative legal devices may help a creditor to improve its position in the event of the debtor's insolvency.[11]

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[10] The Agnew case is often also referred to as Re Brumark Ltd. It is a decision of the Judicial Committee of the Privy Council. The Judicial Committee of the Privy Council which normally sits in London hears appeals from certain British Commonwealth countries and territories (principally in the Caribbean) -– see www.jcpc.uk . There is a strong equivalence of membership between the Privy Council and the UK Supreme Court which under the Constitutional Reform Act 2005 replaced the appellate committee of the House of Lords as the UK's highest court

[11] See generally on the company charge registration system WJ Gough *Company Charges* (London, Butterworths, 2nd ed 1996); G McCormack *Registration of Company Charges* (London, Sweet & Maxwell, 1994).

10. Fourthly, English law generally provides for effective methods of recovering secured debts from secured assets. From the point of view of a charge holder there has been a traditional and especially efficacious method of enforcing security rights through the out-of-court appointment of a receiver pursuant to a facility contained in the instrument of charge.[12] Although nominally the agent of the borrowing company to which he was appointed, the basic function of the receiver is to realise the secured assets for the benefit of the secured creditor. For most cases, the Enterprise Act 2002 changed the procedure by taking away the power to appoint an administrative receiver i.e. a receiver of the whole, or substantially the whole of a company's property. The holder of a general floating charge may however appoint an administrator out-of-court though the administrator must perform his functions with the objective of rescuing the company as a going concern where this is reasonably practicable and even in circumstances where it is not, the administrator must not unnecessarily harm the interests of company creditors as a whole.

11. Fifthly and finally, under English law the cost of creating, maintaining and exercising security interests appear to be at reasonable levels in that there are no notarisation fees or other levies payable on instruments of charge. Registering a charge and searching the register are subject to payment of a small fee but there are no other transaction costs apart of course from lawyer's remuneration.

12. If English law is judged against the benchmark of the EBRD principles then it scores quite well. The main pluses are the freedom to create security interests in almost all classes of assets and the general absence of procedural barriers in respect of the creation of security interests. The minuses, on the other hand, are based around the fact firstly, that there is no single reference point for determining priorities between competing security interests in the same property; secondly, a tension with the goals of corporate rescue and rehabilitation; thirdly, the relatively formalistic preoccupations of the law coupled with the fact that the law is not contained in a single source but in a mixture of common law and statute, and for this reason is not easily saleable internationally.

13. Firstly and on the issue of priorities, unlike the position in the United States under Article 9 of the Uniform Commercial Code, registration of security interests does not, of itself, determine priorities between more than one security interest over the same asset and seeking satisfaction out of that asset. As far as charges are concerned, while failure to register a charge

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[12] As far as floating charges created after a certain date are concerned, the Enterprise Act 2002, in the generality of cases but subject to certain exceptions, removes the power of a floating charge holder to appoint an administrative receiver over a company's assets. Section 250 Enterprise Act inserts a new section 72A into the Insolvency Act 1986 to this effect.

will result in the invalidation of the charge in the event of the corporate debtor entering insolvency proceedings, once registration has been duly effected then the basic rule is that priority among competing charges turns on the date of creation. Whether the charge is fixed or floating however, may also have a role as well as whether the floating charge instrument contains a 'negative pledge' or 'restrictive' clause i.e. a clause forbidding the creation of any subsequent security having priority to the floating charge.

14. Where there is more than one assignment of the same debt, then priority among competing assignments is determined by the order in which notice of the assignments is given to the debtor unless a subsequent assignee has actual or constructive notice of an earlier assignment at the time that the subsequent assignment is made. In the latter situation priority is governed by a simple 'first-in-time-has-priority' rule.

15. The complexities in the law governing priorities has often led to the negotiation of priority agreements between secured parties in particular cases.

16. Secondly, there is a view that the enforcement of security should not conflict with the goal of corporate restructuring. In consideration of a business rescue objective, the Enterprise Act 2002 has watered down some of the enforcement rights of security interest holders. There have been suggestions however, for a wider stay on the enforcement of security in the context of 'pre-insolvency' restructuring proceedings.[13]

17. Thirdly, the fact that the English law of security interests consists of some statutory encrustations on a thick base of judge made law means that the law sometimes appears less than transparent to a foreign observer. The fact that it is not written down in a single statute may obscure understanding and lead to the conclusion that the law is more complex that it actually is.[14] The lack of something in the nature of a comprehensive code attracts unfavourable comparisons with Article 9 of the US Uniform Commercial Code and the Personal Property Securities Acts in Canada, Australia and New Zealand though there is a separate and distinct body of law in these countries applying to real estate.[15] By and large however, the law of personal property security interests in these jurisdictions is set out in a

[13] See the proposal for a restructuring moratorium which was never implemented - http://webarchive.nationalarchives.gov.uk/+/http:/www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/RestructuringMoratoriumConsultationDocument.pdf

[14] For proposals for a Secured Transactions Code by the Financial Law Committee of the City of London Law Society – see http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=129&Itemid=469

[15] See generally J De Lacy ed. *The Reform of UK Personal Property Security Law* (London, Routledge-Cavendish, 2010).

single statute though the underlying principles and statutory language may be complex and there may also be a complex and multi-faceted interaction with Insolvency law.

18. There have been periodic calls to reshape the English law of security interests along North American and Australasian lines.[16] These regimes also adopt a wider, functional, approach towards classification of security interests by 'recharacterising' title based mechanisms as security interests, or at least applying many of the same rules to them.

19. Lawyers in England however, generally feel comfortable with the existing legal principles and these advantages of familiarity are not easily forsaken.[17] Moreover, and more importantly, the credit industry as a whole, and banks in particular, see no obvious merits in moving over to a new system. This reluctance seems well-founded, at least from their point of view. It may be that writing a new legislative blueprint risks reopening old controversies on the scope of secured creditor rights that have long been resolved in favour of banks. When the alternatives remain to be determined, the attractions of the 'tried and trusted' are obvious. As far as practitioners are concerned, and to use a colourful metaphor, one might safely sacrifice theoretical perfection at the altar of practical utility.

Security Rights (rights in rem)

1. In general terms to what extent is it possible in your legal system to create security rights (rights in rem) over assets?

20. English law provides for the granting of security in the widest possible range of circumstances. Security rights under English common law are rights in rem. In other words, they are enforceable against third parties and not just inter parties i.e. between debtor and creditor.

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[16] See generally G McCormack "Pressured by the paradigm: the Law Commission and company security interests" in J De Lacy ed *The Reform of UK Personal Property Security Law* (London, Routledge-Cavendish, 2010) at pp 83-116; H Beale "The Exportability of North American Chattel Security Regimes: the Fate of the English Law Commission's Proposals" [2006] *Canadian Business Law Journal*; J Ziegel "The travails of English chattel security law reform – a transatlantic view" [2006] *Lloyds Maritime and Commercial Law Quarterly* 110. More recently, see the work done by the Secured Transactions Law Reform project – see http://securedtransactionslawreformproject.org/.

[17] Strong opposition to US style reform proposals have been mounted by the Financial Law committee of the City of London Law Society. Its views can be found at www.citysolicitors.org.uk and see also the article by its chair, Richard Calnan of the law firm, Norton Rose Fulbright [2005] *Butterworths Journal of International Banking and Financial Law* 25 which summarises the views of the Financial Law Committee.

21. There are many different types of security right recognised under English law but the main feature of the secured credit industry has traditionally been the charge – whether the fixed charge or the floating charge.

22. Under the floating charge it is possible to create security over the entirety of a company's business operations by simply charging the company's undertaking. It is also possible to create an additional or alternative security - the fixed charge over almost any asset belonging to a debtor company - provided that the company is restricted in the manner that it can deal with the assets that form the subject matter of the security. For instance, the courts have acknowledged the possibility of creating a fixed charge over future receivables i.e. income flows from contracts, provided that the charge giver pays the proceeds of the receivables into a special bank account under the control of the charge taker.[18]

23. It is appropriate to consider the different types of security right under English law and the extent to which these make it possible to 'collateralise' assets.

<u>Basic distinctions</u>

24. The main types of security interest are mortgages, charges, pledges and liens. There are three basic distinctions; firstly, between possessory and non-possessory security interests; secondly, between consensual and non-consensual security interests and thirdly, between legal and equitable security interests. These various distinctions cut across one another.

25. The distinction between possessory and non-possessory security interests is highly significant in practical terms. Mortgages, charges and equitable liens are non-possessory security interests; in other words, the lender does not have possession of the assets used as security whereas the pledge and the common law lien are possessory in nature i.e. the lender is entrusted with possession of the assets used as security or at least documents of title to these assets. Finally, mortgages, charges and pledges are consensual security interests i.e. in other words they are created by agreement between the parties. Liens, on the other hand, are non-consensual i.e. they arise by operation of law, irrespective of the agreement of the parties, in certain defined circumstances.

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[18] <u>Siebe Gorman v Barclays Bank</u> [1979] 2 Lloyd's Rep 142; <u>Re Brightlife Ltd</u> [1987] Ch 200; <u>Agnew v Commissioner of Inland Revenue</u> [2001] 2 AC 710; <u>National Westminster Bank plc v Spectrum Plus Ltd</u> [2005] 2 AC 680.

26. The distinction between legal and equitable security interests is perhaps most confusing to a non-common lawyer but it is easy to exaggerate the importance of the distinction in practice. The distinction stems from the historical distinction between the separate systems of common law and equity and the fact that certain kinds of security right were only recognised in courts of equity, as distinct from courts of common law, prior to the unification of the court structure in the 1870s. For example, a mortgage of future property was void at common law and consequently, any security interest in future property must necessarily be equitable in nature.[19] The distinction retains some importance in the context of priorities. Legal interests are said to bind the whole world whereas equitable interests are said to bind all, save for a bona fide purchaser of a legal interest in the same property for value without notice of the prior equitable interest. The priority issue is however affected by the question of registration because, generally speaking, a charge created by a corporate debtor is invalid in the event of the debtor going into liquidation. Moreover, if an equitable security interest on property requires registration then the fact of registration should infect the holders of subsequent legal security interests in the same property with notice.

27. A brief description of each of the different types of security right is appropriate.

[19] See e.g. Lunn v Thornton (1845) I CB 379; Tailby v Official Receiver (1888) 13 App Cas 523.

Mortgages and Charges

28. The words ‘mortgage’ and ‘charge’ are used interchangeably in many contexts[20] whereas in other settings ‘charge’ is defined so as to encompass a ‘mortgage’.[21] There is however a distinction between the two concepts. As Slade J. explained in Re Bond Worth Ltd[22] the technical difference between a ‘mortgage’ and a ‘charge’ lies in the fact that a mortgage involves a conveyance of property subject to a right of redemption, whereas a charge conveys nothing and merely gives the chargee certain rights over the property as security for the loan.[23] In other words, a mortgage involves the transfer of rights of ownership whereas the phrase ‘charge’ is a general umbrella expression to cover a right of recourse to property for security purposes.[24] The chargee has certain rights over the property of the chargor to ensure the payment of money due or the performance of some other obligation. The chargee is entitled to resort to the property only for the purpose of satisfying some liability due to him, and, whatever the form of the transaction, the chargor has an equity of redemption to get the property back free from the charge once the liability has been cleared.

29. In Re BCCI (No 8)[25] Lord Hoffmann described an equitable charge as ‘a species of charge, which is a proprietary interest granted by way of security. Proprietary interests confer rights in rem which, subject to questions of registration and the equitable doctrine of purchaser for value without notice, will be binding upon third parties and unaffected by the insolvency of the owner of the property charged. A proprietary interest provided by way of security entitles the holder to resort to the property only for the purpose of satisfying some liability due to him (whether from the person providing the security or a third party) and, whatever the form of the transaction, the owner of the property retains an equity of redemption to have the property restored to him when the liability has been discharged.’

30. In Re TXU Europe Group plc[26] Blackburne J suggested that to create an equitable charge what must be shown is: ‘(1) that a particular asset (or class of asset) has been appropriated

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[20] See Re Leyland Daf Ltd; Buchler v Talbot [2004] 2 AC 298.
[21] The Companies Act 2006 in what is now s 859A(7)(a) provides that ‘charge’ includes ‘mortgage’. The Law of Property Act 1925, s 205(1)(xvi) states that ‘mortgage’ includes any charge or lien on any property for securing money or money’s worth; and see also Insolvency Act 1986, s 248.
[22] [1980] Ch 228.
[23] Ibid at 250.
[24] See also the comments of Buckley LJ in Swiss Bank Corporation v Lloyds Bank Ltd [1982] AC 584 at 595: ‘An equitable charge which is not an equitable mortgage is said to be created when property is expressly or constructively made liable or specifically appropriated, to the discharge of a debt or some other obligation, and confers on the chargee a right of realisation by judicial process, that is to say, by the appointment of a receiver or an order for sale ....’
[25] [1998] AC 214.
[26] [2003] EWHC 3105 (Ch), [2004] 1 P & CR D20 at para 35. See also the comments of Jonathan Parker LJ, speaking for the Court of Appeal, in Edwards v Flightline Ltd [2003] 1 WLR 1200 at paras 47, 48 and

to the satisfaction of a debt or other obligation of the charger or a third party and (2) that the chargee has a specifically enforceable right to look to the asset (or class of asset) or its proceeds for the discharge of the liability.'

31. He added that whether a particular transaction gives rise to a charge depends upon the intentions of the parties, ascertained on the basis of what they have done. The intention may be express or inferred but an expression of intention would not be determinative of the legal effect of the transaction. It was equally irrelevant that the parties did not realise that the legal effect of the transaction was to create a charge if that was in fact its effect upon a proper understanding of the evidence. The decisive consideration is whether or not an asset has been made available as security for the performance of an obligation rather than for some other purpose.

32. For instance, in Re Cosslett (Contractors) Ltd[27]it was held that the right of an employer under a construction contract to retain possession of equipment brought onto its premises by the contractor and use it to complete the works did not constitute a charge. The employer was not given a proprietary interest in the equipment but only rights of possession and use and these rights were not by way of security. Millett LJ said:[28] 'It is of the essence of a charge that a particular asset or class of assets is appropriated to the satisfaction of a debt or other obligation of the chargor or a third party, so that the chargee is entitled to look to the asset and its proceeds for the discharge of the liability. This right creates a transmissible interest in the asset. A mere right to retain possession of an asset and to make use of it for a particular purpose does not create such an interest and does not constitute a charge.'

33. In Re Lehman Brothers International (Europe)[29] it was held that it was not inherent in the nature of a charge that the charge holder should be the creditor, or a trustee or fiduciary for, the creditor. It was only necessary is that the charge holder should have a specifically enforceable right to have the relevant property appropriated to the payment or discharge of the relevant debt or other obligation. That right of specific enforcement transforms what might have otherwise been a purely personal right into a proprietary interest in the charged property.

Lord Wrenbury in Palmer v Carey [1926] AC 703 at 706–707 that '[a]n agreement for valuable consideration that a fund shall be applied in a particular way may found an injunction to restrain its application in another way. But if there be nothing more, such a stipulation may not amount to an equitable assignment. It is necessary to find, further, that an obligation has been imposed in favour of the creditor to pay the debt out of the fund'.

[27] [1998] Ch 495.

[28] [1998] Ch 495 at 508.

[29] [2012] EWHC 2997 (Ch) at para 43.

34. This pragmatic nature of the charge is illustrated by the decision of the House of Lords in Re BCCI (No 8)[30] where a unanimous court categorically rejected the doctrine that it was conceptually impossible for a security interest to be taken by a creditor over his own obligations to the debtor, e.g. for a bank to be granted a charge over its own indebtedness to a customer.[31] In Lord Hoffmann's view, the law should be slow to declare a practice of the commercial community to be commercially impossible given the fact that the law was fashioned to suit the practicalities of life. He added that legal concepts like 'proprietary interest' and 'charge' were no more than labels given to clusters of related and self-consistent rules of law. Such concepts did not have a life of their own from which the rules were inexorably derived.

35. The difference between a fixed and floating charge lies in the degree of control exercised by the person taking the benefit of charge though it must be recognised that the concept of 'control' is somewhat problematic. If the charge giver has the authority to sell or dispose of assets covered by the charge in the ordinary course of business, without having to get the consent of the charge taker, then the charge is a floating charge. If however, the charge giver has no such authority, then the charge is a fixed charge.

Pledges

36. A pledge involves the actual or constructive delivery of possession of an asset to a creditor by way of security. In the case of a pledge, the pledgee (lender) is given possession of the items pledged whereas ownership of the items remains with the pledgor (borrower).[32] As possessor, the pledgee is said to enjoy a "special property" in the goods but the general property however, or what might be termed "ownership", still belongs to the pledgor.[33] The actual or constructive delivery of possession is necessary to the creation of a pledge In the case of a pledge but the delivery of possession need not be contemporaneous with the making of the loan. The requirement of delivery means that the class of assets capable of forming the subject-matter of a pledge is confined to goods and to documentary intangibles i.e. documents of title where the entitlement to the asset can be transferred by delivery of the document with any necessary indorsement.[34] Pledges may be created in respect of documents of title to goods but not over

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[30] [1998] AC 214.
[31] As was held by Millett J in Re Charge Card Services Ltd [1987] Ch 150.
[32] See generally Willes J in Halliday v Holgate (1868) LR 3 Ex 299.
[33] The pledgee has an inherent right to sell unredeemed chattels after the loan period has expired. In Matthew v TM Sutton Ltd [1994] 4 All ER 793 it was held that a pledgee who sells unredeemed chattels for more than the sum owed by the pledgor holds the surplus as a fiduciary on trust for the pledgor.
[34] In Armstrong DLW GmbH v Winnington Networks Ltd [2012] EWHC 10; [2013] Ch 156 the judge suggested (at para 47) that documentary intangibles were 'documents of title to the payment of money (instruments) (including bills of exchange, promissory notes and cheques), to negotiable securities (e.g. bearer bonds and notes) and to goods (e,g. bills of lading). Documentary intangibles that can be transferred by endorsement (rather than mere delivery) are termed "negotiable"'.

common commercial contracts. Bills of lading i.e. shipping documents, are regarded by mercantile usage as documents of title in respect of the cargo referred to in the documents and the fact that a bill of lading may be pledged suggests the usefulness of pledges for the financing of international trade.[35] The requirement however that a creditor takes a pledge over a document which is actually a document of title implies the limitations of the pledge as a security vehicle. Warehouse receipts are not, for example, documents of title nor are certificates relating to registered shares.[36] Bearer share certificates are however, documents of title.

37. The usefulness of the pledge mechanism has been extended by judicial validation of three techniques. The first is that of 'constructive delivery of possession'.[37] The second is that of attornment and the third technique is the "trust receipt". The concepts of "constructive delivery of possession" and attornment were explained by the court in Official Assignee of Madras v Mercantile Bank of India Ltd:[38]"At common law a pledge could not be created except by a delivery of possession of the thing pledged, either actual or constructive. It involved a bailment. If the pledgor had the actual goods in his physical possession, he could effect the pledge by physical delivery; in other cases he could give possession by some symbolic act, such as handing over the key of the store in which they were. If, however, the goods were in the custody of a third person, who held for the bailor so that in law his possession was that of the bailor, the pledge could be effected by a change of the possession of the third party, that is by an order to him from the pledgor to hold for the pledgee, the change being perfected by the third party attorning to the pledgee, that is acknowledging that he thereupon held for him; there was thus a change of possession and a constructive delivery; the goods in the hands of the third party became by this process in the possession constructively of the pledgee."

38. As the judicial statement shows, where goods are in the possession of a third party rather than the debtor, the third party can 'attorn' to the creditor i.e. undertake to hold the goods for the benefit of the creditor. For instance, if the debtor is an art dealer who has deposited works of art with an auction house, the latter can, by 'attorning' in favour of the creditor transfer constructive possession of the art works to the creditor and create a pledge in the creditor's favour.

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[35] For an explanation of some of the historical background to bills of lading see Sewell v Burdick (1884) 10 App Cas 74.

[36] Harrold v Plenty [1901] 2 Ch. 314.

[37] The example was given in Hilton v Tucker (1888) 39 Ch D 669 of delivery of a key as the symbol of possession where the transfer of possession itself was practically impossible.

[38] [1935] AC 53 at 58-59. In this statement, the bailor is the pledgor.

39. On the third technique, the 'trust receipt' permits a pledgee to release goods to his pledgor as agent for sale and trustee of the proceeds but simultaneously maintaining the pledge interest.[39] The fact that goods are released back by the 'pledgee' to the 'pledgor' will not prejudice the claim to a pledge where the release takes place on the basis of a trust receipt. Trust receipts received the approval of the courts in North Western Bank Ltd v Poynter, Son and Macdonalds.[40] It was held that a pledgee may redeliver the goods to the pledgor for a limited purpose without thereby losing its rights under the contract of pledge. Pledgees of a bill of lading representing a specific cargo returned the bill of lading to the pledgors to obtain delivery of the merchandise and sell it on the pledgees' behalf and account for the proceeds towards satisfaction of the debt. The court took the view that the pledgees' security was not affected and that they were entitled to the proceeds of the cargo as against the general creditors of the pledgors.

Liens

40. There are three forms of lien – common law lien, equitable lines and contractual liens. The common law lien is a right to retain possession of an asset until discharge of an outstanding debt. It is founded on possession and, except as modified either by statute or by contractual agreement between the parties, merely confers a right to retain the asset until payment.[41] The equitable lien, on the other hand, is essentially a form of non-possessory security interest arising by operation of law. The equitable lien is not dependent on possession and the holder of the lien has the right to request an order of sale from the courts.

41. In Tappenden v Artus[42] Diplock LJ compared the common law remedy of a possessory lien with other 'primitive remedies' such as abatement of nuisance, self-defence or ejection of trespassers to land. The remedy was said to be a self-help one. Diplock LJ said the possessory lien was a remedy in rem exercisable on the goods and its exercise required no intervention by the courts, for it was exercisable only by a person who had actual possession of the goods subject to the lien. A common law lien afforded a defense to an action for recovery of the goods by a person who, but for the lien, would be entitled to immediate possession.

[39] See generally North Western Bank Ltd v Poynter, Son and Macdonalds [1895] AC 56; Re David Allester Ltd [1922] 2 Ch211.
[40] [1895] AC 56.
[41] There is a procedure laid down for the disposal of uncollected goods including those deposited for storage and repair in s 12 and Schedule 1 of the Torts (Interference with Goods) Act 1977.
[42] [1964] 2 QB 185.

42. Common law liens are non-consensual in nature and are confined to historically determined situations. For instance, in Your Response Ltd v Database Business Media[43] it was held that it was not possible to have a common law lien over intangible property. This meant that when the parties to a database hosting contract did not provide in the agreement about what happened to the database when the contract ended, the service provider had to return the database to the customer. The provider could not claim a common law lien over the database to ensure payment of its fees.

43. Statute however, has sometimes brought into existence lien-type rights. Section 88 Civil Aviation Act 1982[44] which was considered in Bristol Airport plc v Powdrill[45] serves as a case in point. The section confers on airport authorities the right to detain aircraft to force payment of unpaid airport charges. The Court of Appeal took the view that the statutory right of detention was a 'lien or security' over property within the meaning of section 248 of the Insolvency Act 1986. In general a common law lien equals a passive power of detention. The lienee may however, have a power of sale in the case of a statutorily-conferred lien as is the situation with section 88 Civil Aviation Act 1982. Moreover, statute sometimes gives the holder of the lien a power of sale in other circumstances.[46]

44. An equitable lien is a form of equitable charge arising by operation of law.[47] In other words, it is a right against property which arises automatically in certain circumstances to secure the discharge of an actual or potential indebtedness. The equitable lien may be enforced by obtaining an order for the sale of the property from the court.[48] The best known equitable liens are the vendor's lien for unpaid purchase money and the purchaser's lien; both arising in the case of contracts for the sale of land.[49] The former is founded on the principle that 'a person, having got the estate of another, shall not, as between them, keep it, and not pay the consideration.'[50] The purchaser's lien rests on the converse principle that a person who has

[43] [2014] EWCA Civ 281
[44] For an Irish equivalent see section 40 of the Air Navigation and Transport (Amendment) Act 1998.
[45] [1990] Ch 744.
[46] See, for example, Torts (Interference with Goods) Act 1977, sections 12 and 13. Moreover, under the Civil Procedure Rules, r 25.1(1)(c)(v) the court has power to order the sale of any property which is the subject of a claim or as to which any question may arise on a claim and which is of a perishable nature or which for any other good reason it is desirable to sell quickly.
[47] See generally on equitable liens the decision of the High Court of Australia in Hewett v Court (1983) 149 CLR 639.
[48] Bowles v Rogers (1800) 31 ER 957; Re Stucley [1906] 1 Ch 67.
[49] Under sections 41-43 Sale of Goods Act 1979 an unpaid seller of goods has a possessory lien and also a right to stop goods in transit but the courts have refused to recognise equitable liens in sale of goods transactions that operate independently of the legislation – Re Wait [1927] 1 Ch 606.
[50] Mackreth v Symmons (1808) 15 Ves 329 at 340; 33 ER 778 at 782.

agreed to convey property in return for a purchase price should not be allowed to keep the price if he fails to convey the property as agreed.[51]

2 Is it possible to create security rights over all assets of the debtor?

45. A distinction should be drawn in this connection between corporates and individuals. As far as corporates are concerned, English law permits ‘all-assets’ security through the medium of the floating charge and this facilitates lending.

46. As the Law Commission has pointed out, it is also possible for consumers to borrow on the security of assets but significant legal obstacles exist in the way of this:[52] ‘If a lender wishes to take a charge or mortgage over a consumer’s existing goods, they must comply with the complex requirements laid down in the Bills of Sale Acts. Some of the restrictions imposed by those Acts are valuable. For example, the requirement that all the consumer’s property be listed in the documents prevents consumers from charging goods that they may acquire in the future and from creating a floating charge over their goods.”’
47. The Bills of Sale Acts date from the 19th century and essentially require that charges over goods granted by individuals should be in a certain prescribed form and registered at court offices.[53] The requirements of the Acts are difficult to comply with in practice but non-compliance with the statutory requirements means that the security granted by the documentation is void; not only against the grantor’s trustee in bankruptcy but also against the grantor himself. The obscure and archaic statutory provisions[54] mean than consumer finance in England, when done on a ‘secured’ basis, is generally done through ‘quasi-security’x arrangements such as the hire purchase/conditional sale agreement. Bills of Sale lending however, has increased particularly with respect to loans over motor vehicles and the rise of specialist lenders. This has led to calls for reform of the Bills of Sale Acts and the

[51] See Rose v Watson (1864) 10 HL Cas 672 at 684.
[52] Law Com no 296 *Company Security Interests* (2005) at para 1.50. The report is available at www.lawcom.gov.uk/

[53] The main Acts are the Bills of Sale Acts of 1878 and 1882. The registration requirement is laid down in s 8 of the 1878 Act. The prescribed form is set out in a schedule to the 1882 Act. See generally G McBain “Repealing the Bills of Sale Acts” [2011] *Journal of Business Law* 475. There is similar Bills of Sale legislation in Ireland.
[54] See the comments of Vos J in Chapman v Wilson [2010] EWHC 1746 (Ch) at para 129 ‘The twists and turns of the Bills of Sale Acts have already been the subject of much judicial and academic comment…. 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.’

implementation of new measures of consumer protection. [55] For example, the Consumer Credit Act 1974 provides that where a debtor under a hire purchase or conditional sale agreement has paid more than a third of the price, the creditor may not repossess the goods except by means of a court order.66 This procedural safeguard does not apply in respect of bills of sale. If a debtor defaults on a loan that is secured by a registered bill of sale, the lender on serving a default notice may obtain possession of the goods (an example being a motor vehicle) without any court order.[56]

48. The Agricultural Credits Act 1928 exempts 'agricultural charges' as defined in the Act from the requirements of the Bills of Sale legislation. Essentially, the Act permits individual farmers to grant fixed or floating charges over their livestock and machinery without having to adhere to the burdensome Bills of Sale Acts conditions.[57] The Act is designed to facilitate lending but is of marginal significance since extensive farming in the UK is often carried out under the corporate umbrella.[58]

49. For corporates, the floating charge developed in the 19th century. It is essentially a charge on a class of assets, both present and future, which permits the company creating the charge to dispose of a clean title to the assets which form the subject-matter of the charge until some event occurs which causes the holder of the charge to intervene. Such an event is called a "crystallising" event. Put another way, the corporate debtor has management autonomy with respect to the category of assets covered by the floating charge. The centrality of the floating charge in English lending practice was acknowledged in Agnew v Commissioner of Inland Revenue.[59] Lord Millett said:[60]'The floating charge is capable of affording the creditor, by a

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[55] See the Department for Business, Innovation and Skills consultation on proposals to ban the use of bills of sale for consumer lending – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31481/a_20better_20deal_20for_20consumers_20consultation_20on_20proposals_20to_20ban_20the_use_20of_20bills_20of_20sale_20for_20consumer_20lending.pdf
In the event, the proposals were never implemented and instead an industry Code of Practice was put in place instead – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31484/11-516-government-response-proposal-ban-bills-of-sale.pdf.
See now the Law Commission proposals on Bills of Sale - http://www.lawcom.gov.uk/project/bills-of-sale/

[56] Bills of Sale (1878) Act (Amendment) Act 1882, sections 7 and 7a as amended by the Consumer Credit Act 2006.
[57] See section 5 of the Act.
[58] In Ireland, the Agricultural Credit Act 1978 applies. Sections 23 and 26 of the Act requires that charges, whether fixed or floating, over agricultural stock cannot take effect unless they are registered in local courts offices. The Act applies to charges created both by individuals and by companies. In Re Castlemahon Poultry Products Ltd (13th December 1985, unreported) it was held that registration with the Companies registry means that a company does not have to register a second time in the chattel mortgage register under the Agricultural Credit Act though there is no express statutory basis for this decision. In the UK, the Agricultural Credits Act 1928 only applies to charges granted by individual farmers – see s 5(7).
[59] [2001] 2 AC 710.
[60] [2001] 2 AC 710 at para 8.

single instrument, an effective and comprehensive security upon the entire undertaking of the debtor company and its assets from time to time, while at the same time leaving the company free to deal with its assets and pay its trade creditors in the ordinary course of business without reference to the holder. Such a form of security is particularly attractive to banks, and it rapidly acquired an importance in English commercial life which … should not be underestimated.'

50. In Re Spectrum Plus Ltd[61] Lord Scott explained the history and development of the floating charge. He said: 'By the middle of the 19th century industrial and commercial expansion in this country had led to an increasing need by companies for more capital. Subscription for share capital could not meet this need and loan capital had to be raised. But the lenders required security for the loans. Traditional security, in the form of legal or equitable charges on the borrowers' fixed assets, whether land or goods, could not meet the need. The greater part of most entrepreneurial companies' assets would consist of raw materials, work in progress, stock-in-trade and trade debts. These were circulating assets, replaced in the normal course of business and constantly changing. Assets of this character were not amenable to being the subject of traditional forms of security.'

51. Lord Scott pointed out that by the last decade of the 19th century the "floating security" had become firmly established and was in regular use. This new form of security was not created by statute but had been developed by lawyers and judges out of the needs of the commercial and industrial entrepreneurs of the time.

52. Floating charges have been the subject of statutory regulation for over a century, although there is no statutory definition of a floating charge. The expression 'floating charge' bears the meaning attributed to it by judicial decision. A leading account of the floating charge is contained in the judgment of Romer LJ in Re Yorkshire Woolcombers Association Ltd[62] and this description refers primarily to the nature of the assets over which the security is taken.[63] Romer LJ said:[64]'[If] a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that, by the charge, it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may

[61] [2005] 2 AC 680 at paras 95, 97.
[62] [1903] 2 Ch 284.
[63] The nature of the floating charge was first set out by the Court of Appeal in Re Panama, New Zealand and Australian Royal Mail Co (1870) 5 Ch App 318.
[64] [1903] 2 Ch 284 at 295.

carry on business in the ordinary way as far as concerns the particular class of assets I am dealing with.'[65]

53. Normally a fixed charge is taken over 'fixed' or specific assets, and a floating charge over circulating assets. The essence of the distinction however, is the autonomy of the charge giver in dealing with the assets charged. If the charge giver has freedom to deal with the assets charged in the ordinary course of business then the charge is a floating charge but if the charge giver has no such freedom then the charge is a fixed charge. The distinction nevertheless, becomes somewhat blurred in that the floating charge is compatible with some restrictions on the debtor's conduct and such restrictions are common in floating charges.[66] In Re Cosslett (Contractors) Ltd[67] it was held that the fixed/floating charge distinction turned on the question of control over the charged assets. Millett LJ observed:[68]''The chargor's unfettered freedom to deal with assets in the ordinary course of business free from the charge is obviously inconsistent with the nature of a fixed charge; but it does not follow that his unfettered freedom to deal with the charged assets is essential to the existence of a floating charge… The question is not whether the chargor has complete freedom to carry on his business as he chooses, but whether the chargor has control of the charged assets.'

54. Apart from the fact that the security giver has a greater liberty to dispose of the assets in the ordinary course of business, there are many other reasons for distinguishing between fixed and floating charges over property.[69]

55. First, under the provisions of the Insolvency Act dealing with the avoidance of transactions, the floating charge is more vulnerable to challenge in a liquidation than a fixed charge. Both fixed and floating charges as well as other forms of transaction are subject to attack under s 239 of the Insolvency Act, which renders voidable acts or things done by an insolvent company in the 6 month period immediately prior to liquidation or administration that have the effect of putting a creditor in a better position than it would occupy in the event of the company's

[65] It should be stressed that it is the members of the class rather than the boundaries of the class that is changing.
[66] The leading cases are Re Brumark Ltd; Agnew v Commissioner of Inland Revenue [2001] 2 AC 710 and National Westminster Bank plc v Spectrum Plus Ltd [2005] 2 AC 680.
[67] [1998] Ch 495.
[68] [1998] Ch 495 at 510. The decision of the Court of Appeal was upheld by the House of Lords – see Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend Borough Council [2002] 1 AC 336.
[69] Both fixed and floating charges (and indeed the other forms of security interest) exist in the Republic of Ireland and it is necessary to make the distinction for largely similar reasons though tax claims still have preferential status in Ireland in certain circumstances and there is no carve out of floating charge realisations for the benefit of unsecured creditors. The legislation relating to insolvency is also largely similar though there is no exact equivalent to administration. Instead, there is an 'examinership' procedure introduced by the Companies (Amendment) Act 1990 which performs broadly similar functions. See generally on this procedure T Courtney *The Law of Companies* (Bloomsbury, London, 3rd ed 2012) Chapter 22.

insolvent liquidation and where the company was influenced by a desire to prefer the creditor or a guarantor for the debt. The ‘influenced by a desire’ criterion has been interpreted as requiring a subjective wish to improve the creditor’s position[70] and means that in practice there is very little chance of setting aside transactions unless the benefit has gone to a connected person.[71] On the other hand, floating charges alone are caught by the more draconian and far-reaching s 245 of the Insolvency Act 1986. This provision invalidates floating charges granted by insolvent companies to secure past indebtedness in the 12-month period prior to liquidation or administration.

56. Secondly, the fixed charge outranks the floating charge for priority purposes. Where there are two charges over the same property; one fixed and one floating, the fixed charge holder will generally prevail over the floating charge holder in any priority battle. This has given rise to the expression ‘the fixed charge for priority; the floating charge for control’.

57. Thirdly, under what is now s 176A of the Insolvency Act 1986, introduced by s 252 of the Enterprise Act 2002, a proportion of set floating charge recoveries are set aside for the benefit of unsecured creditors.[72] The percentage is calculated on a sliding scale basis and constitutes 50 per cent of the first £10,000, then 20 per cent of the remainder but subject to an overall ceiling of £600,000 so that the fund for unsecured creditors will not in any case exceed £600,000.[73] The set aside provisions, however, only operate in respect of floating charges. If a security taker has the benefit of a fixed charge, its security will not be subject to the carve-out for unsecured creditors.

58. Fourthly, preferential claims are payable out of floating charge assets in priority to the floating charge holder, though the latter can recoup itself out of the free assets of the company to the extent that these assets are sufficient to satisfy the claims secured by the floating charge.[74]

59. Fifthly, in an administration it appears that under Schedule B1, para 99(3) of the Insolvency Act 1986 the administrator’s remuneration and expenses are payable out of floating charge

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[70] Re MC Bacon Ltd [1990] BCC 78.
[71] The company is presumed to have been influenced by a desire to prefer if the preference was given to a connected person and there is also a longer 2 year vulnerability period.
[72] The Enterprise Act abolished Crown Preference and the fund for unsecured creditors was established as a balancing measure to ensure that the benefits of the abolition did not go exclusively for the benefit of unsecured creditors. The fund has its origins in a recommendation of the Cork Committee on Insolvency Law and Practice (Cmnd 8558 at para 1538) that 10 per cent of net realisations of property subject to a floating charge should be set aside for unsecured creditors.
[73] SI 2003/2097 Insolvency (Prescribed Part) Order 2003, SI 2003/2097.
[74] Insolvency Act 1986, IA 1986, sections 40 and 175.

assets in priority to the floating charge holder, but these items cannot be paid in the same way out of fixed charge assets.[75]

60. Finally, under the Insolvency Act 1986 the holder of a floating charge over the whole or substantially the whole of a company's assets has certain powers in relation to the appointment of an administrator, including the power to make an appointment out of court.[76]

61. A floating charge 'crystallises' i.e. becomes fixed upon the happening of certain events. The effect of crystallisation is to terminate the company's management authority, i.e. its freedom to dispose of assets in the ordinary course of business clear of the security interest. It seems, however, on the basis of normal agency principles that a third party who is unaware that crystallisation has occurred pursuant to an automatic crystallisation is entitled to assume the continuance of a company's managerial authority implied by the floating charge until cessation of that authority has been brought explicitly to its attention.[77]

62. The floating charge crystallises upon the charge holders, or their trustees, taking possession or appointing a receiver. It also crystallises if certain events occur which, under the instrument of charge, renders the security enforceable. If the company goes into liquidation the charge will also crystallise.

63. In Re Woodroffes (Musical Instruments) Ltd[78] it was decided that the cessation of a company's business had the same effect. This was because cessation removed the raison d'être of the floating charge, which was to permit the company to carry on business in the ordinary way insofar as the class of assets charged was concerned.

64. Then, in Re Brightlife Ltd[79] Hoffmann J held that notice given by the charge holder to the chargor could convert a floating charge into a fixed charge. He said it was not open to the courts to restrict the contractual freedom of parties to a floating charge. He pointed to the limited and pragmatic interventions by the legislature in the area and suggested that these rendered it wholly inappropriate for the courts to impose additional restrictive rules on grounds of public policy.

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[75] See also Insolvency Act 1986, section 19.
[76] Insolvency Act 1986, IA 1986 sections 72A-H (which were added by Enterprise Act 2002 s 250) and Schedule B1 of the Insolvency Act which contains the substantive law on 'new' administrations.
[77] See the comments of McGarvie J in the Australian case Horsburgh v Deputy Commissioner of Taxation (1984) 54 ALR 397 at 413 who doubted whether 'modern equity would be forced to run in such established grooves that if employees received pay and customers bought goods from a company, while reasonably unaware that the property of the company, had become subject to a fixed equitable charge, they would be losers'.
[78] [1986] Ch 366.
[79] [1987] Ch 200.

65. The decision Re Brightlife Ltd opens the door for clauses that stipulate for crystallisation on the occurrence of events such as borrowing of the company exceeding a certain level or its assets falling below a stated sum. These events may take place at a time unknown to the chargee, so that he is not aware that crystallisation has occurred.

66. One of the objectives of widely drafted crystallisation clauses is to secure the charge holder as prominent a place as possible in the queue of creditors. The Insolvency Act 1986 has, however, reduced the attractions of automatic crystallisation clauses in this respect. According to sections 40 and 175 of the Insolvency Act, preferential debts are payable in priority to the claim secured by a floating charge in a receivership or liquidation.[80] A floating charge is defined in s 251 of the Insolvency Act, for the purpose, inter alia, of these provisions, as a charge that, as created, was a floating charge.[81] So even if a floating charge has crystallised automatically prior to receivership or liquidation, it still ranks after the preferential creditors. A crystallised floating charge will still, however, take priority over a prior ranking floating charge, a subsequently created equitable fixed charge and execution creditors.

3 Is it possible to create security rights over assets not yet owned by the debtor at the time of the creation of the security interest?

67. It is possible to create security rights over assets not yet owned by the debtor at the time of the creation of the security interests by means of both fixed and floating charges. In respect of the extensiveness of security interests, English law earns a reputation for being favourably disposed towards the secured creditor.[82]

68. In the 19th century legal practitioners and the courts responded to the growing needs of commerce by the development of an all-encompassing form of security - the floating charge. The transition from an agricultural to an industrial economy brought about by the Industrial Revolution meant that only a small proportion of a company's wealth might be tied up in buildings and fixed equipment. The bulk of a company's assets could now be in the form of raw materials, manufactured goods or goods in the process of manufacture, stock-in-trade and debts owed to the company by trade customers. The existing fixed forms of security could not capture fully these assets and the advent of the limited liability company meant that bank

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[80] In Ireland, the equivalent provisions – now sections 440 and 621 Companies Act 2014- have now been interpreted by the Supreme Court in the same way - see Re JD Brian Ltd [2015] IESC 62 - overturning the decision of the High Court at {2011] IEHC 113.
[81] See also the Insolvency Act 1986, s 29(2).
[82] See generally on the history and development of the floating charge R Pennington, "The Genesis of the Floating Charge" (1960) 23 Modern Law Review 630.

lending on a totally unsecured basis was an even more hazardous proposition.[83] There were two major developments in response to this state of affairs.

69. Firstly, the validity of fixed charges on after-acquired property - both goods and receivables - was recognised.[84] Holroyd v Marshall[85] is the leading House of Lords authority from the 19th century concerning goods. Lord Westbury said in the case that 'if a vendor or mortgagor agrees to sell or mortgage property, real or personal, of which he is not possessed at the time, and he receives the consideration for the contract, and afterwards becomes possessed of property answering the description in the contract, there is no doubt that a Court of Equity would compel him to perform the contract, and that the contract would, in equity, transfer the beneficial interest to the mortgagee or purchaser immediately on the property being acquired.' The contract binds the property as soon as it comes into existence.

70. In Tailby v Official Receiver[86] the House of Lords confirmed the validity of an assignment of future receivables by way of security. The case concerned a security instrument that purported to assign all the book debts due and owing, or which might during the continuance of the security, become due and owing to the security provider.[87] It was held that the assignment of future book debts, though not limited to book debts in any particular business, was sufficiently defined. It transferred to the security taker the equitable interest in book debts that arose after the date of the assignment, whether these debts arose from the business carried on by the security provider at the time of the assignment or in any other business. Lord Macnaghten said[88] that it 'has long been settled that future property, possibilities and expectancies are assignable in equity for value. The mode or form of assignment is absolutely immaterial provided the intention of the parties is clear. To effectuate the intention an assignment for value, in terms present and immediate, has always been regarded in equity as a contract

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[83] Limited Liability Act 1855.
[84] Holroyd v Marshal (1862) 10 HL Cas 191 and Tailby v Official Receiver (1888) 13 App Cas 523.
[85] Holroyd v Marshall (1862) 10 HL Cas 191 at 209 and Tailby v Official Receiver (1888) 13 App Cas 523. According to Bridge, Gullifer, McMeel and Worthingon, The Law of Personal Property (London, Sweet & Maxwell, 2013) at p 178 the House of Lords in Holroyd v Marshall 'insisted that it was merely applying established principles of law, although the facts suggest this rather underplays the decision's significance'.
[86] (1888) 13 App Cas 523.
[87] There is not a statutory definition of book debts but they are generally defined as debts that could or would be entered as books of account as debts owing to the business - Paul and Frank Ltd v Discount Bank (Overseas) Ltd [1967] Ch 348. They are an asset of the business in the same way as land or buildings. The meaning of the word 'receivable' depends on the particular contractual or statutory context but it may potentially encompass assets or income flows that are not caught by the expression 'book debts'. Lending agreements may purport to create a charge over both 'book debts and receivables'.
[88] (1888) 13 App Cas 523 at 543 and see also his comments at 546 that '[l]ong before Holroyd v. Marshall was determined it was well settled that an assignment of future property for value operates in equity by way of agreement, binding the conscience of the assignor, and so binding the property from the moment when the contract becomes capable of being performed, on the principle that equity considers as done that which ought to be done…'

binding on the conscience of the assignor and so binding the subject-matter of the contract when it comes into existence, if it is of such a nature and so described as to be capable of being ascertained and identified.'

71. Secondly, the floating charge received approval from the courts and this form of security makes it possible to create a security interest over the entire existing and future assets of a corporation with relative ease. In Re Panama, New Zealand and Australian Royal Mail Co[89] an instrument of charge (debenture) purported to charge a company's undertaking. It was held that the word 'undertaking' referred to all the property of the company, not only that existing at the date of the debenture, but also including property that might be acquired by the company subsequently. Moreover, the word 'undertaking' was taken to infer that the company could carry on business in the ordinary way without interference by the charge holder.

4 Is it possible to create security rights over assets that are not yet in existence at the time of the execution of the security agreement?

72. Yes. This can be done in the same way as it is possible to create security rights over assets not yet owned by the debtor at the time of the creation of the security interest.

5 Is it possible to have a "global" security agreement i.e. covering all assets of the debtor?

73. This can be done by means of the floating charge. Corporate debtors can create a floating charge over their entire business operations if they simply charge their 'undertaking'.

74. The requirements of the Bills of Sale Acts means that it is not practicable for individuals to create 'all assets' security.[90]

[89] (1870) 5 Ch App 318.
[90] Law Com no 296 *Company Security Interests* (2005) at para 1.50. The report is available at www.lawcom.gov.uk/

6 In general terms, what are the formalities in your legal system for the creation of a security interest over assets?

75. In theory and in general there are no special requirements under English law for the creation of a security interest. Both charges and pledges may be created orally though invariably there will be a written security agreement which may be a long and detailed.

7 Do the rules for the creation of security rights vary depending on the nature of the asset in question?

76. There are some variations depending on the nature of the asset in question.

77. Under s 2 of the Law of Property (Miscellaneous Provisions) Act 1989 a contract for the sale of an interest in land must be in writing and the wording is sufficiently broad to include the creation of a security interest over land.[91] So oral security interests of whatever type over land are impermissible.

78. The different types of security interest that may exist have somewhat different formality requirements. Since 2003 the only way of creating a legal mortgage over registered land is by what is referred to by statute as a charge by deed expressed to be by way of legal mortgage.[92] The shorthand for this is a legal charge and the deed simply states that the property in question has been charged with the debt by way of legal mortgage.[93]

79. An equitable mortgage over land can arise in two situations. The first is where the 'owner' has merely an equitable rather than a legal interest in the property. In this circumstance any mortgage is necessarily equitable in character. The second situation is where there is a contract to create a legal mortgage. Equity regards as done what ought to have been done

[91] In Ireland the relevant provision is s 2 Statute of Frauds (Ireland) Act 1695 which requires an agreement for the sale of an interest in land to be evidenced in writing.

[92] See generally Megarry & Wade *The Law of Real Property* (8th ed 2012) chapter 24. With registered land, title to the land is registered at the Land Registry. It is to be contrasted with unregistered land where there is no statutory register of title. Nearly all urban land is now registered land – see generally www.landregistry.gov.uk/

[93] See s 87 Law of Property Act 1925 and s 23 Land Registration Act 2002. In Ireland, under s89 of the Land and Conveyancing Law Reform Act 2000, all mortgages can only be created by way of charge. This provision applies to unregistered titles what previously, under s 62 of the Irish Registration of Title Act 1964, was the position in respect of registered titles under the Irish Land Registry and see also the Property Registration Authority in Ireland – www.prai.ie/.

and an equitable mortgage is deemed to come into existence as soon as there is a specifically enforceable contract for the creation of a legal mortgage.

80. No specific form or language is required for the creation of an equitable charge on land. It suffices if language is used which makes it clear that the creditor has a right to look to the property for payment of the debt.

81. There is also a special form for mortgages of ships. In accordance with the Merchant Shipping Act 1995 and the Merchant Shipping (Registration of Ships) Regulations 1993[94] legal mortgages of ships must be in a prescribed form[95] and there is also provision under the legislation for a centralised register for ships, divided into separate Parts for different kinds of ship. It should be noted however that the requirement for a prescribed form only applies to legal mortgages and not to equitable mortgages.

82. In respect of intellectual property rights, s 30(6) of the Patents Act 1977 provides that any assignment or mortgage of a patent is void unless it is in writing and signed by or on behalf of the assignor or mortgagor.[96] It is laid down in the Trade Marks Act 1994 that a charge on a registered trade mark is not effective unless it is in writing signed by or on behalf of the chargor.[97]Similar requirements apply in respect of security over registered designs.[98]

Enforcement of security and insolvency proceedings

8 To what extent is it possible for the secured party to enforce the security without having to use formal court procedures?

83. Traditionally under English law, secured creditors have had great freedom and flexibility in relation to the enforcement of their security interests. The enforcement of security has been seen largely as a self-help remedy to be exercised by the secured creditor in accordance with

[94] SI 1993/3138. For the Irish provision see s 50 Merchant Marine Act 1955.
[95] Merchant Shipping Act 1995, section 16 Sch 1.
[96] In Ireland, s 79 Patents Act 1992 provides that the rules of law applicable to the ownership and devolution of personal property shall apply in relation to patent applications and patents as they apply in relation to other choses in action.
[97] Section 24(3) and (4). Section 28 of the Irish Trade Marks Act 1996 is in similar terms.
[98] Registered Designs Act 1949, s 15B. For Ireland see s 76(3) of the Industrial Designs Act 2001.

the provisions of the security agreement. The enforcements rights vary somewhat however depending on the nature of the security and the type of secured asset (collateral)

Pledges and pawns

84. In the case of a pledge, if the pledgor defaults in respect of the loan agreement, then the pledgee has authority to sell the goods pledged and to apply the proceeds in discharge of the debt.[99] There is no requirement that the sale should be by way of public auction but, nevertheless, the sale must be a provident one. If however, the proceeds of sale are insufficient to discharge the debt, then the pledgee has a right of action against the pledgor in respect of the balance. In Jones v Marshall[100] it was explained that if the item pledged does not realise the amount lent on it, the pledgee may bring an action for the deficit. The converse case was examined in Matthew v TM Sutton Ltd[101] and it was held that a pledgee who sells unredeemed chattels for more than the sum owed by the pledgor holds the surplus as a fiduciary on trust for the pledgor.

85. There appears to be a statutory exception to this in s 120 Consumer Credit Act 1974 which applies where the loan period is at least 6 months; the pledge has not been redeemed and the amount of the credit does not exceed £75. This seems to be a pragmatic response to the situation where low value items are pledged to a 'pawnbroker' and the pledger takes no steps to redeem the pledge. Effectively the pawnbroker is allowed to take the items in satisfaction of the debt but, in theory, the items could be worth a lot more than the outstanding debt.

86. The expression 'pawnbroker' connotes somebody who makes small loans in return for the pledge of domestic goods. The services of a pawnbroker were often availed of by persons denied conventional sources of credit, and in nineteenth-century literature a strong association was made between pawn broking and the driving of harsh bargains.[102] The recent financial crisis may have witnessed a revival of this rudimentary form of credit though pawn broking has long been subject to statutory controls which contain a measure of consumer protection including the Pawnbrokers Acts 1872–1960. These Acts have now been replaced by the Consumer Credit Act 1974. Sections 114–122 of the Consumer Credit Act lay down various requirements that must be complied with in respect of transactions of pawn or pledge but the regime covers only 'articles taken in pawn under a regulated consumer credit agreement'.[103]

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[99] See Bowen LJ in Re Hubbard ex parte Hardwick (1886) 17 QBD 690 at 698.
[100] (1890) 24 QBD 269.
[101] [1994] 4 All ER 793.
[102] See Charles Dickens *Sketches by Boz* and Kellow Chesney *The Victorian Underworld* (1970). See generally N Palmer *Bailment* (LawBook, Sydney, 2nd ed 1991) at p 1380.
[103] For Ireland see the Pawnbrokers Act 1964, which remains in force, and in particular sections 29 and 30.

All consumer credit agreements are now regulated by the 1974 Act unless specifically exempted, regardless of the amount of the credit. The Act does not apply however, to cases where the pledgor is a body corporate.

Possessory liens

87. In the case of a possessory lien, the remedies of the holder of the lien (lienee) are in general much more restricted than would be the case if the transaction was in the nature of a pledge. The distinction between the two types of transaction is well established. In Donald v Suckling,[104] for instance, it was observed:[105]'In the case of a simple lien there can be no power of sale or disposition of the goods, which is inconsistent with the retention of the possession by the person entitled to the lien; whereas in the case of a pledge or pawn of goods, to secure the payment of money at a certain day, on default by the pawnor, the pawnee may sell the goods deposited and realise the amount, and become a trustee for the surplus for the pawnor; or even if no day of payment be named, he may, upon waiting a reasonable time, and taking the proper steps, realise his debt in like manner.'

88. The powers of a lien holder however, may be expanded either by contract between the parties or by statute. For instance, in relation to the statutory lien granted by the Civil Aviation Act 1982 in respect of unpaid airport charges, s 82 provides that the airport authority may sell the aircraft in order to satisfy the charges if the charges are not paid within 56 days of the date when the detention begins.

Mortgages and charges

89. With the pledge and the possessory lien, the creditor already has possession of the assets that are subject to the security interest. Mortgages and charges are non-possessory security interests but the charge holder may seek possession of the property as a prelude to sale and obtaining satisfaction of the debt from the proceeds of sale of the property. In fact, it has even been held in respect of a legal mortgage that the mortgagee 'may go into possession before the ink is dry on the mortgage unless there is something in the contract, expressly or by implication, whereby he has contracted himself out of that right'.[106] No such power exists in relation to a charge.[107] But a well drafted security agreement would typically contain extensive

[104] (1866) LR 1 QB 585.
[105] (1866) LR 1 QB 585 at 604.
[106] Four Maids Ltd v Dudley Marshall (Properties) Ltd [1957] Ch 317 at 320.
[107] In respect of equitable mortgages of land, s 90 Law of Property Act 1925 provides that the court may make an order of possession in favour of the secured party as a preliminary to sale. In Ireland, under s 97 of the Land and Conveyancing Law Reform Act 2009, a mortgagee may not take possession of mortgaged property unless the mortgagor consents in writing to such taking at least 7 days beforehand.

provisions specifying circumstances of default in which the creditor may take control of, and ultimately sell, the debtor's property.

90. The Consumer Credit Acts contains detailed measures on protection for consumers in respect of credit transactions including mortgages and charges over lands and goods. But the Act is subject to a number of exemptions which means that most mortgages for house purchase or commercial finance are excluded though second mortgages on residential property securing consumer loans would be included. Where the consumer credit legislation does apply, the creditor must serve a default notice specifying the nature of the alleged breach. If the breach is capable of remedy, the debtor must be given at least 14 days to remedy the breach. If the breach is not capable of remedy, then the default notice should specify the sum that is required to be paid as compensation for the breach and give the debtor at least 14 days to pay.[108]

91. The debtor is also given the right to redeem the loan early at any time and the court, if it appears just to do so, may suspend any possession order and/or provide for the payment by instalments of any sums owed having regard to the means of the debtor.[109] Also in the cases of land mortgages subject to the Act, a court order is needed for enforcement.[110]

92. More generally in cases where the secured property consists of or includes a dwelling house, the court is given a wide statutory discretion in possession actions either to adjourn those proceedings, suspend the execution of any possession order, or postpone the date for delivery of possession for such period as it thinks fit.[111]

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[108] See sections 87 and 88 Consumer Credit Act 1974.

[109] Section 94 Consumer Credit Act 1974.

[110] Section 126 Consumer Credit Act 1974. In Ireland there is the Consumer Protection Code produced by the Central Bank under various statutory powers including Section 8H of the Consumer Credit Act 1995. Entities regulated by the Central Bank must comply with the code. Failure to comply may result in the Central Bank using its administrative sanctions procedure and culminating in the entity losing its licence to operate in Ireland. Failure to comply with the code will not however, automatically invalidate a loan or mortgage contract, or render it unenforceable - Friends First Finance Ltd v Cronin [2013] IEHC 59.

[111] See s 36 Administration of Justice 1970 and s 8 Administration of Justice Act 1973. The effect of a possession order on "family life" under the European Convention on Human Rights, implemented in the UK by the Human Rights Act 1998, must also be considered. For more general powers in Ireland to stay orders for possession and sale of mortgaged property, see s 101 Land and Conveyancing Law Reform Act 2009. See also s 2 of the Irish Land and Conveyancing Law Reform Act 2009 which permits the adjournment of possession proceedings affecting the mortgagor's principal private residence to facilitate the making by the mortgagor of a proposal for a personal insolvency arrangement. There has been some disagreement in the Irish courts about whether a failure to comply with the requirements of the Code of Conduct on Mortgage Arrears (CCMA) promulgated by the Irish Central Bank might affect a mortgagee's ability to obtain a possession order in relation to residential mortgage property – compare Stepstone Mortgage Funding Limited v Fitzell [2012] IEHC 142 with Irish Life & Permanent plc v Duff [2013] IEHC 43. In Irish Life and Permanent plc -v- Dunne [2015] IESC 46 it was held by the Irish Supreme Court that so far as a breach of the Code involves a failure by a lender to abide by the moratorium period referred to in the Code, but in no other circumstances, non-compliance with the Code affects, as a matter of law, a lender's entitlement to obtain an order for possession.

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93. Leaving aside these provisions, the common law is pretty tolerant of self-help enforcement of security rights under mortgages and charges. Under the standard charge of corporate assets, once payment is due under the terms of the loan agreement, a demand for payment has been made and sufficient time has elapsed to allow the debtor to implement the mechanics of payment,[112] the secured creditor may enforce the security by taking possession of the secured assets. The more normal practice though would be to appoint a receiver over the charged assets and s101 Law of Property Act 1925 confers an express power to appoint a receiver of the income of the charged property. The Insolvency Act 1986 also introduced the concept of an 'administrative receiver' defined as a receiver of the whole, or substantially the whole of a company's property, appointed by a floating charge holder.[113]

Receivership as a security enforcement remedy

94. Receivership as a remedy developed historically in the context of real property. The remedy developed because secured creditors were reluctant to take possession of mortgaged property due to the potential risks of incurring a liability to the mortgagor.[114] A secured creditor who went into possession was liable on the basis of 'wilful default'. In consequence, the practice developed of the mortgagee instead appointing a receiver and manager who would take possession of the mortgaged business and proceed to run its operations with a view to using the proceeds so as to reduce the secured debt.[115] Also, contracts of loan began to specify that any receiver appointed would be deemed to be the agent of the mortgagor rather than the mortgagee. This state of affairs has received statutory endorsement. Section 109(2) of the Law of Property Act 1925 provides that any receiver appointed pursuant to that statute is deemed to be the agent of the mortgagor who is solely responsible for the receiver's act or defaults unless the mortgage deed provides otherwise.[116] Section 44 of the Insolvency Act 1986 lays down that an administrative receiver is deemed to be the company's agent unless and until the company goes into liquidation.[117]

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112 See Bank of Baroda v Panessar [1987] Ch 335.
113 Section 29(2) Insolvency Act 1986.
114 Gaskell v Gosling [1896] 1 QB 669 and [1897] AC 575.
115 The historical development of the law was explained by Rigby LJ in Gaskell v Gosling [1896] 1 QB 669 at 692–693. This judgment was approved by the House of Lords in the same case: [1897] AC 575. For the distinction between a receiver on the one hand and a receiver and manager on the other – see Jessel MR in Re Manchester & Milford Rly Co (1880) 14 Ch D 645 at 653.
116 For the Irish provision see s 108 Land and Conveyancing Reform Act 2009.
117 The Republic of Ireland does not have the administrative receiver/non-administrative receiver distinction but the same basic law on receiverships applies. Section 439 Companies Act 2014 provides that: 'A receiver, in selling property of a company, shall exercise all reasonable care to obtain the best price reasonably obtainable for the property as at the time of sale.' See also s 103 Land and Conveyancing Law Reform Act 2009.

95. Hoffmann J commented however in Gomba Holdings (UK) Ltd v Homan[118] that while nominally the agent of the company, the receiver's primary duty is to realise the assets in the interests of the charge holder and its powers of management are really ancillary to that duty.

96. The peculiar incidents of the agency were stressed by the Court of Appeal in Silven Properties Ltd v Royal Bank of Scotland:[119]'In particular: (1) the agency is one where the principal, the mortgagor, has no say in the appointment or identity of the receiver and is not entitled to give any instructions to the receiver or to dismiss the receiver … . (2) there is no contractual relationship or duty owed in tort by the receiver to the mortgagor: the relationship and duties owed by the receiver are equitable only … (3) the equitable duty is owed to the mortgagee as well as the mortgagor. The relationship created by the mortgage is tripartite involving the mortgagor, the mortgagee and the receiver; (4) the duty owed by the receiver (like the duty owed by a mortgagee) to the mortgagor is not owed to him individually but to him as one of the persons interested in the equity of redemption … (5) not merely does the receiver owe a duty of care to the mortgagee as well as the mortgagor, but his primary duty in exercising his powers of management is to try and bring about a situation in which the secured debt is repaid … (6) the receiver is not managing the mortgagor's property for the benefit of the mortgagor, but the security, the property of the mortgagee, for the benefit of the mortgagee…'

97. A receiver, in realising the secured property, has a duty to exercise reasonable care to obtain the best price reasonably obtainable at the time of sale. This is a duty owed to the debtor, subsequent creditors and guarantors of the secured debt[120] but the duty does not extend to a guarantor who has not been called to pay under the guarantee.[121]

98. On the other hand, it seems to follow from the Privy Council decision in China and South Sea Bank Ltd v Tan[122] there is no duty owed to exercise reasonable care about the timing of sale. This view was endorsed by the Court of Appeal in Silven Properties Ltd v Royal Bank of Scotland[123] and applied in Bell v Long.[124] In the latter case it was held that receivers were

[118] [1986] 3 All ER 94 at 97.
[119] [2004] 1 WLR 997 at para 27.
[120] Standard Chartered Bank v Walker [1982] 1 WLR 1410. Alternatively, it may be argued that where a secured creditor, or his receiver, sacrifices or impairs the security or by his neglect or default allows it to be lost or diminished, the surety is entitled to be credited with the deficiency in reduction of his liability.
[121] Burgess v Auger [1998] 2 BCLC 478. See also Raja v Austin Gray [2002] EWCA Civ 1965; [2003] BPIR 725.
[122] [1990] 1 AC 536.
[123] [2004] 1 WLR 997. See also Den Norske Bank ASA v Acemex Management Co Ltd [2003] EWHC 326 (Comm), [2003] 2 All ER (Comm) 318; Saltri III Ltd v MD Mezzanine SA [2012] EWHC 3025 (Comm), [2013] 1 All ER (Comm) 661 and Alpstream AG v PK Airfinance [2015] EWCA Civ 1318. It seems there is no difference in this connection between a receiver appointed under the Law of Property Act and an administrative receiver – see Raja v Austin Gray [2002] EWCA Civ 1965, [2003] BPIR 725.
[124] [2008] EWHC 1273 (Ch); [2008] BPIR 1211.

entitled to sell four properties in a portfolio at a discount to their individual valuations. The receivers were entitled to choose the time of sale and the portfolio sale produced a guaranteed disposal of all the properties compared with the uncertainties of a longer period of marketing against a background of changing market conditions.

99. The administrative receiver/receiver distinction was introduced in 1986 by the Insolvency Act. Administrative receivers are, broadly, receivers appointed under floating charges on the whole or substantially the whole of the company's property. Schedule 1 to the Insolvency Act 1986 confers various implied powers on an administrative receiver including power to carry on the business of the company. Essentially, the appointment of an administrative receiver will displace the board of directors from its management functions though the directors remain in office and are still empowered to carry out various non-management' tasks.

100. The role of administrative receivers is considerably more important than that of other types of receiver though the Enterprise Act 2002 introduced reforms to the Insolvency Act by abolishing the right to appoint administrative receivers in the generality of cases. A non-administrative receiver of part of the company's business may also be required by the administrator to vacate office.[125]

101. There are still however, a significant number of residual cases where administrative receivers may be appointed. These are set out in sections 72B to 72GA of the Insolvency Act 1986 and, in the main, cover high-end financing transactions and sector-specific financing, particularly in the context of public-private partnerships. Section 72B refers to capital market investments where a party incurs or, when the agreement was entered into, was expected to incur, a debt of at least £50m under the arrangement. The remaining sections relate to the following areas: s 72C – public-private partnerships with step-in rights; s 72D – utilities; s 72DA – urban regeneration projects; s 72E – financed project companies including step-in rights; s 72F – charges in connection with financial markets; s 72G – registered social landlords; s 72GA – protected railway companies.

102. Perhaps the greatest potential are offered by the capital markets exception in s 72B and the project finance exception in s 72E although reliance on the latter provision failed in Feetum v Levy.[126]Section 72E(2)(a) provides that a project is a 'financed project' if under an agreement relating to the project a project company incurred, or when the agreement was entered into, expected to incur, a debt of at least £50m for the purposes of carrying out the

[125] Para 41(2) Schedule B1 Insolvency Act 1986.
[126] [2005] EWCA Civ 1601, [2006] Ch 585.

project. In Feetum v Levy there was no expectation that the company would borrow at least £50m and therefore, the exception was held not apply. Moreover, it was held that there were no "step-in rights" within the meaning of the provision. Under s. 72E, a project has step-in rights if a person who provided finance in connection with the project had a conditional entitlement under an agreement to (a) assume sole or principal responsibility under an agreement for carrying out all or part of the project, or (b) make arrangements for the carrying out of all, or part of, the project. The lending agreement stated that any administrative receiver appointed was the agent of the company and not of the lender. Therefore, if the receiver decided to carry out the project, the borrower would be treated in law as carrying it out or as making the necessary arrangements to do so. The lender was not entitled to make the arrangements to carry out the project for it was dependent on the discretionary decision of the receiver. Consequently, the project was not one in which there were step-in rights. The case holds that the power to appoint an administrative receiver should not be equated with step in rights. Otherwise, the inclusion of a requirement for step-in rights would become superfluous.[127]

Foreclosure and 'appropriation' as security enforcement remedies – financial collateral

103. The expression 'foreclosure' is sometimes used as a journalistic shorthand for sale of charged property and paying the charge holder out of the proceeds of sale with the surplus going to lower ranking charge holders in order of priority and then any balance becoming available to the debtor (chargor). The chargor is said to have an 'equity of redemption' i.e. a right to any balance that remains after the secured debt(s) plus any expenses of realisation have been paid.

104. But the expression 'foreclosure' has a traditional and somewhat different technical meaning denoting a process whereby the creditor takes the mortgaged property in satisfaction of the secured debt and the borrower's equity of redemption is extinguished.[128] Foreclosure actions require a court sanction and today the court would invariably order a sale of the property rather than authorising foreclosure in the strict, technical sense.[129] In Palk v Mortgage Services [130]Nicholls VC remarked that 'foreclosure actions are almost unheard of today and have been so for many years. Mortgagees prefer to exercise other remedies. They usually appoint a receiver or exercise their powers of sale.'

[127] See Jonathan Parker LJ at para 93.
[128] For a small scale statutory equivalent of forfeiture see s 120 Consumer Credit Act 1974.
[129] In Ireland, s 96(2) Land Conveyancing Law Reform Act 2009 abolishes the mortgagee's right of forfeiture.
[130] [1993] Ch 330 at 336.

105. The Financial Collateral Arrangements (No 2) Regulations 2003, however, introduced a remedy of appropriation into English law and this remedy has some similarities with the foreclosure remedy. Appropriation may be defined as the sale by the secured party to itself of the collateral at a price that is commercially reasonable. The regulations are designed to implement the EU Financial Collateral Directive,[131] which is part of the EU's Financial Services Action Plan,[132] and contain a number of provisions that impact on the English law of security interests. The Directive makes provision for the establishment of a Europe-wide regime under which cash, financial instruments, and now credit claims[133], may be used as collateral under both security interest and title transfer structures.134 According to the preamble, this will aid in the 'integration and cost-efficiency of the financial market as well as to the stability of the financial system in the Community, thereby supporting the freedom to provide services and the free movement of capital in the single market in financial services.'[135]

106. Member States may exclude the application of the Directive where one of the parties to the collateral transaction is neither a public authority nor a financial institution.[136] In fact, the UK in the Financial Collateral Arrangements (No 2) Regulations 2003 not only did not avail of the opt-out, but 'gold plated' the directive and applied the new regime to all cases where the collateral-provider and the collateral-taker are both non-natural persons.[137]In Ireland the

[131] Directive 2002/47/EC on financial collateral arrangements (OJ 2002 L 168). The SI 2003/3226 Financial Collateral Arrangements (No 2) Regulations 2003 have been amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, SI 2010/2993, which, inter alia, introduce a new definition of possession of financial collateral. In Ireland the implementing regulations are now the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010.

[132] COM (1999) 232. The Financial Services Action Plan is designed to contribute to the creation and maintenance of more efficient and competitive financial markets in Europe.

[133] The extension to cover credit claims was made in the 2010 Amendment regulations. These are essentially loans or, more technically, pecuniary claims which arise out of an agreement whereby a credit institution grants credit in the form of a loan. In Ireland under the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010, financial collateral is also defined as meaning cash, financial instruments or credit claims but it does not include shares in a company whose exclusive purpose is (a) to own means of production that are essential to the collateral provider's business or (b) to own real property.

[134] For a definition of cash and financial instruments see Art 2 of the Directive. See generally on this whole area of security over shares and investment property the website of the Financial Markets Law Committee (www.fmlc.org).

[135] Paragraph 3 of the preamble.

[136] Article 1(3).

[137] SI 2003/3226, reg 3. The discussion paper "Implementation of the Directive on Financial Collateral Arrangements" (July 2003) at para 2.4 canvassed the possibility of going further and applying the same principles to all financial collateral arrangements, including those involving individual natural persons:" However, our view is that this is unlikely to be legally feasible using the implementing powers in the European Communities Act 1972."' In R (Cukurova Finance International Ltd) v HM Treasury [2008] EWHC 2567, [2009] EuLR 317, leave to challenge the Regulations as being ultra vires section 2(2) of the European Communities Act 1972 was refused on the ground of delay in bringing the application. Moses LJ also commented however, that the challenge was unlikely to succeed on its merits. See now however, US v Nolan [2015] UKSC 63 where the comments of Lord Mance cast doubt on the regulations. But s 255 Banking Act 2009 gives power to make regulations about financial collateral arrangements even if it is not required to do so under the Collateral Directive. These may provide that the Regulations, and anything done in reliance on them, will be treated as

financial collateral regime is more limited in that it only applies where both parties to the transaction are either public authorities, financial institutions or a 'bondholder or the holder of any other form of securitised debt.'[138]

107. The Financial Collateral Directive seeks to resolve the main problems affecting cross-border use of collateral in wholesale financial markets, inter alia by restricting the imposition of onerous formalities on either the creation or enforcement of collateral arrangements.[139] Recital (17) of the preamble states that the directive 'provides for rapid and non-formalistic enforcement procedures in order to safeguard financial stability and limit contagion effects in case of a default of a party to a financial collateral arrangement.' But the recital also refers to 'a posteriori control which the courts can exercise in relation to the realisation or valuation of financial collateral and the calculation of the relevant financial obligations. Such control should allow for the judicial authorities to verify that the realisation or valuation has been conducted in a commercially reasonable manner.'

108. Article 4 provides that where an enforcement event has occurred, a collateral taker should be able to realise or appropriate any financial collateral by applying it in discharge of the financial obligations. Appropriation is only possible only if it has been agreed by the parties in the security financial collateral arrangement and the parties have also agreed on the valuation of the financial instruments. Reg 17 of the UK regulations provides that a collateral-taker may exercise the remedy of appropriation in accordance with the terms of the security financial collateral arrangement without any foreclosure order from the courts.[140]Reg 18 provides that the collateral-taker must account to the collateral-provider for any surplus and also that the collateral-provider remains liable for any deficiency.

109. In Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd[141] the appropriation remedy was considered by the Privy Council. The case originated in an offshore Caribbean jurisdiction, the British Virgin Islands, and stemmed from a battle for control of Turkey's largest mobile phone operator between Turkish and Russian interests. The resultant litigation was long drawn out and gave rise to a number of Privy Council appeals. In Cukurova (No 1), the court pointed out that the drafters of the regulations wrongly assumed that appropriation was

having had effect despite any lack of vires.

[138] European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010 – para 3(2).

[139] Furthermore, the Directive, inter alia, permits the re-pledging of collateral and provides limited protection of collateral arrangements from some rules of insolvency law that might inhibit the use of top-up or substitute collateral.

[140] The Irish provision is regulation 6 of the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010. It is drafted somewhat differently and refers to the realisation of financial collateral.

[141] [2009] UKPC 19.

already a self-help remedy known to English law. Lord Walker said that this remedy, in practice, was possibly available in relation to charges over funds of cash that were either payable on demand, or held on short-term deposit.[142] In relation however, to charges over shares in a company, particularly an unlisted company where valuation of the shares was difficult, 'the notion of appropriation by the unilateral act of the collateral-taker was a novel concept … Before the Directive it would have been open to attack not only as self-dealing but also as a clog on the equity of redemption, an old-established but not obsolete doctrine of equity …'[143]

110. The court also pointed out that if 'the power of appropriation is exercised the collateral-taker takes the collateral as his own property, at its value under the agreed mechanism, subject (if that value exceeds the secured debt) to a liability to pay the excess to the collateral-provider, and with a claim for the balance of the debt if the value is less than the secured debt. In these respects (as well as in not needing an application to the court) appropriation differs from the traditional (but now obsolescent) English remedy of foreclosure.'[144]

111. In subsequent litigation[145], the collateral taker was held to have exercised the remedy of appropriation in respect of the financial collateral. This consisted of shares in a company ultimately giving control of Turkey's largest mobile phone enterprise. The collateral provider committed some largely technical acts of default under a loan agreement and the collateral taker in fact had made available the loan thinking that the borrower would default and would thereby have to yield up the shares. The lender's intention all along was to take control of the shares and gain control of the mobile phone company. But it was held that this secondary purpose did not vitiate enforcement of the security. The court said that enforcement of the security purely for a collateral purpose would be ineffective between mortgagor and mortgagee. In this particular case, the charge holder had enforced the security for the proper purpose of satisfying the debt and the fact that it might have additional purposes did not invalidate the enforcement.

112. The Privy Council held however, that the new statutory regime did not preclude application of the ancient equitable principle of relief against forfeiture. This meant that the debtor could get the property back free from the security on repaying the loan plus interest.

[142] Reference was made in this connection to the discussion by Lord Hoffmann in In re Bank of Credit & Commerce International SA (No 8) [1998] AC 214 at 226–227.
[143] [2009] UKPC 19 at para 11. Reference was made in this connection to see Jones v Morgan [2001] Lloyd's Rep Bank 323.
[144] 2009] UKPC 19 at para 13.
[145] [2013] UKPC 2. See also [2013] UKPC 20 where the court settled the terms of relief, i.e. the amount that the borrower would have to pay to have the appropriation of the shares reversed.

The court said that repayment of the loan was secured by charges over the shares. The prime objective of the transaction was to secure the repayment of the loan along with contractual interest. The power to appropriate the shares was essentially a forfeiture provision and was added to secure that result. The court's jurisdiction to grant relief against forfeiture could not, in principle, be limited to particular types of collateral and there was nothing in the Financial Collateral Regulations that excluded the possibility of such relief. The court recognised the need for commercial certainty but suggested that the present case combined a number of unusual features that were unlikely to be repeated.

9 Is the secured party affected by a "stay" on the enforcement of security if the debtor enters insolvency proceedings?

113. It is necessary for this purpose to distinguish between 'administration' and 'liquidation'. Administration and liquidation are similar procedures, to the extent that they both involve the appointment of a qualified insolvency practitioner to a company and the displacement of the company's existing board of directors from their management function.

114. Liquidation and administration differ significantly however in terms of intended purposes.[146] Liquidation of a company involves the cessation of its business, the realisation of its assets, the payment of its debts and liabilities, and the distribution of any remaining assets to the members of the company. At the end of a liquidation, a company is wound up and ceases to exist.

115. Administration, in contrast, was designed primarily as a rescue procedure aimed at facilitating the survival of the company's business either in whole or in part. In practice however, it has been used to achieve a more advantageous realisation of the company assets than can be achieved in a winding up.[147] Often, more advantageous realization of assets is accomplished by means of a 'pre-pack' administration whereby a deal has already been agreed for the sale of company assets prior to the company entering administration.[148] The buyer may be the incumbent management team and the sale takes place immediately after the company is placed into administration. The assets are transferred to a new company but

[146] See Re MF Global UK Ltd [2013] 1 WLR 903.
[147] See the empirical evidence presented on the Insolvency Service website – www.insolvency.gov.uk/

[148] See generally P Walton and M Wellard, "A Comparative Analysis of Anglo-Australian Pre-Packs: Can the Means be Made to Justify the Ends?" (2012) 21 *International Insolvency Review* 143; V Finch, "Pre-Packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains" [2006] *Journal of Business Law* 568.

the unsecured debt is left behind in the old corporate structure. The result of the process may be that the business of the company, but not the old corporate vehicle itself, survives but it will have managed to jettison some or all of the unsecured debt and therefore should be in a stronger financial position. The procedure effectively needs the support of the company's secured creditors i.e. bankers, since the security will continue to attach to the assets. Pre-packs are however not explicitly recognised in the Insolvency Act though they are subject to extra-statutory regulation.[149]

116. The Insolvency Act states that an administrator must perform his functions with the objective of (a) rescuing the company as a going concern, or (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or (c) realising property in order to make a distribution to one or more secured or preferential creditors.[150] There is this hierarchy of objectives and an administrator can only go down the list of objectives if he thinks that it is not reasonably practicable to achieve any of the preceding objectives.

117. Under the administration regime, secured creditors are however in a strong position. For instance, an administrator can be appointed by the holder of a floating charge over substantially the whole of a company's property out of court; by the court; or by the company itself upon giving prior notice to the floating charge holder. During the notice period, the floating charge holder may step in and make its own appointment.[151] The strong position of the floating charge holder is also seen in two provisions relating to court appointment of administrators.[152] Firstly, where an administration application is made by somebody other than a qualified floating charge holder, the latter may intervene in the proceedings and suggest to the court the appointment of a specified person as administrator. The court is obliged to respond positively to this intervention unless it thinks it right to refuse the application 'because of the particular circumstances of the case''.[153] Secondly, where an administration application is made by a qualified floating charge holder there is no threshold insolvency requirement.[154]

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[149] See Statement of Insolvency Practice 16 (SIP 16) and the Graham Review into Pre-pack Administration (2014) available at https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration. See now https://www.prepackpool.co.uk/

[150] For the list of statutory objectives see Schedule B1 Insolvency Act 1986, para 3.

[151] See in particular Schedule B1 Insolvency Act 1986, paras 15 and 18.

[152] Schedule B1 Insolvency Act 1986 para 36. See also para 37 which enables a qualifying floating charge holder to apply to have an existing liquidation converted into an administration but the court is not obliged to accede to such an application. Paragraph 38 enables the liquidator to make a similar application.

[153] See also Re Super Aguri F1 Ltd [2011] BCC 452 and more generally on challenges to the appointment of particular administrators Finnerty v Clark [2011] EWCA Civ 858; [2011] BCC 702.

[154] Schedule B1, para 35.

118. One of the most important features of administration is the moratorium. The commencement of the administration procedure imposes a freeze on proceedings or executions against the company and its assets. This provides a breathing space during which the company has an opportunity to make arrangements for the sale of its assets and/or the rescheduling of its debts and the restructuring of its affairs.[155] By virtue of the moratorium, no steps may be taken to enforce any security over the company's property[156] or to repossess goods in the company's possession under any hire-purchase agreement[157] and no legal process[158] including distress[159] may be instituted or continued against the company except with the leave of the court and subject to such terms as the court may impose; and or else with the consent of the administrator. Furthermore, when a company is in administration, any administrative receiver of the company shall vacate office, as well as a receiver of part of the company's property if the administrator so requires.[160] It should be noted however, that these restrictions on the enforcement of security do not apply to any security interest created or otherwise arising under a financial collateral arrangement.[161]

119. While the Enterprise Act 2002 has modified and restricted the traditional enforcement rights of secured creditors in the context of company administration, it does not affect the secured creditor's enforcement powers in liquidation. A secured creditor may continue to enforce its security notwithstanding the fact that a company has gone into liquidation.

120. In the Republic of Ireland, there is the liquidation procedure which functions in roughly the same way as in England. There is however, no exact equivalent of administration. Instead, there is the examinership procedure. This procedure was introduced in 1990 by the Companies (Amendment) Act 1990 and since amended more than once by statute with a view to improving its effectiveness.[162] The relevant provisions are now contained in the Irish

[155] The administration moratorium does not apply in relation to the enforcement of market charges under s 173 Companies Act 1989. Basically there are charges in favour of a recognised investment exchange, for the purpose of securing debts or liabilities arising in connection with the settlement of market contracts.
[156] Schedule B1 Insolvency Act 1986, para 43(2).
[157] Ibid, para 43(3) and defined by para 111 as including conditional sale agreements, chattel leasing agreements and retention of title agreements.
[158] The proceedings in question are legal proceedings or quasi-legal proceedings such as arbitration: Bristol Airport v Powdrill [1990] Ch 744. A 'legal process' requires the assistance of the court and therefore the service of a notice making time of the essence is not within this category: Re Olympia and York Canary Wharf Ltd [1993] BCC 15; McMullen & Sons v Cerrone [1994] BCC 25. See now on 'legal process' for the purpose of the moratorium Re Railtrack plc [2002] 2 BCLC 755 and see also Environment Agency v Clark [2001] Ch 57.
[159] The essential feature of distress is that the assets distrained are seized and detained by the distrainor: Bristol Airport v Powdrill [1990] Ch 744.
[160] Schedule B1, para 41.
[161] Reg 8 of the Financial Collateral Regulations 2003, SI 2003/3112.
[162] On the procedure see generally T Courtney *The Law of Companies* (Bloomsbury, London, 3rd ed 2012) Ch 22.

Companies Act 2014. Examinership is, in effect, intended as a form of ‘debtor-in-possession’ type restructuring and the procedure is, in some respects, a ‘halfway house’ between administration and restructurings under Chapter 11 of the US Bankruptcy Code.

121. Section 509 (1) Companies Act 2014 prescribes the initial task of the examiner as being to examine the state of the company’s affairs. Section 509(2) of the Act provides that the court shall not order the appointment of an examiner unless it is satisfied that there is a reasonable prospect of the survival of the company, and the whole or any part of its undertaking, as a going concern.[163] The legislation sees the examiner as a sort of company doctor who analyses the patient, prescribes remedies and gets the parties concerned to try to agree.

122. During the period of examinership, a company enjoys protection from its creditors like a company in administration. The key elements in the system are the appointment of an examiner by the court and the placing of the company concerned under the protection of the court for an initial period of 70 days. During this period of protection the company may not be wound up, a receiver may not be appointed, debts cannot be executed against it and no security can be enforced against the company.[164] Moreover, the directors of a company have a three day grace period from the appointment of a receiver to decide whether or not to seek to place the company into examinership. Section 512(4) Companies Act provides that the court shall not give a hearing to an examinership petition if a receiver stands appointed to the company and the receiver has stood so appointed for a continuous period of at least three days prior to the presentation of the petition.

123. If the examiner is of the view that the company, or a part of it, can be saved and that this would be more advantageous than a winding-up, he will prepare a draft rescue plan. This will be put to appropriate meetings of creditors and members, and, if approved, will go to the court for confirmation. If the court approves the plan, it will become binding on those concerned and the examiner's appointment will be terminated. It should be noted that the appointment of an examiner does not entail automatically the suspension of the management powers of the company directors. The examiner, though, is given the option of applying to the

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[163] There is provision for an independent accountant’s report to assist the court in deciding whether the company has a reasonable prospect of survival. In Re Gallium Ltd (2009) 8 IESC Fennelly J stated at para 47 that: the ‘entire purpose of Examinership is to make it possible to rescue companies in difficulties. The protection period is there to facilitate examination of the prospects of the rescue. However, the protection may prejudice the interests of some creditors. The court will weigh the existence and degree of any such prejudice in the balance. It will have regard to the report of the independent accountant.’

[164] Section 520(4) Companies Act 2014. Reg 7 of the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010 provides that a financial collateral arrangement has effect in accordance with its terms notwithstanding the commencement of winding up or reorganisation proceedings in respect of either the collateral provider or the collateral taker.

court for an order that all or any of the functions or powers which are vested in or exercisable by the directors shall be performable or exercisable only by the examiner.[165]

10 Can the secured party apply to have any stay lifted?

124. Yes. With the leave of the court or with the administrator's consent, security may be enforced, goods may be repossessed and other legal processes may be instituted or continued notwithstanding the fact that the company is in administration.[166]

11 Under what circumstances can the stay be lifted?

125. There have been a number of test cases in which the courts have had an opportunity to spell out their approach to the lifting of the administration stay. The leading authorities are the decisions of the Court of Appeal in Bristol Airport plc v Powdrill[167] and Re Atlantic Computer Systems plc (No 1).[168] In the former case it was held that the exercise by an airport authority of its rights under the Civil Aviation Act 1982 to detain an aircraft for non-payment of landing charges constituted a 'step taken to enforce security' and thus came within the statutory moratorium. Leave was refused to enforce the security. Particularly telling factors against the airports were that none of the company's aircraft were on their runways at the commencement of the administration and had only arrived there subsequently because of the administrator's decision to continue the business; the airports had acquiesced in the administrator's proposal to sell the business as a going concern, which detention of the aircraft would prevent; and the airports had benefited financially from the continuation of the business by the administrator because they had received payment of substantial fees. Having supported the administration when it suited them, the airports could not later seek to enforce a right which was inconsistent with the achievement of the purpose of the administration.[169]

126. The Court of Appeal in Powdrill accepted that its reasoning would extend to a case where the holder of a possessory lien[170] on chattels was requested by an administrator to give

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[165] Section 528 Companies Act 2014.
[166] Schedule B1 Insolvency Act 1986, para 43(6). In Ireland, the examinership moratorium may be relaxed with the consent of the examiner or the court.
[167] [1990] Ch 744.
[168] [1992] Ch 505.
[169] [1990] Ch 744, at 767, per Browne-Wilkinson V-C.
[170] Under s 246, liens and similar rights on the company's books, papers or other records are unenforceable against '"office-holders", a category which includes administrators. On lien-holders, see also Re Sabre International Products Ltd [1991] BCLC 470.

up the chattels. Refusal to comply with the request would amount to a step taken to enforce security and fall within the statutory moratorium. The Court of Appeal accepted that it would be practically inconvenient and costly for the holder of every lien to have to apply to court for leave but thought that these potential difficulties would be mitigated in practice by the fact that the administrator and the holder of the lien could simply agree the matter between themselves without the intervention of the courts.

127. Re Atlantic Computer Systems plc (No 1) set out in general terms the approach of the court in leave applications. The underlying principle is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights except to the extent that this may be unavoidable.[171]

- The onus is on the applicant to establish a case for leave to be granted.
- The moratorium is intended to assist in the achievement of the purpose for which the administration order was made. If granting leave to the applicant is unlikely to impede that purpose, leave should normally be given.
- In other cases, the court should balance the legitimate interests of the applicant and the legitimate interests of the other creditors of the company.[172]
- In carrying out the balancing exercise great importance is normally to be given to the proprietary interest of the applicant. In general, so far as possible the administration procedure should not be used to prejudice those who were secured creditors or lessors at the commencement of the administration.
- It will normally be sufficient ground for the grant of leave if significant loss would be caused to the applicant by the refusal. But if substantially greater loss would be caused to others by the grant of leave, or loss which is out of all proportion to the benefit which leave would confer on the applicant, that may outweigh the loss to the applicant caused by a refusal.
- In assessing the respective losses, the court will have regard to matters such as:
    - the financial position of the company;
    - its ability to pay rental arrears and continuing rentals (or, in the case of security, to meet its obligations under its loans);
    - the administrator's proposals;
    - the period for which the administration order has been in force and is expected to remain in force;
    - the effect on the administration if leave is given and on the applicant if it is refused;

[171] See also Mackay v Kaupthing Singer [2013] EWHC 2533 (Ch) where the court said at para 75 that the court was only required to balance the interests of secured and unsecured creditors if the relevant property was required for the purposes of the administration.
[172] For an example of the operation of this balancing process, see Re Meesan Investments Ltd (Royal Trust Bank v Buchler) (1988) 4 BCC 788, [1989] BCLC 130.

- the end result sought to be achieved by the administration;
- the prospects of that result being achieved; and
- the history of the administration so far.

- In considering these suggested consequences it will often be necessary to assess how probable they are.
- Other factors, such as the conduct of the applicant, may also be relevant.
- The above conditions also apply to a decision to impose terms if leave is granted and to impose terms as a condition for refusing leave. An example of refusal to grant leave on terms is provided by Re Meesan Investments,[173] where leave to enforce security was refused but the administrator was ordered to return to court in 2 months' time if the secured property had not been sold by then. The guidelines envisage refusal on terms becoming a common phenomenon.
- On applications to enforce security, an important consideration will often be whether the applicant is fully secured. If he is, delay in enforcement is likely to be less prejudicial than in cases where his security is insufficient.
- Unless the issue can be easily resolved, it is not appropriate on a leave application for the court to resolve a dispute about the existence, validity or nature of a security which the applicant seeks leave to enforce. The court needs to be satisfied only that the applicant has a seriously arguable case.

128. Wrongful refusal by an administrator to enforce security could render the administrator liable to pay compensation.[174]

12 In insolvency proceedings, can an Insolvency Practitioner (IP) 'enforce' the security i.e. realise the secured assets, without the consent of the secured party.

129. In many cases, in order to achieve the purposes of administration, the administrator will need to be able to use or dispose of all the company's property, including that part of it which is charged to a third party, e.g. the company's bankers. Schedule B1, paras 70-72 give the administrator certain powers to deal with property that is charged to third parties and also chattels owned by third parties but in the company's possession, irrespective of the wishes of

[173] [1989] BCLC 130.
[174] Barclay Mercantile Business Finance Ltd v Sibec Development Ltd [1992] 1 WLR 1253.

the charge holders or owners.[175] These provision does not apply however, with respect to financial collateral.[176]

13 Are there are any conditions that must be satisfied before an IP may 'enforce' the security?

130. In this connection, there is a distinction between, on the one hand, assets subject to a fixed charge (or to hire-purchase agreements),[177] and, on the other hand, assets subject to a floating charge. In the case of assets subject to a floating charge, the administrator is given power to dispose of such assets or otherwise exercise his powers in relation to them as if the assets were not subject to the floating charge. Accordingly, the administrator can deal with such assets and dispose of them without being fettered by any contractual restrictions contained within the floating charge, for example by a negative pledge clause prohibiting the grant of other security over the assets. The reference to a floating charge means a charge which, as created, was a floating charge.[178] Consequently, the crystallisation of the floating charge prior to the administration order would not prevent the administrator from exercising these wide powers.

131. Where the administrator disposes of floating charge assets, the holder of the floating charge is given the same priority in respect of any of the company's property that directly, or indirectly, represents the assets disposed of as he would have had in respect of the assets subject to the floating charge. If, for example, the administrator sells plant and machinery subject to the floating charge, the proceeds of the sale will fall within the floating charge and the holder of the charge will be entitled to the same priority as against third parties (e.g. holders of subsequent floating charges) in respect of the proceeds as he had in respect of the plant and machinery.

132. As regards assets subject to a fixed charge (as created), or goods which are in the possession of the company under a hire-purchase agreement, the administrator may apply to court in accordance with Sch B1, paras 71 and 72, for an order authorising him to dispose of the property. The court may make such an order if it is satisfied that the disposal (with or without other assets) of the fixed charge assets or goods acquired on hire purchase would be likely to promote the purpose, or one or more of the purposes, specified in the administration

[175] For Ireland see s 530 Companies Act 2014.
[176] Financial Collateral Arrangements (No 2) Regulations 2003 reg 7 and for Ireland see Reg 7 of the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010.
[177] This term includes conditional sale agreements, chattel leasing agreements and retention of title agreements: Insolvency Act schedule B1, para 111.
[178] Ibid.

order. The court order will authorise the administrator to dispose of the assets or goods as if they were not subject to the fixed charge or, as the case may be, as if the owner's rights under the hire-purchase agreement were vested in the company. Schedule B1, paras 71(3) and 72(3) provide that the court must make it a condition of any such order that:

(1) the net proceeds of the disposal; and

(2) a sum equaling the deficit between the net proceeds of disposal and the net amount which would be realised by a sale of the assets at market value as determined by the court, must be applied towards discharging the sums secured by the fixed charge or payable under the hire-purchase agreement.

133. The operation of this provision was considered in Re ARV Aviation Ltd[179] where it was held that the task of the court in leave applications was to balance the prejudice that would be felt by the secured creditor by the making of an order against the prejudice that would be felt by those interested in the promotion of the administration purpose if it were not made. The view that the court takes of the open-market value of the assets is extremely important because this is the amount that the administrator is required to discharge as a condition of obtaining leave. In ARV Aviation, the court proceeded on the assumption that the purpose of this condition was to protect, to the maximum practicable extent, the secured creditor.[180] It was held that the granting of leave could be a two-stage process, with the open-market valuation being assessed at some point after the making of the order granting the administrator leave to dispose of the assets.

134. Leave may be sought in circumstances where the administrator and the secured creditor[181] are unable themselves to agree on a valuation; but such a dispute is not an essential prerequisite of the jurisdiction. Where a secured creditor consents to the sale of the charged assets,[182] the administrator may not use the statutory mechanism to retain the proceeds of the sale but must deal with these proceeds in accordance with the terms on which the secured creditor has agreed to release its security.[183]

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[179] (1988) 4 BCC 708, [1989] BCLC 664. See also Re Capitol Films Ltd [2011] BPIR 334 and O'Connell v Rollings [2014] EWCA Civ 639.

[180] The same underlying purpose would exist where the administrator seeks leave to dispose of goods in the possession of the company under a hire-purchase agreement.

[181] Or supplier of goods on hire purchase, as the case may be.

[182] Or a supplier of goods on hire purchase consents to the sale of those goods.

[183] Re Newman Shopfitters (Cleveland) Ltd [1991] BCLC 407.

135. Where assets are subject to more than one fixed charge and the court makes an order authorising the disposal of such assets, the proceeds of sale must be applied towards discharging the sums secured by the securities in their order of priority.[184]

14 Do the rules or conditions differ depending on the nature of the insolvency proceedings in question?

136. Yes. There is a clear difference in this respect between administration and liquidation. In liquidation the secured creditor's rights are unaffected and a liquidator cannot dispose of a clear title to the assets that form the subject matter of the security interest without the consent of the charge holder. The liquidator can only dispose of the borrower's 'equity of redemption' i.e. the encumbrance on the property represented by the security interest will remain unless the secured creditor consents to a sale.

137. The secured creditor is free to realise its security without reference to the liquidator. Thus, where the value of the security is more than sufficient to discharge the debt or the security is a floating charge on all of the company's assets, the secured creditor may simply choose to enforce its security outside the liquidation. It is possible for a secured creditor voluntarily to surrender his security and prove for its debt as if it were unsecured[185] but it is very unlikely to be advantageous for a creditor to give up its security in this way.

138. If a secured creditor realises its security but the amount so realised is insufficient to discharge the debt, then it may prove for the balance in the liquidation.[186] A secured creditor also has the option of valuing its security and submitting a proof for the balance. In that case, the liquidator can offer to redeem the security at the value stated in the proof.[187] It may choose to do this where it considers that the value stated in the proof is less than the value which the assets subject to the security could fetch on a disposal. Because however, there is some scope for the secured creditor to revise the value stated in its proof,[188] the matter may then become one for negotiation between the liquidator and the creditor.

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[184] Schedule B1, para 71(4).
[185] Rule 4.88(2) Insolvency Rules. Note r 4.96 which deems a secured creditor to have voluntarily surrendered its security (unless the court grants relief) if it omits to disclose its security in its proof.
[186] Rule 4.88(1).
[187] Rule 4.97.
[188] Rules 4.84 and 4.95.

15 Is a secured party liable to pay the general costs i.e. costs apart from those incurred in connection with the realisation of security, of insolvency proceedings affecting the debtor?

139. A fixed charge holder is not liable to pay the general costs of administration or liquidation. The position is different in the case of the floating charge holder. In the context of administration, para 99(3) Schedule B1 Insolvency Act 1986 provides that where a person ceases to be an administrator, his remuneration and expenses shall be charged on and payable out of property of which he had custody or control immediately before cessation and will be payable in priority to any floating charge.

140. Rule 2.67 of the Insolvency Rules sets out the order in which the expenses of the administration are payable though the court may adjust this order of priority. Under the Rule 'necessary disbursements' by the liquidator are payable in priority to the administrator's own remuneration. In the Bloom v Pensions Regulator[189] Briggs J at first instance considered the interaction between the Insolvency Act and rules, and the scheme under the Pensions Act 2004 for meeting unfunded pension fund liabilities of insolvent companies. It was held that the imposition of a 'financial support direction' by the Pensions Regulator under the Pensions Act upon companies in administration or insolvent liquidation created necessary disbursements, and therefore expenses within r 2.67. Therefore, these expenses had prima facie priority over the administrator's own claim to remuneration and a fortiori, the unsecured debts of the company. Briggs J took the view that the liability was not a provable debt under r 13.12 of the Insolvency Rules and as result had to be a 'necessary disbursement' because the liability could not fall into a statutory black hole.

141. The decision was confirmed by the Court of Appeal[190] but was reversed by the Supreme Court[191]. The court held that the mere fact that an event occurred during the administration which gave rise to a statutory debt on the part of the company was not enough to render payment of the debt 'an expense of the administration'. It was suggested that a disbursement fell within rule 2.67 it arose out of something done in the administration (normally by the administrator or on the administrator's behalf), or if it was imposed by a statute which made it clear that the liability to make the disbursement fell on an administrator as part of the administration. This could be due either to the terms of the statute or the nature of the liability.

[189] [2011] BCC 277.
[190] [2012] BCC 83.
[191] [2014] AC 209.

142. In liquidation, it is provided that the 'expenses of winding up ... so far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over any claims to property comprised in or subject to any floating charge created by the company and shall be paid out of any such property accordingly'.[192]

143. Rule 4.218 of the Insolvency Rules 1986 defines the liquidation expenses and the order in which they are payable. The liquidator's own remuneration is included in the list. The courts have also expanded the concept of 'liquidation expenses' to include liabilities incurred before the liquidation in respect of property afterwards retained by the liquidator for the benefit of the insolvent estate. Consequently, rent or hire purchase charges in respect of land or goods in the possession of the company which the liquidator continues to use for the purposes of the liquidation are included within the concept of liquidation expenses.[193]

144. Among the items listed in r 4.218 are 'any necessary disbursements by the liquidator'. In Re Toshoku Finance (UK) plc[194] it was held that the liability to corporation tax is a sum which, by statute, is payable by a company in respect of profits or gains arising during a winding up. Therefore it is a 'necessary disbursement' which the liquidator had to make and was payable as a liquidation expense. Costs incurred by a liquidator in an unsuccessful attempt to recover assets were not originally included in the concept of liquidation expenses[195] but the position has been altered somewhat. It is now only possible for a liquidator to pursue such proceedings with the sanction of creditors and the costs of such proceedings are now deemed to be a liquidation expense.[196]

145. In Ireland the relevant statutory provisions are sections 554(4) and 617 Companies Act 2014. Sections 554(4) deals with examinership and s 617 with liquidation. Essentially, s 554(4) lays down that the costs and expenses of examinership are paid ahead of claims secured by a floating charge but after claims secured by a fixed charge. Section 617 provides that all 'costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator … shall be payable out of the property of the company in priority

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[192] Section 176ZA Insolvency Act 1986 which effectively overturns the decision in Re Leyland Daf Ltd: Buchler v Talbot [2004] 2 AC 298 on the interpretation of earlier legislation. According to s 176ZA(3), however, rules may be made restricting the application of this provision in such circumstances as may be prescribed, to expenses authorised or approved (a) by the holders of debentures secured by, or holders of, the floating charges and by any preferential creditors entitled to be paid in priority to them, or (b) by the court. See also rules 4.218A–4.218E of the Insolvency Rules.

[193] Re Lundy Granite Co (1871) LR 6 Ch App 462; Re Atlantic Computer Systems plc [1992] Ch 505 where the earlier authorities are reviewed.

[194] [2002] 1 WLR 671.

[195] Re M C Bacon Ltd (No 2) [1991] Ch 127.

[196] Rule 4.218(3) of the Insolvency Rules now refers to expenses or costs which are properly chargeable or incurred by the official receiver or the liquidator in preserving, realising or getting in any of the assets of the company or otherwise relating to the conduct of any legal proceedings.

to all other claims'. It has been held that this provision is to be interpreted as meaning that general expenses of liquidation are payable in priority to claims secured by a floating charge.[197]

16 Is the secured party liable to 'set aside' any portion of the amount realised from the enforcement of security, for the benefit of (a) preferential or (b) unsecured creditors of the debtor?

146. In certain circumstances 'yes' but it is necessary for this purpose to distinguish between (a) preferential and (b) unsecured creditors.

(a) Preferential creditors

In Re Nortel GmbH[198] Lord Neuberger said:

'In a liquidation of a company and in an administration (where there is no question of trying to save the company or its business), the effect of the insolvency legislation…, as interpreted and extended by the courts, is that the order of priority for payment out of the company's assets is, in summary terms, as follows:

(1) Fixed charge creditors;

(2) Expenses of the insolvency proceedings;

(3) Preferential creditors;

(4) Floating charge creditors;

(5) Unsecured provable debts;

(6) Statutory interest;

(7) Non-provable liabilities; and

(8) Shareholders.'[199]

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[197] See generally Irish Bank Resolution Corporation Ltd v DTZ Debenham [2013] EWHC 596 (Comm), [2013] All ER (D) 155. The court followed the English decision in Re Barleycorn Enterprises Ltd [1970] Ch 465 in preference to that in Re Leyland Daf Ltd [2004] 2 AC 298.

[198] [2013] UKSC 52; [2013] 3 WLR 504 at para 39 and see also David Richards J in Re Lehman Brothers International (Europe) [2014] EWHC 704 (Ch) at para 15.

[199] Sections 107 and 115 (voluntary liquidations) and 143 and 156 (compulsory liquidations) and s 175 and

147. Preferential debts rank equally among themselves after the expenses of the winding-up and must be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions.[200] Also, whilst preferential debts rank behind debts secured by fixed charges, so far as the assets of the company available for payment of general creditors are insufficient to meet them, they have priority over claims secured by a floating charge created by the company and must be paid accordingly out of any property comprised in or subject to that charge.[201] The fact that the floating charge may have crystallised prior to the commencement of the winding-up does not deprive the preferential debts of this special priority, because it is expressly provided by s 251 of the Insolvency Act that a floating charge for this purpose means a charge created as such.[202]

148. Schedule 6 of the Insolvency Act sets out the categories of preferential debts. As amended by the Enterprise Act 2002,[203] this now covers only up to 4 months' back-pay to employees and former employees (up to a prescribed maximum limit per employee) as well as unpaid holiday pay and contributions to State and occupational pension schemes.[204] Giving these claims preferential status in a liquidation, administration or receivership is a way of protecting the interests of 'vulnerable' creditors i.e. creditors who are not in a position to negotiate an enhanced position for themselves, whether by means of security or otherwise.[205]

149. The Enterprise Act introduced a new provision into the Insolvency Act setting aside a proportion of floating charge recoveries for the benefit of unsecured creditors.[206] The provision

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r 4.218 (both types of liquidation).

[200] Section 175(2)(a).

[201] Section 175(2)(b).

[202] In Ireland s 621 Companies Act 2014 provides that preferential debts should be paid ahead of floating charge realisations. There is no statutory equivalent of s 251 of the Insolvency Act and it has recently been held by the Irish Supreme Court that a floating charge holder will gain priority over preferential creditors if the floating charge has crystallised prior to liquidation or receivership – see Re JD Brian Ltd [2015] IESC 62. In Ireland however, the implications of what is now s 1001 of the Taxes Consolidation Act 1997 should be noted. This section provides that if a chargor is in arrears on certain tax obligations to the Revenue, the tax authorities can serve a notice on any creditor of the chargor which has a fixed charge over the chargor's book debts to the effect that any monies received by the creditor from the chargor from the time of the notice, not only in respect of book debts, must be remitted to the tax authorities in or towards the discharge of the arrears of PAYE or VAT.

[203] Which abolished preferences that the Crown used to have in respect of unpaid taxes of various sorts.

[204] It should be noted that under part 12 of the Employment Rights 1996 Act, the National Insurance Fund pays certain entitlements (subject to limits) owed to former employees of insolvent companies. The Act implements the EU Insolvency Directive 80/987/EEC and guarantees a basic minimum payment to employees of insolvent employers, who might otherwise have to wait some considerable time for payment, or receive no payment at all in their capacity as creditors in the insolvency proceedings. Once they have made these payments, the employee rights in the insolvency proceedings are statutorily transferred to the National Insurance Fund. In Ireland there is a similar scheme – the Insolvency Payments Scheme – and the statutory foundation for this is the Protection of Employees (Employers' Insolvency) Acts, 1984 – 2004 and associated regulations.

[205] See generally, L Bebchuk and J Fried 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' [1996] 105 *Yale Law Journal* 857 but for criticism of redistributive provisions see J Armour "Should we Redistribute in Insolvency" in J Getzler and J Payne (eds) *Company Charges: Spectrum and Beyond* (Oxford, OUP, 2006).

[206] The Enterprise Act abolished preference for unpaid tax claims and the fund for unsecured creditors was

operates when the company is in liquidation, administration or receivership. The amount set aside is a percentage share of the company's net property as defined by statutory instrument and the percentage may be different for different classes of property.[207] The percentage may also be altered by statutory instrument from time to time. At the moment, under the Insolvency Act 1986 (Prescribed Part) Order 2003,[208] the proportion of floating charge recoveries set aside for the benefit of unsecured creditors of a company is based on a sliding scale. It is calculated as 50 per cent of the first £10,000, then 20 per cent of the remainder but subject to an overall ceiling so that the fund for unsecured creditors shall not exceed £600,000 in a particular case. It should be noted however that the provision may not apply if the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. The court disapplied the rights of unsecured creditors on this ground in Re Hydroserve Ltd.[209]

150. In Re Courts plc[210] the court rejected the proposition that it could make a partial disapplication order. It attached importance to the principle of pari passu distribution, which meant that, subject to the claims of preferential creditors, the company's unsecured creditors were to rank equally between themselves. This was the case even though the claims of some creditors were small compared with others. The fact that, averaged out, the liquidator's expenses of processing each claim exceeded the distribution to a particular creditor was irrelevant. The fact that the actual cost of processing a particular creditor's claim could exceed the distribution to that creditor was also irrelevant. There was nothing in the legislation indicating that Parliament intended to treat as a material consideration the balance of cost and benefit on an individual creditor basis.

151. In International Sections Ltd[211] it was held that the court should not be too ready to disapply the prescribed part because the dividend for unsecured creditors as a result would be small. This was often the case irrespective of the costs of making any distribution. Disapplication should be the exception, and not the rule. In QMD Hotels Ltd Administrators[212] it was reiterated that the court should not be too ready to disapply the prescribed part provisions. But the court also said that it should endeavour to ensure that the already small

established as a balancing measure to ensure that the benefits of the abolition did not go exclusively for the benefit of unsecured creditors. The fund has its origins in a recommendation of the Cork Committee on Insolvency Law and Practice (Cmnd 8558 at para 1538) that 10% of net realisations of property subject to a floating charge should be set aside for unsecured creditors.

[207] There is no equivalent of this provision in Ireland.

[208] SI 2003/2097SI 2003/2097.

[209] [2008] BCC 175.

[210] [2009] 1 WLR 1499.

[211] [2009] EWHC 137 (Ch); [2009] BCC 574.

[212] [2010] CSOH 168.

dividend payable to the unsecured creditors out of the prescribed part was not further reduced by an overzealous approach to the adjudication of such claims.

152. There has been considerable debate about whether the holders of a floating charge can receive any payment from the prescribed part in respect of a deficiency under the floating charge. In Re Permacell Finesse Ltd213 this question was answered in the negative with the court holding that the prohibition on distributing the prescribed part to a floating charge holder was absolute. The Enterprise Act created a fund out of the floating charge holder's security to which unsecured creditors could have recourse and, in return, floating charge holders benefited by the abolition of the preferential status of tax claims. The prescribed part should not then be diluted by secured creditors having an effective 'second bite at the cherry'. In Re Pal SC Realisations 2007 Ltd 214 it was held however, that a charge holder was entitled to participate in the prescribed part if it surrendered its entire security in accordance with r 4.88(2) of the Insolvency Rules. Consequently, it was entitled to prove as if its debt was unsecured.

17 Can the secured party be bound against its wishes by a restructuring plan that negatively affects either the secured debt or the enforcement of the security interest?

153. Yes in practice this can be done through a scheme of arrangement under the Companies Act though not in the administration procedure alone nor in a company voluntary arrangement under the Insolvency Act.[215]

154. In the UK generally, there are certain statutory possibilities for overcoming holdouts among minority creditors in a corporate restructuring context. These procedures are premised on the assumption that for a company with a large number of creditors, reaching agreement with all of them may not be practicable.[216] There may be considerable coordination costs in assembling the necessary parties and obtaining their agreement. There is also the free-rider issue in that some parties have incentives to hold out for a better deal for themselves or to

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[213] [2008] BCC 208. See also Thorniley v Revenue and Customs Commissioners [2008] EWHC 124 (Ch), [2008] 1 WLR 1516.

[214] [2011] BCCC 933.

[215] In Ireland there is no equivalent to company voluntary arrangements under Insolvency legislation but schemes of arrangement under the Irish Companies Act function in a broadly similar way to their UK counterparts and enable 'holdouts' to be overcome.

[216] Many large company rescues are accomplished outside formal insolvency procedures by means of consensual 'workouts'. This is the so-called 'London Approach' on which see J Armour and S Deakin, "Norms in Private Insolvency Procedures: The London Approach to the Resolution of Financial Distress" (2001) 1 *Journal of Corporate Law Studies* 21. See also more generally J Payne, "Debt Restructuring in English Law: Lessons from the US and the need for reform" (2014) *Law Quarterly Review* 282; S Paterson, "Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards" (2014) 14 *Journal of Corporate Law Studies* 333.

'free ride' on other parties by remaining outside the agreement in the expectation that others would sign up to it, thus leading to an improvement in the company's fortunes from which they would also benefit. Thus some concession to majority rule seems appropriate but a simple majority rule principle appears to involve too great an infringement on the rights of individual creditors.

155. In the administration procedure, the administrator manages the company's affairs while formulating proposals to achieve the statutory goals, including the goal of rescuing the company as a going concern. The legislation is based on the principle that, in exchange for the moratorium, creditors are to have an important say in the conduct of the administration and should normally be afforded the opportunity of considering and reviewing what the administrator proposes to do. The basic model of creditor consultation and approval of proposals ignores however the possibility of circumstances arising where the administrator should act before there is an opportunity to convene a meeting of creditors. For instance, the administrator might be offered a favourable price for the business that is conditional upon a sale being concluded in accordance with a tight timetable. The administrator is given wide powers, even before approval of proposals by creditors, and it has been judicially affirmed that these powers extend to selling off the company's business prior to the holding of the creditors' meeting.[217]

156. Creditor approval of proposals requires a simple majority of votes cast, as measured by the amount of the outstanding indebtedness,[218] although the proposals may not result in non-preferential entitlements being paid ahead of preferential entitlements or one preferential creditor of the company being paid a smaller proportion of his debt than another.[219] More generally, it is specifically provided that an administrator's statement of proposals may include any action which affects the right of a secured creditor of the company to enforce its security. Secured creditors' rights are inviolate in this respect. Moreover, changing the substantive rights of creditors of whatever kind cannot simply be done by means of approval of proposals in the administration context. Something more has to be done before creditors' rights can be discharged or varied without their consent.

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[217] See Re Transbus International Ltd [2004] 2 All ER 911.
[218] See Rule 2.43(1) of the Insolvency Rules which provide that 'at a creditors' meeting in administration proceedings, a resolution is passed when a majority (in value) of those present and voting, in person or by proxy, have voted in favour of it.' The resolution however is invalid if more than half of creditors not connected with the company voted against it. A secured creditor may note for the amount of his secured debt only where there is insufficient property to make a distribution to unsecured creditors apart from the prescribed part. Normally, at a creditors' meeting under Rule 2.40 a secured creditor is 'entitled to vote only in respect of the balance (if any) of his debt after deducting the value of his security as estimated by him.'
[219] Sch B1 para 73(1)(a) and (b).

157. If a company is in administration and it is decided that corporate restructuring is the best way forward rather than the sale of assets, then there are the options of a company voluntary arrangement (CVA) under the Insolvency legislation or a scheme of arrangement under the Companies Act. The use of CVAs has certain advantages - the process is administratively simple with no need for multiple court applications. Indeed, the matter does not come before the court at all unless a dissenting creditor brings a challenge either on procedural grounds or on grounds of unfair prejudice.[220]

158. CVAs under Part 1 Insolvency Act 1986 are based upon a proposal to the company and its creditors for a composition in satisfaction of its debts, or a scheme of arrangement of its affairs. The proposal must provide for some person to act as trustee, or otherwise to supervise its implementation. That person is referred to as the 'nominee' and must be a licensed insolvency practitioner.[221] While not required to do so, an administrator may be designated as the nominee and this is usually the case.[222] The nominee must then summon meetings of the creditors and shareholders[223] to decide whether to approve the proposal.[224] The meetings may modify the proposal in certain respects, but the modifications must not be so extensive as to change the character of the proposal so that it is no longer a composition in satisfaction of the company's debts or a scheme of arrangement in respect of its affairs.[225]

159. In the CVA context, there are no separate classes and so there is no need to sort out potentially tricky issues concerning the proper composition of a class of creditors. Approval of a CVA requires a majority in excess of 75% in value of creditors present at the creditors' meeting so long as those voting in favour include more than half in value of independent creditors. A CVA, however, may not affect the rights of secured creditors without their consent or the rights of preferential creditors to be paid ahead of unsecured creditors. There is no

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[220] Section 6(7). There is a tight timescale for bringing a challenge. A procedural irregularity does not invalidate the approval given at a meeting unless it is the subject of a successful statutory challenge. Where the court is satisfied that grounds for challenge are made out, it may revoke or suspend approvals given by the meetings and direct the summoning of further meetings, either to consider a new proposal from the original proposer or to reconsider the original proposal. The court itself has no power to devise a new proposal for consideration.

[221] Section 1(2).

[222] Section 1.

[223] Section 3. Where the nominee is not the liquidator or administrator, the summoning of meetings is subject to directions from the court: section 3(1). The procedural aspects of the meetings are governed by the Insolvency Rules 1986, Part 1, chapter 5.

[224] Section 4. Failure to provide sufficient and accurate information to enable the creditor to consider the merits of the proposed arrangement with a view to determining if and how to cast her vote at the meeting is a material irregularity entitling the court to revoke approval of the arrangement under section 6(4) of the Insolvency Act – see Re Trident Fashions [2004] 2 BCLC 35. Lewison J added however, at para 39: "It seems to me that the court should only interfere if a judgment made by the administrator about the material to be placed before the creditors was a judgment to which no reasonable insolvency practitioner could come. The judgment should I think be made on the basis of the material available to the administrator at the time and not with the benefit of hindsight."

[225] Section 4(2).

procedure whereby the objections of secured creditors can be overcome.[226] Moreover, the lack of court sanction in the general run of cases may act as an obstacle to the recognition of CVAs abroad. Schemes of arrangement may be more easily 'saleable' internationally in this respect since they come with the judicial imprimatur of fairness.[227]

160. The scheme of arrangement procedure has proved popular as a restructuring vehicle for large companies, and large corporate debt though it has also been used as a takeover device. In effect, it serves as a form of 'debtor-in-possession' restructuring. The procedure enables a company, irrespective of solvency, to enter into a compromise or arrangement with any class of creditors. The statute requires that a majority in number representing 75% in value of the class of creditors affected must accept the scheme. Court sanction is also required and once these conditions are fulfilled, the arrangement binds abstainers or dissenters. In this way, the objections of a minority within a class of secured creditors may be overcome.[228] Schemes of arrangement do not necessarily involve an administration filing. Nor do they benefit from a statutory stay under the Insolvency Act though recently the court has fashioned a limited stay from the Civil Procedure Rules.[229]

161. The approval of a scheme of arrangement is a three-stage process.[230] Firstly, there must be an application to the court for an order that a meeting or meetings should be summoned. Secondly, the scheme proposals are put to the relevant meetings with a view to obtaining the appropriate level of approval. Thirdly, if approved, there must be a further application to the court for its sanction. At the first stage, the court tries to ensure that those affected have a proper opportunity of being present (in person or by proxy) at the meetings. The second stage ensures that the proposals are acceptable to the necessary majorities and, at the third stage, the court tries to ensure that the views and interests of scheme opponents receive impartial consideration.

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[226] Section 4(3) and (4). Some 'wriggle-room' is however introduced by the decision in <u>IRC v Wimbledon Football Club Ltd</u> [2005] 1 BCLC 66.

[227] See generally J Payne, "Cross-border Schemes of Arrangement and Forum Shopping" (2013) 14 *European Business Organization Law Review* 563; Look Chan Ho, "Making and Enforcing International Schemes of Arrangement" (2011) 26 *Journal of International Banking Law and Regulation* 434.

[228] Under s 895 Companies Act 2006 it has been held that the court has authority to sanction a scheme of arrangement in respect of a foreign incorporated company provided that sufficient connection with England is shown - see <u>Primacom Holdings GmbH v Credit Agricole</u> [2011] EWHC 3746. In <u>Re Rodenstock GmbH</u> [2011] EWHC 1104; [2011] WLR (D) 150, for instance, where a scheme of arrangement was approved in respect of a German incorporated company, sufficient connection with England was found to exist by virtue of the fact that the credit facilities extended to the company contained an English choice of law clause and an English jurisdiction clause. Moreover, there was expert evidence to the effect that the German courts would recognise the English court order.

[229] <u>BlueCrest Mercantile BV v Vietnam Shipbuilding Industry Group</u> [2013] EWHC 1146. In Ireland there is provision for a court ordered stay under s 451 Companies Act 2014.

[230] <u>Re Hawk Insurance Co Ltd</u> [2001] 2 BCLC 480

162. In Re Telewest (No 2)[231] it was held that in deciding whether to sanction a scheme, the court must be satisfied that it is a fair scheme - one that 'an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.' The scheme proposed need not be the only fair scheme however, or even in the court's view, the best scheme. There is room for reasonable differences of view on these issues and, on matters of finance, shareholders or creditors are superior judges of their own interests than the courts. Lewison J in Re British Aviation Insurance Co Ltd[232] pointed out that the test is not whether the opposing creditors have reasonable objections to the scheme. A creditor may be equally reasonable in voting for or against the scheme and, in these circumstances, creditor democracy should prevail.

163. It has also been held by the courts that under the statutory procedure, it is only necessary to get the consent of classes of creditors with an economic interest in the proposed restructuring. Schemes of arrangements can therefore be used to squeeze out intermediate creditors – so-called 'mezzanine' creditors. Re Bluebrook Ltd[233] is a case in point where the 'squeeze out' of mezzanine creditors was held not to constitute unfair prejudice and ground for the court refusing to confirm a scheme.

164. In Ireland, a secured creditor may be deprived of all or part of its security or have the value of its claim written down in the context of a scheme of arrangement[234] and there is a special truncated procedure for the approval of schemes of arrangement under the examinership legislation.[235] The entire rationale of an examinership is the preparation and approval of proposals for a scheme of arrangement. In Re Clare Textiles Ltd[236] Costello J said that the only proposals that an examiner was permitted to formulate were those which made it more likely that (a) the company and (b) the whole or part of its undertaking would survive as a going concern. He added that an examiner had no authority to prepare proposals involving the sale of the company's assets and its business, or its liquidation, and indeed the court had no power to confirm such proposals.

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231 [2005] BCC 36
232 [2005] EWHC 1621 at para 75. The judge added: 'Where, as here, those who voted in favour of the scheme are large and sophisticated corporations, the rigid application of this test as the sole criterion would rarely, I think, enable the court to refuse to sanction the scheme.'
233 [2009] EWHC 2114. See also Re MyTravel plc [2004] EWCA Civ 1734; [2005] 2 BCLC 123.
234 See ss 449-454 Irish Companies Act 2014. In Ireland the procedure for approving a scheme is simpler in that the company itself may summon the relevant meetings of creditors rather than the court.
235 Sections 539-544 Companies Act 2014.
236 [1993] 2 IR 213 at 220.

165. A bare majority of votes cast in person, or by proxy, is all that is required for acceptance of proposals in the case of meetings of members whereas at creditors' meetings a majority in number representing a majority in value of claims represented at the meeting is necessary. After the relevant meetings, the examiner's proposals must come before the court for final sanction. Those entitled to attend are (a) the company (b) the examiner and (c) any creditor or member whose claim or interest would be impaired if the proposals were implemented. The court may confirm, confirm subject to modifications, or reject the examiner's proposals. There must however, be at least one consenting class of members or creditors whose interests or claims would be impaired by the proposals. Moreover, the court may not give approval unless it is satisfied that the scheme proposed is fair and equitable in relation to impaired classes who do not affect the proposals and there is no unfair prejudice to in relation to any interested party.[237]

166. It is specifically provided that where the court confirms proposals, these proposals shall, notwithstanding any other enactment, be binding on all the creditors or the class or classes of creditors affected by the proposals in respect of any claims against the company.[238]

18 Can an under-secured creditor claim from the insolvency estate in respect of any deficiency arising as a result of the enforcement of the security?

167. Yes. If a secured creditor realises his security but the amount so realised is insufficient to discharge the debt, he may prove for the balance in the liquidation.[239]

<u>Publicity and priority of security rights</u>

19 To what extent must security rights over assets be publicised by registration or filing to ensure effectiveness of the security interest over parties other than the debtor and in the event of insolvency proceedings?

168. In the UK details of the main types of charge created by companies have to be registered at the Companies registration office – Companies House. The main consequences of non-registration are suffered by the charge holder who loses its priority where the company goes into administration or liquidation. The registration obligation is now laid down in the

[237] Section 541(4) Companies Act 2014.
[238] Section 541(6) Companies Act 2014.
[239] Rule 4.88(1).

Companies Act 2006 (Amendment of Part 25) Regulations 2013[240] which came into force on 6 April 2013. Schedule 1 to the Regulations is inserted as Chapter A1 at the beginning of Part 25 of the Companies Act 2006.[241]

169. It should be noted that the obligation only applies to charges strictly so-called and does not cover other security mechanisms nor 'quasi-securities'. The latter are functionally equivalent legal devices such as finance leases, retention of title clauses in sale of goods contracts or factoring arrangements i.e. the absolute assignment of receivables. 'Quasi-securities' may involve many of the same economic consequences as charges but have different legal characteristics and effects.[242]

170. The company charge registration system does not apply to security agreements executed by individuals but there is a parallel system in place; namely, the Bills of Sale Acts. 1878-1882 as amended.[243] Moreover, as far individuals engaged in business are concerned, s 344 Insolvency Act 1986 provides that a general assignment of existing or future book debts, or any class of them, has to be registered under the Bills of Sale Act. If the individual is subsequently adjudged bankrupt, then an unregistered assignment is void against the trustee of the bankrupt's estate in respect of book debts which were not paid before the presentation of the bankruptcy petition.

171. The 1878 Act has the long title 'An Act to consolidate and amend the law for preventing frauds upon creditors by secret Bills of Sale of Personal Chattels'. The rationale of this Act and of the Act of 1882 was explained by Lord Herschell in Manchester, Sheffield and Lincolnshire Railway Co v North Wagon Railway Co.[244] He said the former enactment was

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[240] SI 2013/600.

[241] SI 2013/0600 Schedule 1 sets out the new CA 2006 Part 25, Ch A1 of the Act containing CA 2006 sections 859A to 859Q.

[242] In Ireland the system for the registration of charges operates in roughly the same way to that in the UK. As far as companies are concerned, the registration obligation is now contained in Part 7 Companies Act 2014 and applies to all charges subject to certain stated exceptions. There are now two separate procedures for registration of charges. A one-stage procedure requires that particulars of all charges created be delivered to the Companies Registration Office (CRO) within 21 days of their creation while a new two-stage procedure provides that a notice may be sent to the CRO stating the company's intention to create a charge, followed up by a further notification within 21 days of the creation and stating that fact. The CRO is required to issue a certificate of due registration which is stated to be conclusive evidence that there has been compliance with all the requirements of the Act as to registration (s 415) but if the particulars of a charge delivered to the CRO omit the required particulars in respect of one or more properties to which the charge relates, the evidential effect of the certificate shall not extend to these properties..
There is a facility of applying to the court for late registration of a charge (s 417). An unregistered charge becomes void in the event of the company creating the charge going into liquidation and it is also provided that the time of registration rather than the time of creation becomes the priority determinant point in respect of two charges of the same type (s 412).

[243] See generally G McBain "Repealing the Bills of Sale Acts" [2011] *Journal of Business Law* 475. There is similar Bills of Sale legislation in Ireland.

[244] (1880) 13 App Cas 554.

designed for the protection of creditors, and to prevent their rights being affected by secret transfers of chattels that were permitted to remain in the ostensible possession of a person who had parted with the legal title in them. Under the statutory scheme, a bill of sale has to be attested and registered in a public register within seven days. Failure to comply with the registration requirement renders the bill void but only as against creditors or their representatives. As between the parties thereto, an unregistered bill of sale remains perfectly valid.

172. As regards the rationale of the 1882 Act, Lord Herschell said:[245] 'It was to prevent needy persons being entrapped into signing complicated documents which they might often be unable to comprehend and so being subjected by their creditors to the enforcement of harsh and unreasonable provisions. A form was accordingly provided to which bills of sale were to conform, and the result of non-compliance with the statute was to render the bill of sale void even as between the parties to it. But this being the object, the enactment is, as we have seen, limited to bills of sale given 'by way of security for the payment of money by the grantor thereof'.'

173. The 1882 Act requires that security bills of sale should be in a certain form so that the nature and terms of the loan and security are clearly marked out. The insistence on the statutory form has the consequence that certain categories of security cannot be employed as they are by nature incompatible with the statutory form. Section 9 of the 1882 Act also renders invalid a security bill of sale that is not in accordance with the statutory form. The implications of this edict were spelled out in Smith v Whiteman[246] where it was held that derogation from the statutory form avoided a bill even as regards the grantor's personal covenant contained in the bill to repay the principal lent and interest thereon. The money advanced together with reasonable interest was however recoverable in a restitutionary action.

174. The cumbersome nature of the Bills of Sale Acts means that this form of lending has traditionally not been that common in practice though it seems that lending by means of a bill of sale on motor vehicles – 'logbook' lending - has become fairly popular in recent years .[247]

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[245] (1880) 13 App Cas 554 at 560-561.

[246] [1909] 2 KB 437. See also Davies v Rees (1886) 17 QBD 408; Smith v Whiteman [1909] 2 KB 437 and Bradford Advance Co Ltd v Ayers [1924] WN 152.

[247] See the Department for Business, Innovation and Skills consultation on proposals to ban the use of bills of sale for consumer lending – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31481/a_20better_20deal_20for_20consumers_20consultation_20on_20proposals_20to_20ban_20the_use_20of_20bills_20of_20sale_20for_20consumer_20lending.pdf. In the event, the proposals were never implemented and instead an industry Code of Practice was put in place instead – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31484/11-516-government-response-proposal-ban-bills-of-sale.pdf.

Consumer purchases in England are often funded instead, through hire purchase agreements. Technically speaking, these are agreements for the hire of goods coupled with an option to purchase the goods at the end of the hire period.

175. The Bills of Sale Acts have a consumer protection aspect to them albeit one which is imperfectly and inappropriately realised. The company charge registration system has a different orientation however. Its main rationale is the provision of information for persons such as credit reference agencies and prospective charge holders who wish to assess the creditworthiness of the company. For instance, prospective charge holders are able to ascertain from the register whether or not security has already been created over the assets of the company. In consequence, they are better informed about making a lending decision and structuring the terms of any loan.

20 Can you describe briefly the nature of the filing or registration system and whether it is publicly accessible?

176. The Companies Act 2006 (Amendment of Part 25) Regulations 2013[248] introduce a new UK-wide registration system that applies to all UK incorporated companies irrespective of the place of incorporation of the company within the UK. Instead of a lists of charges requiring registration, the requirement to register applies to all charges, subject to specified exceptions. Either the charge holder or the company creating the charge may affect registration and there is a 21-day time limit from the date of creation for registering particulars of a charge. If the charge is not registered within that period it becomes invalid in the event of the company creating the charge going into administration or liquidation. There is however, the possibility of going to court and obtaining an order that permits late registration. The civil consequences of failure to register, impacting severely on the charge holder, means that in practice, it is likely that the charge holder will attend to registration matters as was the former practice.

177. Under the new law, specified particulars of the charge are provided to Companies House along with a certified copy of the instrument of charge although 'personal information' may be redacted from the security instrument. The company's file that is available for public

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See now the Law Commission proposals on Bills of Sale - http://www.lawcom.gov.uk/project/bills-of-sale/

[248] SI 2013/600.

inspection at Companies House contains both the particulars and the security instrument itself (minus the redacted information). The Registrar allocates a unique reference code to the charge and there is also provision for the issue by the Registrar of a certificate of registration of the charge. The certificate must state (a) the registered name and number of the company in respect of which the charge was registered and (b) the unique reference code allocated to the charge. The certificate is stated to be conclusive evidence that the required documents were delivered to the Registrar before the end of the relevant period allowed for delivery.

178. The new law also requires registration of a so-called negative pledge clause: 'whether any of the terms of the charge prohibit or restrict the company from creating any further security that will rank equally with or ahead of the charge'. This may impact on priorities between fixed and floating charges though, unlike in previous drafts of the regulations, there is nothing specific to say that a 'person taking a charge over a company's property shall be taken to have notice of any matter requiring registration and disclosed on the register at the time the charge is created'.[249]

179. Section 859(A) provides that Companies House must register a charge if, before the end of the period allowed for delivery, the company or any person interested in the charge delivers to Companies House for registration a s 859D statement of particulars of the charge alongside a certified copy of the instrument of charge. The period allowed for delivery is 21 days beginning with the day after the date of creation of the charge, unless an order allowing an extended period is made under s 859F(3). For the first time, there is a statutory definition of the date of creation of a charge. In the standard case where a charge has been created or evidenced by an instrument, the date of creation is defined as the date of delivery of the deed where the instrument is a deed that has been executed and has immediate effect on execution and delivery.

180. The new 859D deals with the statement of particulars that has to be delivered to the Registrar alongside a certified copy of the instrument of charge. In the standard case where the charge has been created or evidenced by an instrument, the statement of particulars must contain the following information:

(1) the registered name and number of the company;

(2) the date of creation of the charge;

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[249] In Ireland, s 412 Companies Act 2014 deems particulars of a negative pledge clause to be extraneous material which should not be registered – s 412(6).

(3) the name of each of the persons in whose favour the charge has been created or of the security agents or trustees holding the charge for the benefit of one or more persons; or,

(4) whether the instrument is expressed to contain a floating charge and, if so, whether it is expressed to cover all the property and undertaking of the company;

(5) whether any of the terms of the charge prohibit or restrict the company from creating further security that will rank equally with or ahead of the charge;

(6) whether (and if so, a short description of) any land, ship, aircraft or intellectual property that is registered or required to be registered in the UK, is subject to the charge;

(7) whether the instrument includes a charge over:

(i) any tangible or corporeal property, or

(ii) any intangible or incorporeal property, not described in the previous head.

It should be noted that a company which holds charged property as a trustee can file a statement to that effect.[250] The filing however, is optional rather than compulsory.

181. Section 859B deals with the situation where a series of secured debentures has been issued to which the holders are entitled pari passu. In this case the s 859D statement of particulars must also contain the following information; namely:

(1) the name of each of the trustees for the debenture holders, or where there are more than four such persons, the names of any four persons listed in the charge instrument as trustees for the debenture holders, and a statement that there are other such persons;

(2) the dates of the resolutions authorising the issue of the series;

(3) the date of the covering instrument (if any) by which the series is created or defined.

Section 859G makes provision for the redaction of information. It provides that the certified copy of an instrument delivered to the Registrar need not contain:

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

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

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[250] Section 859J.

(c) a signature.

There is no provision, however, for the redaction of any other information even if it is of a commercially sensitive nature.

182. The changes to the system introduced in 2013 should improve transparency and streamline the practical operation of the registration process. The main practical change sees the introduction of electronic registration and it is envisaged that this will supersede paper-based registration though a facility for the latter is still retained. Despite the changes however, the UK system is still essentially a transaction based system of registration and it should be contrasted with the notice filing system under Article 9 of the United States Uniform Commercial Code (UCC) and the Australian, New Zealand and Canadian Personal Property Security Acts (PPSAs).[251] The main difference between notice filing and traditional systems of registration is that notice filing is party specific rather than specific to a particular transaction. The notice filed does not record details of a particular security but rather the fact that certain parties have entered into, or may, in the future, enter into, a secured transaction in relation to specified property. The nature of the notice filing system means that notice may be filed before a transaction and the contemplated transaction may never in fact materialise. The same notice may also operate in respect of a series of transactions between the same parties. Furthermore, the notice on the register is, of necessity, generic rather than specific in character and functions more as an invitation to make further inquiries rather than being a full description of the security right. Article 9 type regimes also apply to all security interests, regardless of whether the security provider is an individual or a business entity.

183. Security rights over certain types of asset are subject to 'dual' registration requirements i.e. registration at the company charges register and registration at a separate 'assets-based' or 'ownership' register.[252] This dual registration requirement applies in respect of certain security rights over land, ships, aircraft and intellectual property rights.

184. For instance, the Land Registration Act 2002 establishes a register of title to land and, in general, charges over land must be registered with the Land Registry as well as with the Companies Registry.[253] The Merchant Shipping Act 1995 and the Merchant Shipping

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[251] Scottish Law Commission discussion paper Registration of Rights in Security by Companies (October 2002) at p 8.
[252] For more details see the Law Commission Consultative Report No 176 *Company Security Interests* (2004) at para 3.324; and see also WJ Gough *Company Charges* (Butterworths, London, 2nd ed 1996) chapter 35.
[253] For the equivalents in Ireland see the Registration of Deeds and Titles Act 2006 which established a property registration authority - see www.landregistry.ie/

(Registration of Ships) Regulations 1993[254] provide that legal mortgages of ships should be in a prescribed form and also provide for the registration of legal mortgages of ships in a register for ships.[255]

185. The Civil Aviation Act 1982 in s 86 requires the registration of mortgages of aircraft in a 'Register of Aircraft Mortgages' to be maintained by the Civil Aviation Authority.[256]

186. Charges on patents,[257] trade marks[258] and registered designs[259] must, in addition to registration with the Companies Registry, be notified to the Intellectual Property Office.[260]

21 To what extent does 'possession' or control of the secured assets serve as an alternative method to registration or filing in ensuring third party effectiveness of the security interest?

187. Under the original version of Part 25 of the Companies Act 2006, and Companies Acts going back to 1900, the registration requirement applied only to a statutorily defined list of charges. While the categories of registrable charge have been broadened over the years, the basic statutory approach remained the same until the 2013 amending regulations. The registration obligation now covers all charges save for those on the narrow itemised list of exclusions. The registration obligation does not cover pledges and liens. The fact however, that in the case of pledges and liens the creditor generally has possession of the items used as security might be taken as the functional equivalent of notice to third parties of the existence of the security.

[254] SI 1993/3138.

[255] See Merchant Shipping Act 1995, Schedule 1 "Private Law Provisions for registered ships" and Part VII of the 1993 Regulations dealing with mortgages of ships. For the Irish equivalents see Merchant Marine Act 1955 and in particular s 52.

[256] In Ireland, the International Interests in Mobile Equipment (Cape Town Convention) Act 2005 gives effect to the Cape Town Convention and Aircraft Protocol Convention under Irish law. Aircraft mortgages or charges with an international interest must be registered on the international registry established pursuant to the Convention. This registry is supervised by the International Civil Aviation Organisation ((ICAO) and is maintained in Dublin by Aviareto (a joint venture with the Irish government). The UK has now implemented the Convention though the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 SI No 912/2015.

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[257] Patents Act 1977, s 33(2). For Ireland, s 85 Patents Act 1992.

[258] Trade Marks Act 1994, s 25(2). For Ireland, s 29(2) Trade Marks Act 1996.

[259] Registered Designs Act 1949, s 19(1) as amended by Copyright, Designs and Patents Act 1988, Sch 3, para 18. For Ireland, s 41 Industrial Designs Act 2001.

[260] See generally I Davies, "Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law" (2006) 26 *Oxford Journal of Legal Studies* 559.

188. Millett LJ in Re Cosslett (Contractors) Ltd[261] referred to the four types of security interest known to English law: mortgages, charges, pledges and liens. The mortgage/charge is a non-possessory security whereas the pledge is a possessory security. As we have seen, a pledge may be described as the actual or constructive delivery of possession of an asset to a creditor by way of security.[262]

189. The registration obligation also does extend to liens. Liens fall into three categories: common law liens, equitable liens and contractual liens. The first two types come into existence by operation of law in certain circumstances and not by agreement between the parties and therefore may be said to fall outside registration requirements on this basis. The third type of lien (the contractual lien), however, depends on contractual agreement, but it has been held that the existence of a power of sale over the secured property in the relevant contract does not turn a contractual lien into a charge.[263]

190. In Re Lehman Brothers International (Europe) (In Administration)[264] it was common ground between the parties that one could not have contractual lien on anything other than tangibles and old-fashioned bearer securities. More recently however, in Your Response Ltd v Database Business Media[265] it seems to have been implied that the parties to a contract could make express provision in their contract for a lien over at least certain types of intangible property, in that case a database.

191. Apart from the general absence of party consent to their creation, one could also justify the absence of any registration requirements pertaining to liens on the pragmatic basis that they are likely to be short term in duration. Pragmatism is at the heart of what is now s 859A(6) Companies Act 2006 which exempts certain categories of charge from the company charge registration requirements; namely:

(a) a charge in favour of a landlord on a cash deposit given as a security in connection with the lease of land;[266]

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[261] [1998] Ch 495 at 508. In Re Lehman Brothers International (Europe) (In Administration [2012] EWHC 2997 at para 47, Briggs J suggested that "there may be rare cases in which security rights fall wholly outside the recognised categories of lien, pledge, mortgage or charge, and into a residual, purely contractual, category sometimes categorised as turning the grantor's property into a form of 'flawed asset'".
[262] See generally Willes J in Halliday v Holgate (1868) LR 3 Ex 299.
[263] See Re Hamlet International plc [1999] 2 BCLC 506.
[264] [2012] EWHC 2997 at para 34.
[265] [2014] EWCA Civ 281
[266] In CA 2006 s 859A(7) 'cash' is defined as including foreign currency. In Ireland the relevant exemptions are contained in s 408(1) Companies Act 2014 and include cash, shares, bonds or debt instruments.

(b) 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;

(c) a charge excluded from the application of this section by or under any other Act.'

192. According to the Financial Collateral Arrangements (No 2) Regulations 2003, the registration of charge provisions do not apply in respect of a security financial collateral arrangement, or any charge created or otherwise arising under a security financial collateral arrangement. These regulations are designed to implement the EU Financial Collateral Directive[267] and the preamble refers to the need to achieve a balance between market efficiency and the safety of the parties to the arrangement, and of third parties. Consequently, the directive is limited in its application to those financial collateral arrangements which provide for some form of dispossession, i.e. 'the provision of the financial collateral, and where the provision of the financial collateral can be evidenced in writing or in a durable medium, ensuring thereby the traceability of the collateral'.[268] The Financial Collateral Arrangements (No 2) Regulations 2003 apply the new regime in all cases where the collateral-provider and the collateral-taker are both corporates.[269]

193. In Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd[270] the Privy Council pointed out that the assumption underlying the directive that 'full ownership' is with either the collateral provider, or the collateral-taker, did not apply very easily to a legal or equitable English mortgage or charge where each party had a proprietary interest in the collateral as long as the security was in place.[271] The UK implementing regulations are also problematic in practice.[272] According to reg 4 of the Financial Collateral Arrangements (No 2) Regulations, the registration of charge provisions in the Companies Act do not have any application in respect of a security financial collateral arrangement or any charge created or otherwise arising under a security financial collateral arrangement. To constitute a security financial

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267 Directive 2002/47/EC on financial collateral arrangements (OJ 2002 L 168). The SI 2003/3226 Financial Collateral Arrangements (No 2) Regulations 2003 have been amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, SI 2010/2993 extending the collateral subject to the regulations to 'credit claims' and introducing a new definition of possession of financial collateral. In Ireland the implementing regulations are now the European Communities (Financial Collateral Arrangements) Regulations 2010 – SI No 626/2010.

268 Paragraph 10 of the preamble.

269 SI 2003/3226, reg 3.

270 [2009] UKPC 19, [2009] 3 All ER 849 at para 5.

271 It was accepted in the case however that an English charge of shares must be regarded as a security financial collateral arrangement. See also Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd [2013] UKPC 2 at para 101.

272 On the effect of gold-plating of the Directive by the Financial Collateral Arrangements (No 2) Regulations 2003, see Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd [2013] UKPC 2 at paras 100–102.

collateral arrangement there must, inter alia, be an agreement or arrangement, evidenced in writing, where:

(a) the purpose of the agreement or arrangement is to secure the relevant financial obligations owed to the collateral-taker;

(b) the collateral-provider creates or there arises a security interest in financial collateral to secure those obligations.[273]

194. Many aspects of this definition were considered by Briggs J in Re Lehman Brothers International (Europe)[274] including the 'purpose' aspect. He suggested that where there is an express contract for the creation of a security, the purpose test is automatically satisfied. He noted that the directive itself did not contain any 'purpose' test and he seemed sympathetic to the view that the additional 'purpose' requirement in the regulations might reasonably be regarded as mere surplusage. The judge also avoided a strictly literal interpretation of the requirement that a security financial collateral arrangement was limited to securities given for obligations owed to the collateral taker holding that this part of the definition should be treated as descriptive rather than restrictive. Otherwise, and contrary to the purpose of the directive, it would appear to 'exclude security given to a debenture trustee for debts owed by the collateral giver to a class of investors, where the collateral taker would not to any significant extent be likely to be a creditor at all.'[275]

195. 'Financial collateral' is defined as meaning either cash or financial instruments. There is also a lengthy definition of 'financial instruments' which includes shares in companies, and other securities equivalent to shares in companies as well as bonds. The expression 'security interest' is defined to include fixed charges as well as 'a charge created as a floating charge where the financial collateral charged is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral-taker or a person acting on its behalf; any right of the collateral-provider to substitute equivalent financial collateral or withdraw excess financial collateral shall not prevent the financial collateral being in the possession or under the control of the collateral-taker …'

196. According to the UK consultation document on implementation of the regulations, the definition of 'security financial collateral arrangement' and of 'security interest' in the

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[273] See reg 3 of the Financial Collateral Arrangements (No 2) Regulations 2003.
[274] [2012] EWHC 2997 (Ch) at para 94. See also para 98 cautioning against the subjective investigation of the parties' motivation in a scheme that was meant to encourage the reliable creation of security with minimum formality and minimum risk of uncertainty or unenforceability.
[275] [2012] EWHC 2997 (Ch) at para 99.

regulations means that they do 'not apply to floating charges before the charge has crystallised and some control over the collateral has passed to the charge holder. Serious thought was given to extending the regulations to all floating charges. However, we have rejected this extension in the interests of providing appropriate protection for third parties, particularly unsecured creditors who appear after the floating charge has been taken.' [276]

197. It is not clear however, whether the regulations, as drafted, accomplish the professed legislative objective. In support of this interpretation, though one might say that the essence of the floating charge is that the charge-giver and not the charge-taker should have control of the charged assets and therefore the regulations only apply where the floating charge crystallises and control passes to the charge-taker.

198. In Gray v G-T-P Group Ltd,[277] the judge accepted that the requirement for control in the regulations meant that the collateral-taker should have the legal right to deal with collateral as distinct from having merely administrative control over the collateral. In the case of an uncrystallised floating charge, it is the collateral giver and not the collateral-taker who has the legal right to deal with the collateral. Therefore, one could infer from the judgment that the regulations only kick in when the floating charge has crystallised though the judge did not make this point explicitly. He said that if the collateral-taker could not prevent the collateral provider from dealing with the charged assets, then he did not, in any legal sense, have control though he might have control in an administrative or practical sense which was insufficient for the application of the regulations.

199. In coming to this interpretation, the judge looked to the totality of the regulations. For example, it was stated specifically that a right to withdraw excess financial collateral would not prevent the regulations applying but, if the regulations applied anyway, then the collateral provider could withdraw the entirety of the collateral as a matter of legal right. The judge also looked at the preamble to the directive which made it clear that the directive was only intended to cover those financial collateral arrangements which provided for some form of dispossession. 'Dispossession' under the directive seemed to signify a situation where the legal right to the charged asset was removed from the collateral provider.

200. The 'dispossession' requirement under the directive and regulations has also been considered in Re Lehman Brothers International (Europe)[278] – a case where the LBIE

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[276] 'Implementation of the Directive on Financial Collateral Arrangements' (July 2003) at para 2.10.
[277] [2011] BCC 869.
[278] [2012] EWHC 2997 at para 34.

administrators sought directions on the interpretation, characterisation, validity and effect of security provisions in a master custody agreement (MCA) that had been used between LBIE and an affiliated company, namely LBF. LBIE held assets as custodian for clients and affiliates and the documentation provided that LBIE as custodian had a security on property held by it until the satisfaction of all obligations owed by the other party to LBIE or any Lehman Brothers entity. The judge decided that the security created by the MCA was a floating charge even though the MCA had referred to it as a 'general lien'.

201. He went on to decide however, that the floating charge was not a 'security financial collateral arrangement' because the collateral-provider, LBF, had not been sufficiently dispossessed.[279] The MCA provided that LBIE had the right to prevent the other party, LBF, from withdrawing assets beyond those which LBIE considered necessary to pay LBF's debts to LBIE, but this right did not extend to LBF's debts to other Lehman Brothers entities. With regard to the debts owed to LBIE, LBIE was considered to have sufficient possession and control, but not with regard to the debts owed to the other entities. Apart from its debts to LBIE, LBF could do what it liked with the property pending crystallisation of the floating charge, regardless of its liabilities to the other entities.

202. The judge broadly agreed with the analysis that 'control' means legal control, rather than administrative control[280] stating what needs to be shown is that that there is 'sufficient possession or control in the hands of the collateral taker for it to be proper to describe the collateral provider as having been "dispossessed". There will be cases in which the collateral is sufficiently clearly in the possession of the collateral taker that no further investigation of its rights of control is necessary. In other cases … it will be necessary to analyse the degree of control thereby conferred on the collateral taker. There may be some cases, in particular where there is no delivery, transfer or holding to or by the collateral taker, but merely some form of designation, where the collateral remains wholly in the possession of the collateral provider, but on terms which give a legal right to the taker to ensure that it is dealt with in accordance with its directions.'[281]

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[279] Nevertheless, the judge rejected the proposition that there was a 'bilaterality' test in the Regulations – the argument that the MCA charge failed to qualify as a 'security financial collateral arrangement' because it was multilateral to the extent that it created security for the debts of other Lehman Brothers entities, rather than for LBIE alone – [2012] EWHC 2997 at para 86.

[280] Note that the Financial Collateral Arrangements (No 2) Regulations 2003 have been amended by the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010, SI 2010/2993, which, inter alia, introduce a new definition of possession of financial collateral. It is provided that 'possession' includes the case where financial collateral has been credited to an account in the name of the collateral-taker, provided that the rights of the collateral-provider are limited to rights to substitute equivalent collateral or withdraw excess collateral.

[281] [2012] EWHC 2997 at para 136.

22 Is it possible to have more than one set of security rights (security interest) over the same asset?

203. Under the common law, it is theoretically possible to create multiple security interests over the same asset. Effectively what the charge giver is doing is creating a security interest over its "equity of redemption" i.e. its stake in the property after the encumbrance represented by the prior security interest has been discharged.

23 What are the rules for determining priority between competing security interest in the same property?

204. Under current English law the question of priorities between competing security interests is, in theory, fairly complex since one must make do with a system that consists of a mixture of inherited common law and equity, occasionally supplemented by statute. The existing priority rules have been succinctly summarised in the Diamond Report,[282] which states: 'Fixed legal charges which are registered within 21 days of creation rank with one another according to the time of creation and fixed legal charges created before a floating charge crystallises have priority over the floating charge, but subject to this the rules are complicated, resting on the distinction between legal and equitable charges and involving questions of notice.'

205. The asset based property and security registers also establish priority rules of specialised application. In respect of land, priority between registered charges is determined by date of registration rather than date of creation.[283] The Merchant Shipping Act 1995 and the Merchant Shipping (Registration of Ships) Regulations 1993[284] also lay down a statutory scheme of priority for registered mortgages based on the order of registration.[285] Priority is by date of registration irrespective of the date of creation of the security agreement and a registered mortgage will take priority over any other mortgage or charge that is either not registered or registered subsequently. It appears to be irrelevant that the mortgagee had notice of an earlier charge through registration of it at the Companies Registry.[286]

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[282] *A Review of Security Interests in Property* (HMSO, 1989) at p 124.
[283] Land Registration Act 2002, s 48.
[284] SI 1993/3138.
[285] See Merchant Shipping Act 1995 Schedule 1 para 8. In Ireland s 50 of the Mercantile Marine Act 1955 makes provision for the registration of mortgages over Irish flagged ships with priority determined by the order of registration – s 52.
[286] Schedule 1 para 8(1) stating that priority shall be 'determined by the order in which the mortgages were registered (and not by reference to any other matter)'. Regulation 59 of the Merchant Shipping (Registration of Ships) Regulations creates however a system of priority notices. This system allows an intending mortgagee

206. The same broad principles apply to aircraft mortgages.[287] Section 86 of the Civil Aviation Act 1982, as well as making provision for the registration of mortgages of aircraft in a 'Register of Aircraft Mortgages' to be maintained by the Civil Aviation Authority, makes provision for the priority of registered mortgages. The details of the law, embodied in the Mortgaging of Aircraft Order 1972 (MAO),[288] have been succinctly summarised in the Law Commission Consultative Report on Company Security Interests as follows:[289]"'he MAO provides that an aircraft registered in the UK nationality register, or such an aircraft together with any store or spare parts for that aircraft, may be made security for a loan or other valuable consideration.[290] Registered mortgages have priority over unregistered mortgages and charges, and priority between registered mortgages is decided by reference to the date of registration, although nothing in the priority rules is to be construed as giving a registered mortgage any priority over any possessory lien for work done to the aircraft or statutory right of detention.[291] Priority notices may also be entered in the mortgage register.'[292]

207. On the other hand, with the patent[293]and trademark[294] registers, priority is not determined strictly by the order of registration. It appears that actual knowledge of an earlier registered charge in the Companies Registry will prevent a subsequent charge holder from obtaining priority, even if the earlier charge is the second to be registered, or not registered at all, in the patent and trademark registers.

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to lodge a priority notice signifying the intention to take a mortgage and provided that substantive registration takes place within 30 days, priority of the mortgage is backdated to lodgement of the priority notice.

[287] For Ireland, under Article 29 of the Cape Town Convention (implemented in Ireland by the International Interests in Mobile Equipment (Cape Town Convention) Act 2005) there is a similar principle of priority by order of registration irrespective of notice of an earlier unregistered interest.

[288] SI 1972/1268; and for a more detailed treatment see Peter Thorne, "Aircraft mortgages" in N Palmer and E McKendrick (eds) *Interests in Goods* (Lloyds of London Press, London, 2nd ed, 1998); N Meeson *Ship and Aircraft Mortgages* (Lloyds of London Press, London, 1989) and most comprehensively G McBain, *Aircraft Finance: Registration, Security & Enforcement* (Sweet & Maxwell, London, 2014 with updates).

[289] Law Commission Consultation Paper No 176 at para 3.314.

[290] MAO, art 3.

[291] MAO, art 14.

[292] MAO, art 5(1).

[293] According to s 33(1) Patents Act 1977 priority is determined by the date of registration, but a later transaction will have priority over an earlier transaction if (a) it is not registered (b) notice has not been given to the comptroller, or (c) in any case the party to the later transaction was unaware of the earlier one. In Ireland, s 79 Patents Act 1992 provides that the rules of law applicable to the ownership and devolution of personal property apply in relation to patents as they apply in relation to other choses in action.

[294] Section 25(3) Trade Marks Act 1994 provides that a later transaction will have priority over an earlier one if the party to the later transaction is ignorant of the earlier one. In Ireland, s 30(2) Trade Marks Act 1996 states that equities in respect of a registered trade mark may be enforced in like manner as in respect of other personal property.

208. Leaving aside the specialist asset registers, there is no single reference point for determining priorities under English law. Unlike the position in the US under Article 9 of the Uniform Commercial Code, registration is not per se a priority determinant between competing security interests in the same property.[295] Under English law, interests that involve the use of absolute title by way of security, such as interests under trusts and 'simple' retention of title clauses,[296] enjoy super-priority status and, moreover, they are not subject to any requirement of registration. As far as charges, strictly co-called, are concerned, while failure to register a registrable charge will result in the invalidation of the charge in the event of the corporate debtor going into liquidation, once registration has been duly affected, then priority among competing charges turns on the date of creation. In other words, fixed charges rank amongst themselves according to the order of creation but, on the other hand, a floating charge is postponed, priority-wise, to a fixed charge, irrespective of the order in which the two charges were created.[297] This is the position unless it appears that the floating charge instrument contains a 'negative pledge' or 'restrictive clause', i.e. a clause forbidding or restricting the creation of any subsequent security having priority to the floating charge and particulars of the restrictive clause have been duly registered.

209. The complexities in the law governing priorities has led to calls for legislation that clarifies the position, or at least for private law solutions negotiated amongst secured parties. As one commentator has said:[298]'The priority rules are a potential minefield for secured creditors. The rules vary depending on the nature of the assets concerned, floating charges are governed by a different set of rules altogether, and there is yet another set of rules for money lent after the creditor has received notice of a subsequent charge … For all these reasons, it is common practice for secured creditors to enter into a priority agreement with any other secured creditor of which they become aware.'

210. As far as charges are concerned, the priority rules may be stated in more detail in point form as follows –

(1) A duly registered charge (charge A) takes priority over a previously or subsequently created unregistered charge (charge B).

(2) There is an exception to the foregoing rule if charge B is prior in point of time to charge A and

[295] Unlike also the position in Ireland under s 412 Companies Act 2014 where time of registration is established as the reference point for determining priority between two charges of the same type over the same property.
[296] Put shortly, the property never comes into the beneficial ownership of the insolvent entity.
[297] See G McCormack, "Priority of Charges and Registration" [1994] *Journal of Business Law* 587.
[298] See Richard Calnan, "Taking Security in England" in M Bridge and R Stevens (eds) *Cross-Border Security and Insolvency* (OUP, Oxford, 2001) 17 at 33.

charge B was duly registered within 21 days of its creation even though in actual fact it was registered after the registration of particulars of charge A. This is despite the fact that charge holder A may have relied on the absence of any charges appearing on the register when advancing its money. Therefore it is clear that registration is not a reference point for determining priorities.

(3) A registered charge ranks after a prior unregistered charge over the same property where the registered charge takes expressly subject to the first unregistered charge.

(4) Where particulars of a charge (charge A) are delivered for registration outside the 21-day period from the date of the charge's creation and a second charge (charge B) is created before actual registration of charge A, charge B takes priority over charge A, irrespective of whether charge B was created within, or outside, the period of 21 days from the date of creation of charge A.[299]

(5) While the statement of the foregoing four rules was premised on the assumption that all the charges were fixed legal charges, in fact there is little modification of the priority rules if a later legal charge is competing against an equitable fixed charge which is prior in point of time. A holder of a legal interest takes free from the holder of an earlier equitable interest in the same property, provided that the subsequent holder of the legal estate is bona fide, has paid value, and is without notice, actual or constructive of the earlier equitable interest.[300] Since registration is deemed to constitute notice, the holder of the subsequent legal interest will be postponed to the holder of the prior equitable interest.

(6) In certain circumstances, an earlier charge holders may be able to make subsequent advances that rank in priority to any loans made by intervening charge holders.

(7) A duly registered fixed charge ranks ahead of a duly registered floating charge irrespective of the respective dates of creation of the two charges except where the floating charge contains a restrictive clause.

(8) It appears that a floating charge has priority over a subsequent fixed charge (assuming due registration in both cases) where the subsequent fixed charge holder has notice of a restrictive clause in the earlier floating charge.[301] A restrictive clause (sometimes called a negative pledge clause) is a provision in the debenture containing the floating charge which prohibits or restricts the creation of subsequent fixed charges ranking prior to, or pari passu with the earlier floating charge.

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[299] In the Companies Act 1989 the issue was specifically addressed in s 95. This particular provision was never implemented.

[300] For a discussion of the meaning of 'notice' see Gray v Smith [2013] EWHC 4136 (Comm) at paras 128-138.

[301] See generally Wilson v Kelland [1910] 2 Ch 306; Cox v Dublin City Distillery Co [1906] IR 446; Coveney v HS Perse Ltd [1910] 1 IR 194; G and T Earle Ltd v Hemsworth Rural District Council (1928) 44 TLR 605.

(9) The new registration of company charge regime introduced in 2013 makes details of a restrictive clause compulsorily registrable and this ought to give a subsequent fixed charge holder notice of the restrictive clause.

(10) If a fixed charge holder has priority over a floating charge holder in a particular case because the fixed charge holder has actual notice of a restrictive clause, then this gives rise to a circularity problem that also implicates the preferential creditors who, in terms of priorities, are in between the fixed and floating charges. The issue has provoked judicial disagreement, with one view suggesting that, by coming after the floating charge, the fixed charge should therefore come after the preferential creditors.[302] On the other hand, it was also suggested in this case that a different result would follow if the respective secured parties had agreed to exchange their proprietary rights. Another possible solution is to apply the doctrine of subrogation and to hold that, by virtue of the altered priorities between them, the floating charge holder stands in the shoes of the fixed charge holder to the extent of the amount secured by the fixed charge and therefore the floating charge holder will be paid ahead of preferential creditors by the degree to which liabilities are secured by a fixed charge.[303]

(11) A crystallised floating charge takes priority over a subsequently created equitable fixed charge (assuming both charges have been duly registered within the 21-day period from the date of creation). A floating charge is taken to be a fixed equitable charge from the moment of crystallisation.

(12) The priority rules are further complicated by apparent judicial acceptance of the proposition that where a second floating charge covers only part of the assets covered by a prior floating charge, then the second floating charge will have priority, provided that the first instrument of charge authorises the creation of subsequent charges having this effect.[304] In principle however, the question should be whether the first floating charge authorises the creation of superior ranking subsequent floating charges, and not whether the second floating charge is over part only of the assets covered by the first.

(13) Charge holders can agree to alter the priority between them, but such an agreement does not affect the rights or entitlements of a person who is not party to the agreement.

211. Some of these priority rules warrant further explanation and elaboration. For instance, priority rule 6 raises the issue of the priority of further advances. Often a charge is taken to

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[302] Re Portbase Clothing Ltd [1993] Ch 388.
[303] See Re Woodroffes (Musical Instruments) Ltd [1986] Ch 366.
[304] Re Automatic Bottle Makers [1926] Ch 412; Re Benjamin Cope & Co [1914] 1 Ch 800. See also Griffiths v Yorkshire Bank plc [1994] 1 WLR 1427; Re H & K Medway Ltd [1997] 1 WLR 1422.

secure further advances, such as a charge to secure a bank account.[305] The question arises whether a charge holder may make further advances ranking in priority to an intervening charge holder. This is known as 'tacking'. As far as registered land is concerned, the rules on tacking are contained in s 49 Land Registration Act 2002.[306] This provision enables the holder of a registered charge to make a further advance ranking in priority to a subsequent charge in four situations:

(a) if he has not received from the subsequent charge holder notice of the creation of the subsequent charge; or

(b) if the further advance is made pursuant to an obligation which was entered in the register at the time of creation of the subsequent charge - under Rule 108 of the Land Registration Rules 2003 a person applying to be registered who is under an obligation to make further advances, may apply to the registrar for such obligation to be registered on the register; or

(c) the parties to the prior charge have agreed a maximum amount for which the charge is security and such agreement was entered in the register at the time of creation of the subsequent charge

(d) by agreement.

212. In <u>Re Black Ant Co Ltd</u>[307] the court suggested that the four rules basically codified the common law position as laid down by the House of Lords in <u>Hopkinson v Rolt</u>[308] and the argument in the case centred on whether the conditions specified in the rules had been met. The court pointed out that where an obligation to make further advances is noted on the register, the extent of the obligation and the circumstances in which it arises are not noted. Therefore a person who contemplates the making of an advance secured by a second charges

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305 In this case the security will have to be expressed to be a continuing security. Otherwise, under the rule in <u>Clayton's</u> case (1816) 1 Mer 572 and the principle of 'first in, first out' in relation to bank amounts, the security becomes discharged on repayment of the amount of the initial advance.

306 In Ireland, s 111 of the Land and Conveyancing Law Reform Act 2009 provides that the right to tack in any form is abolished. The section also provides however, that where "a mortgage is expressed to be created on any land for the purpose of securing future advances (whether with or without present advances), the mortgagee is entitled, in priority to any subsequent mortgage, to the payment of any sum due in respect of any such future advances, except any advances which may have been made after the date of, and with express notice in writing of, the subsequent mortgage." The provision in the 2009 Act applies more generally what was the position in respect of registered land under s 75 Registration of Titles Act 1964.

307 [2014] EWHC 1161 (Ch) and for the Court of Appeal judgment see [2016] EWCA Civ 30 where David Richards LJ said at para 1: '"Tacking" describes the means by which a creditor, with a charge securing an original advance, is able to use the charge to secure a further advance and so obtain priority for the further advance over sums secured by any second or subsequent charge. Because of the potential prejudice to the interests of the holders of second or subsequent charges, first equity and then statute have severely restricted the circumstances in which tacking will be permitted.'

308 (1861) 9 HL Cas 514, 11 ER 829.

needs to ascertain these matters either from the first charge holder or the borrower, in order to establish what equity, if any, is potentially left in the property.

213. The court said that 'further advance' meant, prima facie, the provision of further or additional funds but there might be a 'further advance' within these provisions without any new money being lent. The example was given of a revolving credit facility where earlier loan amounts were repaid and the facility was replenished with fresh funds though the lender's overall exposure to the borrower did not increase. The holder of the first registered charge would have priority in terms of the further advance under the revolving credit facility even though there was no increase of the total funds available to the borrower.

214. In relation to point (9), under the old registration of company charge regime, English authority suggested that actual rather than just constructive notice of a restrictive clause in an instrument of charge was required before the priority of a subsequent fixed charge holder loses priority to a floating charge holder. A case in point is English and Scottish Mercantile Investment Co Ltd v Brunton[309] where the lawyer acting for the subsequent charge holder knew of the existence of the earlier floating charge, but was misled by the grantor of the charge into believing that there was nothing in the charge to affect its client's security. The subsequent charge holder obtained priority.

215. In Wilson v Kelland,[310] the court took the view that registration of the particulars of a charge pursuant to the company charge registration provisions amounted to constructive notice of a charge affecting the property, but not of any special provisions in the charge that restricted the company from dealing with its property in the usual manner when the charge was a floating security. The same view was clearly articulated in G & T Earle Ltd v Hemsworth Rural District Council[311] with the court stating: 'it has never been held that the mere fact that persons … have constructive notice of the existence of debentures also affects them with constructive notice of the actual terms of the debentures or that the debentures are subject to the restrictive condition to which these debentures were subject. No doubt it is quite common for debentures to be subject to this limiting condition as to further charges, but that fact is not enough in itself to operate as constructive notice of the actual terms of any particular set of debentures.'

[309] [1892] 2 QB 700. See also Re Standard Rotary Machine Co (1906) 95 LT 829; Siebe Gorman v Barclays Bank [1979] 2 Lloyd's Rep 142 and ABN Amro Bank NV v Chiyu Banking Corp Ltd [2001] 2 HKLRD 175, CFI (Hong Kong).
[310] [1910] 2 Ch 306.
[311] (1928) 44 TLR 605. Perhaps the fullest discussion of the authorities in modern times comes from the Irish Supreme Court in Welsh v Bowmaker (Ireland) Ltd [1980] IR 251 where the same view was taken.

216. In order to give greater protection to floating charges, the practice developed, which the registrar accepted, of including details of any negative pledge in the particulars of charge delivered for registration. If a subsequent charge holder actually consulted the register he would discover the existence of the restrictive clause and thereby become infected with actual notice. It was debatable however, whether inclusion among the registered particulars gave constructive notice of the negative pledge. This issue was not tested in the courts in England and the proposition was rejected in New Zealand.[312] There is a strong view that registration only constitutes constructive notice in respect of those matters where registration is compulsorily required and not in respect of optional 'additional' matters.

217. Section 859D(2)(c) now makes details of a restrictive or negative pledge clause in a floating charge compulsorily registrable. The section provides that the statement of particulars of the charge submitted for registration should include details of any of the terms of the charge that prohibit or restrict the company from creating further security that will rank equally with or ahead of the charge. The new provision however, does not say anything directly about constructive notice and the effect of registration of details of a restrictive clause on priorities between fixed and floating charge holders. There is nothing equivalent to s 103 of the Companies Act 1989 which was never implemented. That provision stated that a person taking a charge over a company's property shall be taken to have notice of any matter requiring registration and disclosed on the register at the time the charge is created. But by an apparent side sweep, the new s 859D(2)(c) seems prima facie to have altered the priorities between fixed and floating charges.

218. Priority rule (13) derives from the judgment of the Privy Council in Cheah v Equiticorp Finance Group Ltd[313] Lord Browne-Wilkinson made it clear that where there were two charges over the same property, the chargees could agree to alter the priority of their security interests without the consent of the debtor. He pointed out that in the ordinary case a mortgagor was not affected by the order in which the debts were satisfied. A mortgagor was bound to satisfy all the debts secured on the property before the property could be recovered, and priority of mortgages affected only the rights of the mortgagees inter se, in particular where the security was inadequate to pay all the secured debts in full. Lord Browne-Wilkinson added:[314]'There may be cases (for example where the successive mortgages carry differing rates of interest) where the mortgagor has a genuine interest in ensuring that the debts are satisfied in a

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[312] Dempsey v The Traders Finance Corporation Ltd [1933] NZLR 1258.
[313] [1992] 1 AC 472. See generally R Nolan, "Less Equal than Others" [1995] *Journal of Business Law* 485. In Ireland s 412(5) Companies Act 2014 seems to validate priority agreements between charge holders.
[314] [1992] 1 AC 472 at 477.

particular order. In such a case it will be for the mortgagor to insist upon a specific contractual provision precluding the alteration of the priorities of the mortgages.'

219. Debt subordination agreements were upheld by the court in Re Maxwell Communications Corp plc (No 2).[315] Here a company, Maxwell Finance Jersey (MFJ), issued bonds that were guaranteed by another company, MCC, under a guarantee which provided that MCC's liability to the bondholders was subordinated to MCC's liabilities to other unsecured creditors. In other words, if MCC became insolvent, the rights of the bondholders against MCC were subordinated to all other unsecured liabilities owed by MCC. It was held that the subordination agreement was a valid contract. The court took the view that since a creditor could waive his debt or decline to submit to proof, there was no reason why he should not, prior to any insolvency proceedings, agree to subordinate his claim to that of other creditors in the event of the debtor company's insolvency. Subordination did not undermine the pari passu principle which was understood to preclude a creditor from obtaining some advantage in the winding up of a company to which he was not entitled by virtue of insolvency principles. This principle was not contravened, however, where the performance of an agreement between various parties could not affect the entitlement of creditors who were not parties to the agreement. A liquidator might distribute in accordance with an agreement between the parties where to do so could not adversely affect any creditor not a party to the agreement.

220. The court in Maxwell considered the House of Lords decision in National Westminster Bank Ltd v Halesowen Presswork and Assemblies Ltd[316] on the principles governing the set-off of mutual debts in respect of insolvent companies. The House of Lords held that persons who had dealings with an insolvent company could not validly contract out of the statutory set-off provisions. Bankruptcy set-off was said to be part of a 'code of procedure whereby bankrupts' estates ... are to be administered in a proper and orderly way.'[317] This case was distinguished case on the basis that the rationale underlining the set-off regime was one of public policy. The court drew attention to the inconvenience and potential unfairness to the liquidator and other creditors if a creditor was entitled either to exercise or, at his option, not to exercise the right of set-off. It said:[318]'An agreement between the debtor and the creditor excluding the

[315] [1994] 1 All ER 737. See also Re SSSL Realisations (2002) Ltd [2004] EWHC 1760 where Lloyd J suggested that the effect of a subordination agreement did not involve the diversion of an asset of the junior creditor, but rather its suppression by subordination. See now the decision of the Supreme Court in Belmont Park Investments Pty Ltd v BNY Corporate Trustee [2011] UKSC 38; [2012] 1 AC 383 and that of the Court of Appeal on the 'Lehman Waterfall 1 application' – see Re Lehman Brothers International (Europe) (In Administration) [2015] EWCA Civ 485 at para 38.
[316] [1972] AC 785.
[317] [1972] AC 785 at 809.
[318] [1994] 1 All ER 737 at 746.

creditor's right of set-off, or the waiver by the creditor of his right of set-off, even after the commencement of the bankruptcy or winding up, might thus equally hinder the rapid, efficient and economical process of bankruptcy.' On the other hand, private rights were considered to the basis of the pari passu doctrine.

24 Are there special rules privileging the position of an acquisition financier i.e. a secured party whose advance of funds funded the acquisition of a particular asset and who may be in a priority competition with an earlier general creditor whose security interest extends to all assets of the debtor whenever acquired?

221. In certain circumstances a creditor who has made a loan that enables the debtor to acquire property may outrank an earlier creditor with a security interest that includes property afterwards acquired by the debtor. Basically, for this to happen the property must be fettered at the outset by the security interest in favour of the enabling or purchase money lender. There cannot be a moment of time in which the debtor is the unencumbered owner of the property, for, if this were to happen, the earlier creditor's afterwards acquired property clause would bite and therefore trump the purchase money security interest.

222. In the main, the English cases on "purchase money security interests" have concerned land, although the reasoning employed in the cases is, in principle, applicable in other contexts.[319] The leading authority is the decision of the House of Lords (Supreme Court) in Abbey National v Cann[320] but this decision is best understood in the light of the earlier authorities such as Re Connolly Bros Ltd (No 2)[321] and Wilson v Kelland.[322]

223. In Re Connolly Bros Ltd (No 2)[323] a company created a floating charge upon their undertaking and all their property, including both present and future property. The floating charge contained a condition that the company should not be at liberty to create any other mortgage or charge with priority over it. A couple of years later, the company wished to purchase property but did not have the money for that purpose. Consequently, it borrowed a sum from a purchase money lender to facilitate the acquisition upon terms that the lender should have a charge upon the premises when purchased. The Court of Appeal held that the

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[319] See generally J De Lacy, "The Purchase Money Security Interest: A Company Charge Conundrum?" [1991] *Lloyds Maritime and Commercial Law Quarterly* 531.
[320] [1991] 1 AC 56; on which see generally G Goldberg, "Vivit ac Vivat Scintilla Temporis" (1992) 108 *Law Quarterly Review* 380.
[321] [1912] 2 Ch 25.
[322] [1910] 2 Ch 306.
[323] [1912] 2 Ch 25.

floating charge holder ranked after the purchase money lender on the basis that when the company purported to purchase the property it, in fact, acquired only an equity of redemption, subject to the equitable charge of the purchase money lender. 'Full' ownership never constituted part of the company's assets, insofar as the charge in favour of the floating charge holder was concerned, because the purchase money lender acquired an interest in the property that coincided with its acquisition by the company.[324]

224. Another case in point is Wilson v Kelland[325] where a vendor of land gave up the lien in respect of the unpaid purchase price in return, inter alia, for a contractual promise of an equitable charge over the property. The subsequently created charge was held to prevail over a floating charge over all the assets, present and future of the company, which was prior in point of time. The rationale of the decision was that the company had only acquired an equity of redemption in the property. Any equity which attached to the purchased property in favour of the floating charge holder was subject to the paramount equity of the unpaid vendors.

225. The problem with many of these old cases is that they turn on quite narrow distinctions rather than on the underlying economic realities.[326] The courts have examined the facts in some detail to determine whether or not there has been a split second of time (scintilla temporis) in which it could be said that a borrower has been the unencumbered owner of property. If there is such a period of time, however minute, then an earlier security interest extending over the borrower's after-acquired assets will have time to bite and, consequently, outrank a secured lender whose advance enabled the property in question to be acquired.

226. In Abbey National Building Society v Cann[327] the House of Lords appeared to give wider scope for the recognition of purchase money security interests by rejecting the doctrine of scintilla temporis. In other words, a purchaser of domestic property who relied on a bank or building society mortgage for completion could not be said to be the unencumbered legal and equitable owner of the property for a split second of time. In the court's view, the acquisition of the legal estate and the charge were not only precisely simultaneous, but indissolubly bound up together.[328]

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[324] [1912] 2 Ch 25 at 31.
[325] [1910] 2 Ch 306.
[326] But for recognition of the purchase money security interest in Malaysia on the basis of the old English authorities see United Malayan Banking Corp v Aluminex [1993] 3 MLJ 587.
[327] [1991] 1 AC 56. See also the judgments of the Supreme Court in the "North East Property Buyers Litigation" – Scott v Southern Pacific Mortgages Ltd [2014] UKSC 52 interpreting Cann.
[328] [1991] 1 AC 56 at 92. Lord Oliver also pointed out that in many, if not most, mortgage cases there will have been a formal offer of acceptance of an advance which will ripen into a specifically enforceable agreement immediately the funds are advanced, which will normally be a day or so before completion. See also the comments of Lord Jauncey at 101. Differing views were expressed on the significance of this by Lord Sumption and Lady Hale in Scott v Southern Pacific Mortgages Ltd [2014] UKSC 52.

227. The Court of Appeal decision in Whale v Viaystems Ltd[329] also signifies a wider recognition of the concept of a purchase money security interest. The court said:330'it must now be taken as settled law that, in the context of an issue as to priorities between equitable interests, the court will have regard to the substance, rather than the form of the transaction or transactions which give rise to the competing interests; and in particular that conveyancing technicalities must give way to considerations of commercial and practical reality ... [T]his approach is not limited to cases involving the purchase of a property coupled with the grant of a mortgage or charge to secure repayment of the funds which were required to enable completion of the purchase to take place ... [I]t falls to be adopted generally, in every case where an issue arises as to priority as between equitable interests.'

228. The court suggested that it would be inequitable to allow the previous charge holder a windfall increase in the value of its security that was brought about not with the debtor's money or new funds that had been injected by the charge holder but with new financing provided by a later charge holder.

229. There has been a lot of discussion about the theoretical basis for recognising purchase money security interests (PMSIs) in the United States. It has been suggested that the super priority of the PMSI can be thought of as a mechanism which alleviates the situational monopoly created by an after-acquired property clause.[331] The debtor is in a better position to access alternative lending streams and any dependence on the original lender for additional funds is lessened. Another justification rests on the fact that the release of funds by the purchase money creditor increases the debtor's total pool of assets.[332] The debtor is enabled in consequence to acquire new assets as distinct from merely rolling over existing debt. Whereas a security interest granted by the debtor over property that it already owns is potentially harmful to existing creditors, a security interest granted over newly acquired property to secure the price paid for that property is neutral in its effect on existing creditors. The debt incurred to pay for the property is offset by the addition of the property. Moreover, if an earlier creditor could rely on a provision in the instrument of charge that catches after-acquired property to the prejudice of a PMSI holder, the earlier creditor would gain an

329 [2002] EWCA Civ 480.
330 [2002] EWCA Civ 480 at [72].
331 T Jackson and A Kronman, "Secured Financing and Priorities among Creditors" (1979) 88 *Yale Law Journal* 1143 at 1171–1178.
332 See also A Schwartz, "The Continuing Puzzle of Secured Debt" (1984) 37 *Vanderbilt Law Review* 1051 who argues that whereas a general financier takes account of average risk, the PMSI lender may have particular skills and is able to lend on particularly advantageous terms because of its special knowledge of the collateral.

undeserved windfall, for it was the advance of funds by the later creditor that enabled the property to be acquired.[333]

230. On the other hand, providing privileges to the holder of a PMSI in this manner seems premised on the assumption that the release of funds to facilitate the acquisition of new assets is more valuable to a debtor's business than making advances which enable existing employees to be paid, for example. There is a question mark about whether one of these advances is necessarily of greater social benefit than the other.

231. In the United States, under the Uniform Commercial Code, Article 9, there is an exception to the general first-to-file-has priority rule in the case of purchase-money security interests (PMSIs).[334] A purchase-money security interest will rank ahead of a prior security interest with an after-acquired property clause. If a debtor has granted an all-assets security interest that extends over future property then, notwithstanding the general first-to-perfect priority rule, a creditor whose advances funded the acquisition of 'new property' in the debtor's hands will outrank the earlier financier in respect of the collateral represented by the new property.[335] There is a fairly convoluted definition in Article 9-103 which requires a close nexus between the acquisition of the collateral and the security interest. Basically what is required is the giving of value 'to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.' There are, however, special perfection requirements applicable to PMSIs under Article 9 and compliance with these requirements is necessary to obtain super-priority status. Article 9-324 distinguishes between inventory and other goods with a claim to PMSI status in inventory being more difficult to establish.

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[333] See the discussion at para 17.7 of the Diamond report *A Review of Security Interests in Property* (HMSO, 1989); and for a law and economics perspective see H Kanda and S Levmore, "Explaining Creditor Priorities" (1994) 80 *Virginia Law Review* 2103 at 2138–2141.

[334] Article 9-324 deals with the priority of purchase-money security interests. For an argument against the PMSI super-priority rules see A Schwartz, "A Theory of Loan Priorities" (1989) 18 *Journal of Legal Studies* 209.

[335] Under Article 9-324(g) the holder of a purchase money security interest that secures the unpaid purchase price of collateral will prevail over the holder of a conflicting purchase money security interest that enables the collateral to be acquired. Translated into English law terms, this means that a retention of title seller has priority over a lender that makes an enabling loan. There is some possible inconsistency with Article 9-328, which deals with investment property. Priority in investment property is given to the secured party who has control. Article 9-328(2) provides that if two or more secured parties have control, priority is determined by who obtained control first.

Quasi-security

25 Does your legal system have any rules equating the treatment, in whole or in part, of security interest and 'quasi-security' agreements i.e. agreements that in legal terms do not involve the creation of security interests but have many of the same economic consequences? Examples of quasi-security include the factoring or sale of receivables and finance leases, hire purchase agreements and retention of title clauses in sale of goods contracts.

232. English law recognizes the possibility of having the functional equivalent of a security interest over property through the use of other legal techniques. In Chow Yoong Hong v. Choong Fah Rubber Manufactory[336] Lord Devlin observed that there are many ways of raising cash besides borrowing. To adjust the statement slightly, there are many ways in which a person who has 'advanced' money might enhance its prospects of recovery in the event of the debtor's insolvency besides being party to the creation of a charge. These methods include the following: (1) sale and leaseback/hire purchase; (2) title retention/conditional sale; (3) agency sales financing; (4) factoring/assignment of receivables; (5) Quistclose trusts; (6) trust receipts. These are all "quasi-security" devices and will now be considered.[337]

Quasi-security - Sale and leaseback/hire purchase

233. One financing technique involves the sale of goods or land followed by a lease back. In all probability, the vendor will never have parted with possession and, in practice, it may be difficult to distinguish a genuine sale and lease-back from the creation of a charge over the property in question. In a leading case, Re George Inglefield Ltd,[338] Romer LJ attempted to explain the essential differences. He said:[339]'In a transaction of sale the vendor is not entitled to get back the subject-matter of the sale by returning to the purchaser the money that has passed between them. In the case of a mortgage or charge the mortgagor is entitled, until he has been foreclosed, to get back the subject-matter of the mortgage or charge by returning to the mortgagee the money that has passed between them. The second essential difference is that if the mortgagee realises the subject-matter of the mortgage for a sum more than sufficient to repay him, with interest and the costs, the money that has passed between him and the mortgagor he has to account to the mortgagor for the surplus. If the purchaser sells the

[336] [1962] AC 209 at 216.
[337] See generally S Worthington *Proprietary Interests in Commercial Transactions* (OUP, Oxford, 1996). Ireland recognises the same form of quasi-security.
[338] [1933] Ch 1.
[339] [1933] Ch at pp 26-27. It was made clear in Durham Bros v Robertson however, [1898] 1 QB 765 that once the security nature of a transaction is established, equity will imply a right of redemption; see at p 772 per Chitty LJ. Having regard to this fact, F Oditah in "Financing Trade Credit" [1992] *Journal of Business Law* 541 at 546 argues that the judgment of Romer LJ gives very little, if any, useful guidance.

subject-matter of the purchase, and realises a profit, of course he has not got to account to the vendor for the profit. Thirdly, if the mortgagee realises the mortgage property for a sum that is insufficient to repay him the money that he has paid to the mortgagor, together with interest and costs, then the mortgagee is entitled to recover from the mortgagor the balance of the money... If the purchaser were to resell the purchased property at a price which was insufficient to recoup him the money that he has paid to the vendor, of course he would not be entitled to recover the balance from the vendor.'

234. These distinctions, while easy to state on paper, may become blurred in practice. For example, sale agreements may include options to repurchase and also profit sharing clauses under which the original vendor shares in profits from resales as well as provisions whereby the vendor agrees to indemnify the buyer in respect of any losses incurred on a resale.

235. The hire purchase agreement in relation to goods builds on the clear theoretical distinction between a sale and a lease or hire of goods. Hire purchase entails a hiring coupled with an option to purchase. In legal terms however, there is a lot to be said for the view that this description is, in reality, a legal fiction that bears little or no relation to economic reality.[340] In legal terms there is a contract for the hiring of goods coupled with an option on the part of the hirer to purchase the goods.[341] While the agreement subsists, the property in the goods remains in the owner and the hirer has no power to dispose of them. Moreover, although the hirer has an option to purchase the goods it is not under a binding obligation to do so.

236. Normally a hire purchase transaction involves three parties, namely, a dealer, finance house and hirer. Goods are sold by the dealer to the finance house who then lets them on hire-purchase terms to a hirer who had no prior interest in the goods. The tripartite nature of the transaction makes it difficult to argue that in reality it constitutes a loan. But the essential principle remains the same, irrespective of the fact that there are only two parties as when the owner of goods sells them to a finance house and takes a lease-back under a hire purchase agreement.

[340] See generally Crowther Committee Report on Consumer Credit (1971, Cmnd 4569) at pp 175-176.
[341] For a modern analysis see Forthright Finance Ltd v Carlyle Finance Ltd [1997] 4 All ER 90.

Quasi security – retention of title clauses

237. Title retention clauses may take many forms but basically the clause refers to a situation where the seller of goods retains title to those goods until they have been paid for.[342] This is the simplest and perhaps the most common form of title retention clause but more complicated variants are possible. Under a 'current account' clause, the seller retains title until all debts owing by the buyer to the seller have been paid and not just indebtedness arising under the particular contract of sale. A 'proceeds' or 'tracing' retention of title clause permits the buyer to resell the goods in the ordinary course of business before the original debt has been discharged but transfers the seller's claim to the proceeds generated by the resale. 'Products' clauses are used in quite complex factual scenarios where the goods supplied have formed all or part of the raw materials in a process of manufacture. With such a clause the supplier of the raw materials is claiming all or part of the finished article.

238. 'Simple' retention of title clauses and current account clauses have received judicial approval but the more complex variants - namely, 'proceeds' and 'products' clauses have recently met with judicial disfavour. The analysis goes like this - with a simple clause and a current clause the seller is merely retaining ownership of the goods until satisfaction of some condition. Until this condition is fulfilled the buyer does not acquire any bit of ownership which he can hand back to the seller by way of a security interest.[343] On the other hand, where goods have been sold, the seller's claim does not translate readily into the resale proceeds. Originally the courts were prepared to recognise the seller's claim on the basis that in reselling the seller was acting in a dual capacity i.e. as an agent vis-à-vis the original seller but as a principal as far as the resale buyers were concerned so that the latter were not brought into direct contractual relations with original sellers.[344] More recently however, the courts have moved away from this analysis holding that a seller's entitlement to resale proceeds is a limited interest by way of charge since it comes to an end upon the discharge of the original purchase price.[345] Likewise 'product claims' have attracted the disapproval of the courts. The dominant view is that where there is a mixture of heterogeneous goods in the manufacturing process a new product - nova species - is created which belongs, initially at least, to the manufacturer, so to speak.[346]

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342 For a comprehensive analysis see G McCormack *Reservation of Title* (Sweet & Maxwell, London, 2nd ed 1995).
343 See Clough Mill Ltd v Martin [1985] 1 WLR 111; Armour v Thyssen Edelstahlwerke AG [1991] 2 AC 339.
344 Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd [1976] 1 WLR 676.
345 See, for example, Pfeiffer Weinkellerei-Weineinkauf GmbH Co v Arbuthnot Factors Ltd. [1988] 1 WLR 150; Compaq Computer Ltd v Abercorn Group Ltd [1991] BCC 484 but see, more recently, Caterpillar (NI) Ltd v John Holt & Co [2013] EWCA Civ 1232.
346 Borden v Scottish Timber Products Ltd [1981] Ch 25; Re Peachdart Ltd [1984] Ch. 131.

Quasi-security - Assignment of receivables

239. In England, receivables financing may take the form of either the creation of a charge, whether fixed or floating, on receivables (debts) or else the outright assignment of receivables which is referred to as factoring. Factoring, or the absolute assignment of receivables, serves as the functional economic equivalent of taking a charge over the receivables. Factoring of debts is a well recognised and established activity with many of the major financial institutions having factoring subsidiaries. A factoring transaction does not have to be registered but where a company creates a charge over its debts, registration is a necessity.[347] Of course the factoring of debts equates to a loan of money on the security of debts to the extent that ready cash is released to the assignor. The latter receives money upfront rather than having to wait for the debts to mature, or to be collected. Factoring however, can serve functions other the immediate release of funds. For instance, if it is done on a notification basis then the factor is relieved of the responsibility of collecting the debts. The factor may also take over the burden of accounts administration. Factoring may also take on some of the features of credit insurance if the factor assumes the responsibility for the debtor failing to pay as distinct from the assignor being under an obligation to accept a reassignment of bad debts.

240. Receivables financing is however, often carried out in a manner that blurs the distinction between the factoring (outright sale of receivables) and their transfer by way of security. For instance, a charge may be accompanied by a power of attorney by the chargor in favour of the charge holder which enables the latter to execute an assignment in the chargor's name. In circumstances of default by the chargor, the charge holder can then give notice of assignment to the account debtor and intercept payment before it reaches the assignor thereby providing a speedy and effective means of enforcement of the charge.

241. Because charges over debts executed by companies have to be registered, as distinct from assignments, it remains vitally important at the outset though to distinguish between the factoring of book debts and the creation of a charge over such debts. In Bexhill Ltd v Razzaq[348] the Court of Appeal made a clear distinction between, on the one hand, an absolute assignment of a thing in action which transfers rights in the thing in action from A to B; and, on the other hand, an assignment 'by way of charge only' which is, effective only a right to exercise a claim on some identified property in certain identified events, as opposed to an absolute transfer of a property right.[349]

[347] The distinction between factoring and the creation of a charge over debts was explored at length by the House of Lords in Lloyds & Scottish Finance v Cyril Lord Carpet Sales Ltd [1992] BCLC 609.
[348] [2012] EWCA Civ 1376 at para 34 per Aikens LJ.
[349] See also Lloyds TSB Bank plc v Clarke (Liquidator of Socimer International Bank Ltd) [2002] UKPC 27, [2002] 2 All ER (Comm) 992.

242. An absolute assignment can take the form of either (a) a legal assignment or (b) an equitable assignment. This was made clear in Bexhill Ltd v Razzaq[350] where the alternative possibilities were discussed. It was commented that a legal assignment would need to be in accordance with the Law of Property Act 1925 and 'would be a completed transfer of the equitable and legal title to the thing in action from A to B' whereas with an assignment taking effect in equity only 'the assignee becomes the beneficial owner of the thing in action, but the legal title of the thing in action remains with the assignor'.

243. Section 136 Law of Property Act 1925[351] specifies the following conditions which must be met before an assignment of debts or other choses in action[352] can operate as a legal assignment:

(1) the assignment must be absolute and not by way of charge;

(2) the assignment must relate to the whole of the debt;

(3) the assignment must be in writing under the hand of the assignor;

(4) notice in writing of the assignment must be given to the debtor.

244. The assignee becomes legal owner of the debt and in the words of the section is entitled 'to pass and transfer from the date of such notice – (a) the legal right to such debt or thing in action; (b) all legal and other remedies for the same; and (c) the power to give good discharge for the same without the concurrence of the assignor'. An assignment passes to the assignee 'all legal and other remedies for the same'. To use the words of Peter Gibson LJ in Camdex International Ltd v Bank of Zambia,[353] it is apparent from the wording of the statute that Parliament sanctioned not only the assignment of debts and choses in action but also the transfer of the concomitant right to sue in respect of the same.

245. The legal/equitable assignment distinction has some practical consequences in terms of actions against the debtor. Basically a legal assignee can sue a debtor in its own name without involving the assignor in the proceedings, whereas in the case of an equitable

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350 [2012] EWCA Civ 1376 at para 34 per Aikens LJ.
351 In Ireland the equivalent provision is s 28(6) Supreme Court of Judicature (Ireland) Act 1877.
352 In Torkington v Magee [1902] 2 KB 427 at 430 Channell J said that 'chose in action' is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not by taking physical possession.
353 [1998] QB 22 at 40.

assignment the assignor should be joined as a co-plaintiff if he is willing and as a co-defendant if he is not.[354] In certain circumstances, however, this rule may be waived.[355]

246. For an effective equitable assignment, there is no need for compliance with all or any of the statutory conditions in the Law of Property Act. For instance, notice to the debtor is not required to make an equitable assignment effective and it is not necessary to assign the whole debt- assignments of part of the debt are possible. Consideration for the assignment must however has been provided and the intention to assign must be clear. The validity of equitable assignments was confirmed at the highest judicial level in the 19th century in Tailby v Official Receiver.[356] Lord Macnaghten remarked that it has long been settled that future property, possibilities and expectancies are assignable in equity for value. In his view, the mode or form of assignment was absolutely immaterial provided that the intention of the parties was clear. The judge added that to effectuate the intention: 'an assignment for value, in terms present and immediate, has always been regarded in equity as a contract binding on the conscience of the assignor and so binding the subject-matter of the contract when it comes into existence, if it is of such a nature and so described as to be capable of being ascertained and identified'.

247. In commercial practice, factoring of debts is often done on a non-notification basis and this necessarily involves equitable assignment. The distinction between notification factoring and non-notification factoring is quite crucial in practical terms. With the former, notice of the assignment is given to the debtor and the factor invariably collects the debts. In the second situation, the assignor maintains direct relations with its customers by continuing to collect the debts. The factor remains in the background with the proceeds of the debts being remitted to it.

Quasi-security - Agency sales financing

248. Agency sales financing is a fairly complicated form of financing technique that basically involves the entity requiring finance selling property to a financier without ever parting with physical possession to the financier and then purporting to resell the property as agent for, and on behalf of, the financier to third party buyers. A case in point is Welsh Development Agency v Export Finance Co Ltd[357] where an exporter of computer software financed for its

[354] Weddell v JA Pearce & Major [1988] Ch 26 at 40–1.
[355] See William Brandt's Sons & Co v Dunlop Rubber Co Ltd [1905] AC 454; Hendry v Chartsearch Ltd [1998] CLC 1382.
[356] [1888] 12 App Cas 523.
[357] [1992] BCLC 148. Contrast Re Curtain Dream plc [1990] BCLC 925.

export trade transactions by selling the software in question to a financier and then fulfilling the overseas orders as the financier's agent. The financier acted as an undisclosed principal with the foreign buyers dealing at all times with the software supplier. The buyers made payment into a bank account that was in the name of the software supplier but which was under the complete control of the financier. The price that the financier paid the software supplier for the goods was not fixed at the outset but was subject to variation depending on the speed with which the foreign buyers paid for the goods. The financing arrangement also had a termination clause under which, on cessation of the agreement, the supplier would satisfy all claims owing to the financier by the foreign buyers and, when this payment had been made, the financier would transfer all interests it had in the goods to the supplier. It is important to note that the financing technique purported to involve a sale of goods rather than an assignment of debts.

249. It seems that, in the particular case, this form of financing arrangement was used because of a clause in a prior lending agreement under which the supplier covenanted not to factor, discount or assign its debts. Breach of this undertaking would entitle the lender to appoint a receiver. Unfortunately, the software supplier experienced financial difficulties and it was argued that the financing arrangement was invalid on the basis that, in reality, it represented a charge over goods rather than an absolute sale and that the requisite charge registration requirements had not been fulfilled.[358] The Court of Appeal rejected this proposition. The transaction was not a sham because there was no evidence that the parties intended themselves to have different rights and obligations from those set out in the agreement. Moreover, looking at the internal workings of the transaction, there was nothing therein that was necessarily incompatible with the transaction being one of sale. The termination clause was like a repurchase agreement and options to repurchase were not uncommon in sales transactions. Furthermore, price variation clauses were often found in sales contracts.

[358] See also the comments of Lawrence LJ in Re George Inglefield Ltd [1933] Ch 1 at 23: ‘As the law stands at present, there is nothing to prevent a limited company from selling its assets without giving notice of that sale to the public or to anyone else, remaining in possession of the assets so sold, with the consent of the buyer, and obtaining credit on the faith of that possession. If such a state of things ought to be remedied it is for Parliament to supply the remedy. All that the Court has to do … is to ascertain whether there has, in fact, been a sale of the assets and to give effect to the transaction if that be the case.’

Quasi-security - Quistclose /conditional purpose trusts

250. Some trusts may be regarded as serving a security type function and, in particular, the conditional purpose or 'Quistclose' trust.[359] Under a 'Quistclose' trust money is advanced subject to the condition that it is applied for a particular purpose. If this purpose is not fulfilled, or is no longer capable of being achieved, the money is said to be held on a secondary trust for the payer rather than being part of the debtor's assets available for payment to the debtor's general creditors.[360] The courts have held that debt and trust can coexist – in other words, that the same transaction can give rise to the legal relationship of debt and also to a trust. It has been contended that a Quistclose trust constitutes a security interest in that the 'payer is to be protected from the claims of other creditors of the payee' on the latter's insolvency and thus 'clearly evinces an intention to seek and provide security'.[361] The Quistclose trust secures performance of the debtor's obligation to carry out the purpose of the advance.

251. On the other hand, it must be recognised that the Quistclose trust is not a conventional security interest. In the typical advance, the secured assets and the monies advanced are quite clearly separate and the former secures the latter. With a Quistclose trust, the payer is asserting a de facto security interest in the advance itself and it is not the failure to repay that is secured but rather the execution of the purpose. If the purpose is carried out, the payer is converted from a secured into an unsecured creditor.[362] Under a 'Quistclose' trust, the payee (debtor) never acquires beneficial ownership but is rather a trustee – a conduit for the transmission of funds.

Transactional Avoidance

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[359] See the leading case Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567 and see now Twinsectra Ltd v Yardley [2002] 2 AC 164.

[360] This was the analysis adopted in the Quistclose case itself, but Lord Millett in Twinsectra Ltd v Yardley [2002] 2 AC 164 took a different approach. He said at para 100 that the Quistclose trust was:
'an entirely orthodox example of the kind of default trust known as a resulting trust. The lender pays the money to the borrower by way of loan, but he does not part with the entire beneficial interest in the money, and in so far as he does not it is held on a resulting trust for the lender from the outset ... When the purpose fails, the money is returnable to the lender, not under some new trust in his favour which only comes into being on the failure of the purpose, but because the resulting trust in his favour is no longer subject to any power on the part of the borrower to make use of the money. Whether the borrower is obliged to apply the money for the stated purpose or merely at liberty to do so, and whether the lender can countermand the borrower's mandate while it is still capable of being carried out, must depend on the circumstances of the particular case.'
See also Gore v Mischon de Reya [2015] EWHC 164 (Ch) at paras 30-38 and Bieber v Teathers Ltd [2012] EWHC 190 (Ch); [2012] 2 BCLC 585 at para 16.

[361] See M Bridge, "The Quistclose Trust in a World of Secured Transactions" (1992) 12 *Oxford Journal of Legal Studies* 333 at 345–346 and 360–361.

[362] See the comments of Lord Millett in Twinsectra Ltd v Yardley [2002] 2 AC 164 at para 72: 'Arrangements of this kind are not intended to provide security for repayment of the loan, but to prevent the money from being applied otherwise than in accordance with the lender's wishes. If the money is properly applied the loan is unsecured.'

26 Are their rules in your legal system that operate once a debtor enters insolvency proceedings and that provide for the invalidation of transactions entered into by the debtor prior to the commencement of the insolvency proceedings?

252. Yes. There are a number of rules under English law that operate once a debtor enters insolvency proceedings and that serve to invalidate certain 'pre' insolvency transactions entered into by the debtor.[363] In setting out the avoidance rules one must distinguish between insolvency proceedings affecting corporates and individuals though broadly similar rules apply in both instances except for the fact that s 245 on the invalidation of floating charges granted by companies has no "individual" equivalent.

253. As far as corporates are concerned these transactions are as follows

<u>Transactions at an undervalue</u> under s 238 Insolvency Act'

<u>'Preferences'</u> under s 239 Insolvency Act

<u>Extortionate credit transactions</u> under s 244 Insolvency Act

<u>Invalidation of floating charges</u> under s 245 Insolvency Act

<u>Putting assets beyond the reach of creditors</u> under s 423 Insolvency Act

254. For individual debtors s 339 Insolvency Act deals with transactions at an undervalue; s 340 with 'preferences' and s 343 with extortionate credit transactions.[364] Section 423 Insolvency Act, on undervalue transactions that put assets beyond the reach of creditors, applies to individual debtors as it does to corporates.

255. In respect of individuals engaged in business are concerned, there is a special provision in 344 of the Insolvency Act providing for the invalidation of unregistered general assignments of book debts. The section applies where a person engaged in any business makes a general assignment of his existing or future book debts, or any class of them, and is subsequently adjudged bankrupt. The assignment has to be registered under the Bills of Sale Act. If this is not the position, then the assignment is void against the trustee of the bankrupt's

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[363] J Armour and H Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart Publishing, Oxford, 2003).

[364] Outside insolvency, the court had power to re-open the majority of loans granted for non-business purposes as 'extortionate credit bargains' under sections 137-140 Consumer Credit. But, as explained by Lord Sumption in the Supreme Court in <u>Plevin v Paragon v Personal Finance</u> [2014] UKSC 61, this test was considered to set too high a bar for debtors wishing to challenge the terms of their agreements. Consequently, the 'extortionate credit bargain' test was replaced by a new test of 'unfair relationships' between creditors and debtors under provisions which became s 140A Consumer Credit Act 1974. The court has the power to set aside any credit agreement or related security if it is unfair to the debtor because of various factors.

estate insofar as book debts which were not paid before the presentation of the bankruptcy petition are concerned.

27 Do these transactional avoidance rules catch security and quasi-security type transactions?

256. Yes, in principle these transactional avoidance rules apply in respect of security and quasi-security arrangements as well as to other types of transaction. The term 'transaction' is defined in s 436 of the Insolvency Act to include 'a gift, agreement or arrangement'.

28 If so, describe briefly these rules highlighting in particular (a) the rationale for the rules; (b) the conditions for the application of the rules; (c) the length of the 'suspect period'; (d) whether the rules apply to transactions with a cross-border element; (e) whether the rules operate more stringently in respect of transactions that favour parties who are connected to the debtor and (6) any defences that may be availed of by a counterparty to the transaction i.e. the defendant in an avoidance action.

Transactions at an undervalue under s 238 Insolvency Act

257. An administrator or a liquidator has the power to make an application to court in respect of undervalue transactions. If the application is successful, the court must make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into the transaction.[365]The purpose of the provision is to prevent the assets of the company being depleted by gratuitous or near gratuitous transactions in the run up to formal insolvency proceedings.

258. A transaction at an undervalue as one where:

(1) the company makes a gift to a person or otherwise enters into a transaction with a person on terms that provide for the company to receive no consideration; or

(2) the company enters into a transaction with a person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

[365] Section 238(3).

259. The first part of the definition envisages a total absence of any consideration passing to the company, while the second part covers the case where there is some mutual consideration but significantly differing in amounts.

260. In terms of 'suspect period' or 'relevant time' there are two issues to be considered.[366] Firstly, the transaction must be entered into within 2 years before the onset of the administration or liquidation or at a time between the making of an administration application in respect of the company and the making of an administration order on that application.[367] Secondly, it is only a 'relevant time' if, at the time, the company is unable to pay its debts or if it becomes unable to pay them in consequence of the transaction.

261. In principle, the transactions at an undervalue provisions apply to transactions with an international element since there are no territorial qualifications on the operation of the section. The leading English case is <u>Re Paramount Airways Ltd</u>[368] where the court held that the statutory provisions were sufficiently wide that the court had an overall discretion, if justice so required, to make an order against any other party to the impugned transaction, irrespective of location. But it would need to be satisfied that the party was sufficiently connected with England for it to be just and proper to make the order against him despite the foreign element. The court said that[369] 'in considering whether there is a sufficient connection … [it] will look at all the circumstances, including the residence and place of business of the defendant, his connection with the insolvent, the nature and purpose of the transaction being impugned, the nature and locality of the property involved, the circumstances in which the defendant became involved in the transaction or received a benefit from it or acquired the property in question, whether the defendant acted in good faith, and whether under any relevant foreign law the defendant acquired an unimpeachable title free from any claims even if the insolvent had been adjudged bankrupt or wound up locally. The importance to be attached to these factors will vary from case to case.'

262. For transactions with a person who is connected with the company, the 'suspect period' is not any longer than the standard 2 year period but there is a reversal of the burden of proof in relation to the 'inability to pay debts' requirement. The company is deemed to have been

[366] Section 240.
[367] Section 240(3).
[368] [1993] Ch 223.
[369] [1993] Ch 223 at 240. It should be noted that in <u>Rubin v Eurofinance SA</u> [2012] UKSC 46 at para 130 some scepticism was expressed about a sufficient connection test in connection with the enforcement of foreign judgments - a person who might have connections with a foreign territory that were only arguably 'sufficient' would have to actively defend foreign proceedings which could result in an in personam judgment against him.

unable to pay its debts unless the contrary is shown by the defendant to the avoidance action.[370]

263. In terms of defences, the court may not set aside a transaction at an undervalue if it is satisfied that: (a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and (b) at the time when it did so, there were reasonable grounds for believing the transaction would benefit the company.[371] Good faith, propriety of purpose and reasonableness must all be established to the satisfaction of the court; if any of these elements is missing, the transaction remains vulnerable.

Voidable preferences under s 239 Insolvency Act

264. Section 239 Insolvency Act provides for the invalidation in certain circumstances of transactions that favour one creditor of a debtor company over another – 'improper preferences'. An administrator or liquidator may apply to the court for an order on such terms as the court thinks fit, for restoring the position to what it would have been if the company had not given a preference.

265. There are at least three possible bases for the preference provision. One goal is to achieve a level playing field amongst creditors i.e. to stop one creditor gaining an advantage over another creditor in the immediate run up to formal insolvency proceedings. The Cork Committee on Insolvency Law and Practice pointed out that the 'bankruptcy code ... is directed towards achieving a pari passu distribution of the bankrupt's estate among his creditors. The justification for setting aside a disposition of the bankrupt's assets made shortly before his bankruptcy is that, by depleting his estate, it unfairly prejudices his creditors; and even where the disposition is in satisfaction of a debt lawfully owing by the bankrupt, by altering the distribution of his estate it makes a pari passu distribution among all the creditors impossible.'[372]

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[370] Section 240(2). For the definition of a person connected with the company, see sections 249 and 435.
[371] Section 238(5).
[372] (1982) Cmnd 8558 at para 1209. There are equivalent US provisions in Article 547 of the Bankruptcy Code and according to a US House of Representatives committee report: 'the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally' (HR Rep No 595, 95th Congress, 1st Session 177 (1977)).

266. A second legislative goal is to prevent the premature dismemberment of a debtor company's estate and consequent collapse of the business. If creditors can keep what they can recover from ailing businesses just prior to the institution of formal liquidation proceedings, then a business that needs to be nurtured along may have its life support withdrawn. Moreover, if creditors race to collect what they can from available company assets this may lead to the dissipation or destruction of economic value. Even if all the recoveries are aggregated, a piecemeal break up and sale of company assets is likely to produce less value than if the process is collectivised through formal insolvency proceedings. Protecting the collective nature of insolvency proceedings is a third goal of the preference provisions. Liquidation is a collective process in that creditors no longer have the right to take individual enforcement actions. Everything is collectivised in the person of the liquidator who assumes responsibility for collecting in the assets of the company and then paying its debts. The collective nature of the process is diminished if particular creditors are paid before others in anticipation of liquidation.

267. It is questionable however, whether the relevant provisions accomplish their goals. This has led to calls for reforms of the section along the lines of s 547 US Bankruptcy Code which provides for the strict avoidance of preferences subject to defences such as the fact that the transaction is in the ordinary course of business.[373]

268. A company is deemed to give a preference to a person if (1) that person is one of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities; and (2) the company does anything, or suffers anything to be done, which has the effect of putting that person into a position which, in the event of the company going into insolvent liquidation, will be better than the position he would have been in if that thing had not been done.

269. The court may not make an order to reverse the preference unless the company was influenced in deciding to give it by a desire to put the recipient in a better position in an insolvent liquidation than it would have been in if the preference had not been given. A desire to prefer is narrower than intention in that a person may be held to have 'intended' the necessary consequences of his acts even though he does not desire them to happen. To prove the requisite desire, the company must be shown positively to have wished to improve the creditor's position in its insolvent liquidation. A company is 'influenced' by a desire to prefer

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[373] See e.g. G McCormack, 'Swelling Corporate Assets: changing what is on the menu' (2006) 6 Journal of Corporate Law Studies 39: A Walters, "Preferences", in J Armour and H Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Hart Publishing, Oxford, 2003).

where it is a motivating factor, but it need not be the only or predominant one.374 The desire must be present at the time when the preference is given.375

270. A company gives a preference by providing an unsecured creditor with security. Another example is the decision to pay some debts but not others. The creditors whose debts are paid are obviously placed in a much better position than those who remain unpaid and become obliged to prove for their debts in the company's liquidation.

271. The court is given a very wide discretion to make orders for the purpose of restoring the position to what it would have been if the company had not given the preference. The proceeds of an action to set aside a preference are held for the benefit of general creditors and do not fall within the scope of a floating charge on company assets.376 The underlying reasoning is that the power to attack a preference is granted only to the liquidator and administrator, and is not available to the company itself. Therefore the proceeds of a preference avoidance action cannot be the subject of a charge granted by the company on its assets.

272. The preference is vulnerable only if it was given at a relevant time. This means generally a period of 6 months with the onset of the administration or liquidation. In addition, the time between the presentation of a petition for the making of an administration order and the making of such order is a relevant time. A time will be a relevant time, however, only if the company is unable to pay its debts when the preference is given or becomes unable to pay its debts in consequence of the preference.

273. Where the preference is given to a person connected with the company (otherwise than by reason only of being its employee) then the relevant period is 2 years rather than 6 months and the company is presumed, unless the contrary is shown, to have been influenced in deciding to give the preference by the requisite desire.377

274. There are no explicit statutory defences to a preference avoidance action. It seems however, that the pressure the pressure exerted on the debtor by the recipient of the preference - whether through seeking security or otherwise - the greater the likelihood that the action will be unsuccessful. For instance, in Re MC Bacon Ltd378 where the security was

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[374] Re MC Bacon Ltd [1990] BCC 78; Re Beacon Leisure Ltd [1991] BCC 213; Re Fairway Magazines Ltd [1992] BCC 924; Re Agriplant Services Ltd [1997] BCC 842.
[375] Wills v Corfe Joinery Ltd [1997] BCC 511.
[376] See Re MC Bacon Ltd (No 2) [1991] Ch 127 at 137.
[377] Section 239(6).
[378] [1990] BCC 728.

granted to avert the calling-in of the company's overdraft and the immediate liquidation which would have followed if the bank had withdrawn its support, the requisite desire to prefer was not established and so the action failed. It is worth emphasising however, that the language of s 239 focuses exclusively on the state of mind of the debtor and there is no reference to the position of the creditor. The latter is not required to know of the debtor's insolvency or to have reasonable cause to believe that the debtor is likely to become insolvent.

Extortionate credit transactions under s 244 Insolvency Act

275. This section allows a liquidator or administrator to challenge an extortionate credit transaction to which the company is party. The section is intended to act as a curb on excessively high interest rates. A transaction is regarded as extortionate if, having regard to the risk, the company is required to make grossly exorbitant payments or the transaction otherwise grossly contravenes ordinary principle of fair dealing. There is a three year reach back period under the section which is not extended if the transaction is in favour of a connected party. In principle, the section can catch transactions with an international element provided that there is deemed to be sufficient connection with England. There are no defences available under the section apart from the counterparty establishing that the conditions for the operation of the avoidance provision have not been made out. Among the orders for relief that the court may grant is an order varying the terms of the transaction or varying the terms on which any security for the purpose of the transaction is held.

Avoidance of floating charges under s 245 Insolvency Act

276. Floating charges created by the company within a specified period prior to the commencement of the administration or the liquidation are rendered invalid in certain circumstances. Section 245 is limited to floating charges with fixed charges outside its ambit. The Cork Committee rationalised the provision and its express limitation on the basis that the floating charge was an excessive security because it extended to future assets that were not yet paid for by the company. In its view, it was acceptable for a lender to take a fixed charge over existing assets as the price of allowing the company to continue to trade instead of taking steps to have the company put into liquidation. It was unacceptable, however, for the lender to take a floating security over existing and future company assets.[379] But this justification should not go unquestioned for a fixed charge may also extend to future assets that have not yet been paid for by the company.

[379] *Review Committee on Insolvency Law and Practice*, (1982, Cmnd 8558) at para 1553.

277. The invalidating rule in s 245 operates except to the extent that the consideration for the creation of the charge consists of 'new money'. 'New money' must have been provided at the same time as, or after, the creation of the charge and may consist of money paid or goods or services supplied to the company or the discharge or reduction of any debt of the company.380 The phrase 'at the same time as' which is used in s 245 was considered by the Court of Appeal in Re Shoe Lace Ltd.381 It was held that whether the consideration for the charge was given at the same time as the creation of the charge is a mechanical issue determined solely by the clock, subject only to de minimis delays.

278. In the standard case, the length of the suspect period under s 245 is 12 months but the company, at the time of creating the charge, must have been unable to pay its debts or become unable to do so in consequence of the transaction under which the charge was created.

279. In principle, s 245 should apply to transactions with an international element but no doubt the court would take into account the kind of factors referred to in Re Paramount Airways Ltd [382]in deciding whether or not to make an order under the section. These factors focus largely on the extent to which the transaction is connected with England.

280. If the floating charge has been granted to a person connected with the company, the relevant period is 2 years rather than 12 months and it is not necessary to establish that the company was unable to pay its debts at the time of granting the charge. Transactions in favour of persons connected with the company are still challengeable under section 245 even though the company may have been solvent when the transaction was entered into.

281. There are no defences as such to a challenge under s 245. A floating charge in the circumstances described in section 245 is automatically invalidated. The section is much more draconian in its operation than the preference avoidance provision in s 239. i.e. no need to establish a desire to prefer and this one of the many reasons why an insolvency office holder may wish to go down the section 245 route rather than rely on a preference avoidance action under section 239.

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[380] Section 245 preserves (contrary to the recommendations of the Review Committee on Insolvency Law and Practice, Cmnd 8558 (1982), paras 1561–1562) the decision in Re Yeovil Glove Co Ltd [1965] Ch 148, whereby in respect of a floating charge created in favour of a bank to secure an overdrawn account, if payments are made into the account after the creation of the charge, these will, under the rule in Clayton's Case (1816) 1 Mer 572, go to reduce the pre-charge indebtedness, so that cheques drawn on the account after the creation of the charge will be money paid to the company thereafter and the charge will therefore be valid to this extent.
[381] [1993] BCC 609.
[382] [1993] Ch 223.

Putting assets beyond the reach of creditors under s 423 Insolvency Act 1986

282. Section 423 is a general provision enabling the court to set aside transactions at an undervalue where it is satisfied that the transaction was entered into by the company for the purpose of putting assets beyond the reach of any person who is making, or may at some time make, a claim against the company or of otherwise prejudicing the interests of such a person. The section aims at protecting creditors who are trying to obtain payment or judgment from a company.

283. Section 423 applies both inside and outside formal insolvency proceedings. As well as liquidators and administrators, any person making, or who may at some time make a claim against the company has standing to seek an order under this section. If however, the company is in administration or liquidation, the leave of the court must be sought.383 Whoever brings the claim, it is treated as made on behalf of every victim of the transaction.384 The applicant need only show that a substantial purpose, rather than the dominant purpose, was to achieve one of the proscribed aims though the courts have stressed the need to distinguish between the result of a transaction and the purpose behind it.385

284. There are no time-limit on applications under s 423. Therefore the suspect period extends indefinitely back in time though it would be difficult to satisfy the requirements of the section in respect of a transaction that was far distant. Moreover, it was held in Hill v Spread Trustee Co Ltd386that there was a general 6 year limitation period in relation to claims under the section. It seems that where a claim is made by a liquidator, the limitation period only starts to run once the company enters liquidation.

285. Section 423 in principle applies to transactions with an international element and indeed one of the claims in Re Paramount Airways Ltd387 was a claim under s 423. The potential extra-territorial effect of s 423 was confirmed in Fortress Value Recovery Fund v Blue Skye Special Opportunities Fund[388] where it was held that whether there was a sufficient connection with England to justify relief under the section depended on all the circumstances of the case. It was not a threshold question of jurisdiction.

286. There are no special rules that apply to transactions with connected parties. If the

[383] Section 424(1)(a).
[384] Section 424(2).
[385] See Hashimi v IRC [2002] EWHC Civ 981; [2002] BPIR 974.
[386] [2007] 1 WLR 2404.
[387] Re Paramount Airways Ltd (No 2) [1993] Ch 223.
[388] [2013] EWHC 14 (Comm); [2013] 1 All ER (Comm) 973

beneficiary under the transaction is in some way connected with the debtor this may be a factor that ends to show the existence of the necessary purpose but there no presumptions or evidential aids in the section to facilitate the task of the applicant.

287. In terms of defences to a claim under s 423, the interests of third parties are protected. It is provided, inter alia, in s 425 (2) that an order shall not prejudice any interest in property that was acquired from a person other than the debtor and was acquired in good faith, for value and without notice of the relevant circumstances. It has also been held in 4 Eng Ltd v Harper389 that a change of position defence may be available to transferees.

288. There are however no special defences available to the debtor that puts assets beyond the reach of creditors. It has even been held that the fact that the debtor had acted on the basis of legal advice does not preclude the debtor from having the necessary improper purpose.390

289. In Ireland, the preference avoidance rules follow the same general pattern as in the UK though there are some significant differences in terms of detail.

290. For corporates the relevant provisions are contained in s 604 Companies Act 2014 (preferences); s 597[391] (invalidation of floating charges) and s 608 (fraudulent dispositions of company property). The provisions do not apply to the Irish equivalent of the UK company administration procedure – examinership. For individuals, the relevant provisions are contained in the Bankruptcy Act 1988 as amended by the Personal Insolvency Act 2012 and serve to invalidate fraudulent preferences (s 57); transfers at an undervalue (s 58) and settlements of property not made in good faith and for valuable consideration (s 59).

291. Section 604 of the Irish Companies Act 2014 invalidates improperly preferential acts or things done by a company prior to the commencement of winding up. In general, acts or things done by a company in relation to its property within 6 months of the company's winding up are invalid. The impugned act must have taken place at a time when the company was unable to pay its debts and the act must be done in favour of any creditor of the company with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors. From case law, it is established that company must have

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389 [2009] EWHC 2633 (Ch); [2010] BCC 746.
390 Arbuthnot Leading v Havelet Leasing (No 2) [1990] BCC 636.
391 See also s 598 on the invalidation of payments made under floating charges that were granted to secure debts owed to connected persons.

the 'dominant intention to prefer' and the act must have been done voluntarily as distinct from being coerced by pressure.[392] The 6 month period is extended to 2 years in the case of transactions with persons connected with the company. The onus of establishing the legitimacy of the transaction is also placed on the connected person. A transaction is regarded as having been made with a view to giving such person a preference over the other creditors and to be a fraudulent preference, unless the contrary is shown.

292. Section 597 of the Irish Companies Act 2014 provides that a floating charge created within 12 months prior to the commencement of winding up is rendered invalid by the fact of the company going into liquidation. The suspect period extends to two years in the case of a floating charge given to a person connected with the company. Such invalidity operates except to the extent of cash paid to the company at the time when the charge is created or subsequently. The 'cash paid' exception covers money actually advanced or paid and the actual price or value of goods or services sold or supplied. It is a condition of the operation of the invalidating rule that the company be insolvent at the time of creation of the floating charge. The Irish Supreme Court in Re Creation Printing Co Ltd [393] said that the test of solvency in this context was whether immediately after the floating charge was given, the company was able to pay its debts as they became due. The question was not whether its assets exceeded the estimated value of its liabilities, or whether a businessman would have regarded it as solvent.

293. Section 608 Irish Companies Act 2014 provides for the setting aside and restoration of fraudulent dispositions of company property. The section however, does not apply to any property that has been the subject of a fraudulent preference. The court is empowered to order the restoration to the liquidator of corporate property, or the proceeds of its sale of development, that has been disposed of in such a way as to perpetrate a fraud on the company, its creditors or members. The order may be made on the application of a liquidator or any creditor or member of the company. In deciding whether it is just and equitable to make such an order, the court is obliged to have regard to the rights of persons who bona fide and for value acquired an interest in the property.[394]

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[392] See generally Parkes & Sons Ltd v Hong Kong and Shanghai Banking Corp [1990] ILRM 341; Corran Construction Co v Bank of Ireland Finance Ltd [1976-7] ILRM 175.
[393] [1981] IR 353 at 358-359 (Kenny J).
[394] It seems that a fraudulent conveyance or mortgage can also be challenged under the Conveyances (Ireland) Act 1634 – see Re Kill Inn Motel Ltd [1978-1987] vol 3 ITR 706.

294. For individuals, following amendments made by the Personal Insolvency Act 2012, the relevant transactional avoidance provisions in the Irish Bankruptcy Act 1988 now contain more or less a uniform 3 year reach back period. There is not a longer 'suspect' period for connected parties. Section 57 of the 1988 Act strikes at fraudulent preferences and follows the same lines as its corporate equivalent. Section 58 however, does not have an exact corporate equivalent. Essentially it applies to undervalue transactions. The provision operates if a debtor either sells any of his property at a price substantially below its market value or enters into a transaction which, has the effect of substantially reducing the sum available for distribution to the creditors. The transaction is rendered void as against the Official Assignee in bankruptcy unless it was entered into bona fide and the other party, at the relevant time, had no notice of any prior act of bankruptcy committed by the bankrupt. Section 59 strikes at settlements of property. Basically, a settlement not made in favour of a person who acts in good faith and for valuable consideration, is rendered void if the settlor is adjudicated bankrupt within 3 years of the date of the settlement. There is no requirement that, at the date of the settlement, the settlor should have been unable to pay its debts as they fell. There is, however, a longer 5 year reach back period if the settlor was unable to pay all of its debts without the aid of the property comprised in the settlement.

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