

Mortgages, charges and taking security

23.1 INTRODUCTION

This chapter analyses the use of mortgages and charges to take security in commercial transactions. A range of equitable doctrines, from floating charges to equitable mortgages, is analysed. Unlike trusts, which split title between the legal owner and the equitable owner, the structures considered in this chapter express a similar distinction between legal and equitable ownership but without concepts of trusteeship. The discussion in this Part of commercial uses of trusts and equity has three core aims. First, to examine the ways in which principles of equity are capable of plugging the gaps between the parties' common intentions and the commercial structures which they eventually produce. This discussion will therefore highlight the nature of equitable mortgages, which are inferred in situations in which no formally valid mortgage has been created at law. Secondly, to consider the manner in which the proprietary rights created by a mortgage, or the rights created by a fixed charge or a floating charge differ substantively from the proprietary rights generated by a trust. Thirdly, to consider the way in which equity is able to rewrite unconscionable bargains using the equity of redemption: that is, a principle that the mortgagor must be capable of terminating the mortgage so that the mortgagee's security interest disappears and the mortgagor recovers unencumbered title. These themes will demonstrate both how equity can support the common intention of the parties and also how it can unpick such bargains on grounds of public policy.

23.2 FIXED CHARGES AND FLOATING CHARGES

23.2.1 The nature of charges

Charges, as opposed to mortgages, take effect only in equity.¹ This section will consider charges which do not take effect by way of mortgage, whereas mortgages are considered below. Charges grant a right to seize property in the event that the chargor does not perform some underlying obligation, for example to pay money under a contract of loan; importantly, though, a mere charge does not grant the chargee an immediate right

¹ *Re Coslett Contractors Ltd* [1998] Ch 495. Explained in Gleeson, *Personal Property Law* (FT Law & Tax, 1997) 235, to be the case because title may not be divided at common law. However, of course, title at common law may be held in common, for example by trustees.

in the charged property in the manner that a mortgage grants the mortgagee such an immediate right of ownership in the mortgaged property.² As the current authors of *Fisher and Lightwood's Law of Mortgage* put the matter:

A charge is a security whereby real or personal property is appropriated for the discharge of a debt or other obligation, but which does not pass either an absolute or a special property in the subject of the security to the creditor, nor any right to possession. In the event of non-payment of the debt, the creditor's right of realisation is by judicial process.³

Thus a chargee has a right to apply to the court to seek a right to seize the charged property and to sell it so as to realise the amount owed to it.⁴ Any surplus realised on sale will be held on constructive trust for the chargor.⁵ Charges are created by agreement of the parties, whether by means of contract, settlement, will or by the appropriation of personalty for the discharge of the chargor's obligations to the chargee. There is no specific formality for the creation of a charge over personalty.⁶ Rather, the court will look to the intention of the parties. By contrast, a charge by way of a contract over land or an interest in land must be contained in a single document signed by the parties containing all of the terms of that contract.⁷ A charge over after-acquired property will not be effective.⁸ Thus a charge over a mere *spes* (or, expectancy of receiving property in the future) will not be effective either because the chargor would have no right in the property at the time of purporting to create the charge.⁹ However, where consideration is given for the grant of the charge, then there is authority for the charge taking effect at the time stipulated in the contract.¹⁰

Distinguishing charges from other structures

There is a doctrinal distinction between mortgages and charges due to the immediate right of ownership granted to a mortgagee by a mortgage which is not granted by an

2 It should be noted that the judges are not always so discriminating between charges and mortgages, often using the terms synonymously. See, for example, Slade J in *Siebe Gorman v Barclays Bank* [1979] 2 Lloyd's Rep 142, 159 where the terms are used interchangeably in the following passage: 'a specific charge on the proceeds of [the book debts] as soon as they are received and consequently prevents the mortgagor from disposing of an unencumbered title to the subject matter of such charge without the mortgagee's consent, even before the mortgagee has taken steps to enforce its security.'

3 Falcon Chambers, *Fisher and Lightwood's Law of Mortgage* (11th edn, Butterworths, 2002) 25.

4 *Johnson v Shippen* (1703) 2 Ld Raym 982; *Stainbank v Fenning* (1851) 11 CB 51; *Stainbank v Shepard* (1853) 13 CB 418. This doctrine is also considered in the following cases: *Swiss Bank Corporation v Lloyds Bank Ltd* [1982] AC 584 at 595; [1980] 2 All ER 419 at 425, CA; [1982] AC 584; [1981] 2 All ER 449, HL; *Carreras Rothmans Ltd v Freeman Mathews Treasure Ltd* [1985] Ch 207; [1985] 1 All ER 155 at 169; *Re Charge Card Services Ltd* [1987] Ch 150 at 176; [1989] Ch 497 CA; *Re BCCI (No 8)* [1998] AC 214; [1997] 4 All ER 568, HL; *Re Coslett Contractors Ltd* [1998] Ch 495 at 507, per Millett LJ.

5 Cf Law of Property Act 1925, s 103.

6 *Cradock v Scottish Provident Institution* (1893) 69 LT 380, affirmed at (1894) 70 LT 718, CA.

7 Law of Property (Miscellaneous Provisions) Act 1989, s 2.

8 *Re Earl of Lucan, Hardinge v Cobden* (1890) 45 Ch D 470.

9 *Re Brooks' ST* [1939] 1 Ch 993.

10 *Wellesley v Wellesley* (1839) 4 Myl & Cr 561.

ordinary charge.¹¹ In contrasting an equitable charge with an equitable mortgage, the following *dicta* of Buckley LJ illustrate the great similarity between the concepts which have appeared in a number of the decided cases but also illustrate the need to maintain a distinction between those two concepts:

An equitable charge may, it is said, take the form either of an equitable mortgage or of an equitable charge not by way of mortgage. An equitable mortgage is created when the legal owner of the property constituting the security enters into some instrument or does some act which, though insufficient to confer a legal estate or title in the subject matter upon the mortgagee, nevertheless demonstrates a binding intention to create a security in favour of the mortgagee, or in other words evidences a contract to do so . . . An equitable charge which is not an equitable mortgage is said to be created when property is expressly or constructively made liable, or specially 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.¹²

An equitable charge, then, grants the secured party some right by virtue of the parties' contract to sell the assets provided by way of security,¹³ whether that property is held at the time of the creation of charge or whether it is only capable of first coming into existence once the specific property comes into the hands of the chargor.¹⁴ The key to that charge being an equitable charge is that it is specifically enforceable by virtue of the contract: it is therefore the equitable remedy of specific performance which gives rise to the right as an equitable right.¹⁵ A floating charge is an example of an equitable charge, also arising in equity rather than at common law. The existence of such a charge may be deduced from the circumstances provided that the property to be subject to the charge, if it is a fixed charge, is sufficiently ascertainable.¹⁶

Whether or not a charge may create a proprietary right

Ordinarily, as considered above, a charge does not technically create a proprietary right for the chargee but rather creates a right to judicial process which will then empower

11 There is debate as to the extent to which some of the older cases have, inadvertently or advertently, apparently merged the two categories: see *Fisher and Lightwood's Law of Mortgage* (11th edn, Butterworths, 2002) 26. However, there are a number of recent cases which have asserted the importance of the difference between these categories: see e.g. *Swiss Bank Corporation v Lloyds Bank* [1982] AC 584 at 594; [1980] 2 All ER 419 at 426; *Ladup Ltd v Williams and Glyn's Bank plc* [1985] 2 All ER 577; [1985] 1 WLR 851. Cf. *Re BCCI (No 8)* [1998] AC 214 at 225, *per* Lord Hoffmann. It is suggested that there is a distinction between these two categories – principally the ownership right granted by the mortgage which is not granted by the ordinary charge – and that those dealing with commercial contracts should be astute to observe the distinction between the two.

12 *Swiss Bank Corp v Lloyds Bank* [1982] AC 584, 594, *per* Buckley LJ.

13 *Rodick v Gandell* (1852) 1 De GM & G 763; *Palmer v Carey* [1926] AC 703.

14 In which case there will be no such right until the property is taken legally into possession by the chargor: *Holroyd v Marshall* (1862) 10 HL Cas 191; *National Provincial Bank v Charnley* [1924] 1 KB 431.

15 *Walsh v Lonsdale* (1882) 21 Ch D.9.

16 *In re Namwa Gold Mines Ltd* [1955] 1 WLR 1080. Cf. *Moseley v Cressey's Co.* (1865) LR 1 Eq 405.

the chargee to seize the charged property if an underlying debt or other obligation has not been satisfied in good time or in accordance with the terms of the appropriate contract.¹⁷ Nevertheless, there are two recent decisions of the House of Lords in which it has been suggested that charges create proprietary rights,¹⁸ in spite of the strict position under the case law which has distinguished between charges which ordinarily do not create proprietary interests and other structures which do create proprietary rights such as trusts and mortgages. Lord Hoffmann perhaps demonstrated the judicial attitude to such technical niceties when he held that ‘the law is fashioned to suit the practicalities of life and legal concepts like “proprietary interest” and “charge” are no more than labels given to clusters of related and self-consistent rules of law.’¹⁹ It was recognised by Lord Hoffmann in *Re BCCI (No 8)*²⁰ that, while a charge may be described as creating a proprietary right, nevertheless a ‘charge is a security interest created without any transfer of title or possession to the beneficiary’.²¹ Thus, any proprietary right is not achieved by means of a transfer of title (by which it is assumed his Lordship meant a transfer of outright title, as opposed merely to a transfer of an equitable interest) nor by means of a transfer of possession. Nevertheless, it is suggested that it is only in relation to a fixed charge that there could be said to be such a proprietary right. Thus Lord Scott has held that:

the essential characteristic of a floating charge, the characteristic that distinguishes it from a fixed charge, is that the asset subject to the charge is not finally appropriated as a security for the payment of the debt until the occurrence of some future event.²²

Thus, in relation to a floating charge, there is no appropriation of any property subject to the charge until the event happens which is defined in the terms of the charge as crystallising that right. Consequently, it is suggested, there cannot be a right in any identified property before crystallisation occurs under a floating charge. By contrast, in relation to a fixed charge, there must necessarily be some property which is segregated or separately identified so that it can be subjected to the charge: consequently, it might be possible to think of this fixed charge as creating a right in property. However, even in relation to a fixed charge the property right is contingent on the underlying debt not being paid and an application being made to seize the charged property: therefore, if the chargee’s right under a charge is a proprietary right, it is not a proprietary right equivalent to the rights of a beneficiary under a trust (which comes into existence at the time of the creation of the trust²³). As Lord Walker has expressed the operation of a fixed charge:

17 *Swiss Bank Corp v Lloyds Bank* [1982] AC 584, 594, per Buckley LJ.

18 *In re BCCI (No 8)* [1998] AC 214, 226, per Lord Hoffmann; *In re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680, paras [138] and [139], per Lord Walker.

19 *In re BCCI (No 8)* [1998] AC 214, 227, per Lord Hoffmann.

20 [1998] AC 214, 226, per Lord Hoffmann.

21 *Ibid.*

22 *In re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680, para [111], per Lord Scott.

23 *Saunders v Vautier* (1841) 4 Beav 115.

‘Under a fixed charge the assets charged as security are permanently appropriated to the payment of the sum charged, in such a way as to give the chargee a proprietary interest in the assets.’²⁴

Thus, the chargee is considered to have rights permanently segregated so as to be subjected to the charge. The element, it is suggested, which is missing from this definition is the contingent nature of even a fixed charge: there is no right, unless something to the contrary is made clear in the terms of the charge, to seize the charged property unless and until there has been some default under the payment obligation under the charge. By contrast, in relation specifically to mortgages, the mortgagee has a right of possession at common law ‘even before the ink is dry on the contract’.²⁵ Under a trust, as considered in Chapter 4, the beneficiary under a bare trust, for example, has a proprietary right in the trust property throughout the life of the trust. It is suggested, therefore, that a fixed charge simply does not create a proprietary right of the same quality of the mortgage or of the bare trust.

The remedies of a chargee are sale and the appointment of a receiver. An equitable chargee will not be entitled to foreclosure²⁶ nor to possession:²⁷ these two remedies arise only in relation to mortgages.

23.2.2 Fixed charges

Charges entitle the chargee to seize property in the event that the chargor fails to perform some connected obligation. A fixed charge grants contingent proprietary rights to the rightholder entitling the rightholder to take full proprietary rights over the charged property, the contingency being that the chargor must have defaulted in some defined obligation.²⁸ Charges are different from trusts in that the chargee does not owe the fiduciary duties of a trustee of acting in good conscience towards the chargor. However, fixed charges take effect over specified property and so may appear similar to a trust. Distinguishing between the two is therefore a question of careful construction of the contract which creates the chargee’s rights. The essential nature of a charge has been expressed in the following terms:

any contract which, by way of security for the payment of a debt, confers an interest in property defeasible or destructible upon payment of such debt, or appropriates such property for the discharge of the debt, must necessarily be regarded as creating a mortgage or charge, as the case may be. The existence of the equity of redemption is quite inconsistent with the existence of a bare trustee–beneficiary relationship.²⁹

24 *In re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680, para [138], per Lord Walker.

25 *Four Maids Ltd v Dudley Marshall Ltd* [1957] Ch 317; *Western Bank v Schindler* [1977] Ch. 1; *National Westminster Bank v Skelton* [1993] 1 All ER 242.

26 *Tennant v Trenchard* (1869) 4 Ch App 537; *Re Lloyd* [1903] 1 Ch 385 at 404, CA.

27 *Garfitt v Allen* (1887) 37 Ch D 48, 50.

28 A fixed charge may also be over future property, eg, future book debts: *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd’s Rep 142.

29 *Re Bond Worth* [1980] 1 Ch 228, 248, per Slade J. See also *Re George Inglefield Ltd* [1933] Ch 1.

Thus the distinction between a charge and a trust is that the interests of a beneficiary under a trust are not capable of being expunged simply by payment of a debt, whereas that is precisely the nature of the chargee's property rights under a mortgage or charge. The equity of redemption is precisely that expression of the need for a mortgage or charge to be valid that the chargor be able to extinguish those property rights in the chargee by discharge of the debt.³⁰ It is possible, however, for a retention of title clause to mutate into a charge where the chargor retains its title in the assets subject to the charge, unless it fails to make the repayment required by the charge contract. In relation to a fixed charge, it is necessary that the charged property is sufficiently identifiable.³¹ Therefore, the reader is referred to the discussion of certainty of subject matter (in relation to trusts) in Chapter 3. Without such certainty of the subject matter of the charge, that charge cannot be valid, unless its proper analysis is as a floating charge, as considered below.

23.2.3 Floating charge

By contrast with a fixed charge, in which the rights attach to identified property, a floating charge has a defined value which takes effect over a range of property but not over any specific property until the point in time at which it crystallises.³² A floating charge is different from a fixed charge in that the chargor is entitled to deal with the property over which the charge floats without reference to the chargee, unlike a fixed charge which restrains the chargor from dealing with the charged property without accounting to the chargee.³³

A floating charge will usually be identified by reference to the following factors:

- (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 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 carry on its business in the ordinary way so far as concerns the particular class of assets I am dealing with.³⁴

Therefore, a floating charge enables the owner of that property to continue to use it as though unencumbered by any other rights. The only difficulty then arises on how to deal with the property once the chargee seeks to enforce its rights. In this sense there is a narrow line in many cases between a floating charge and either a fixed charge or a trust. For example, a provision which purported to create a trust over 'the remaining part of what is left' from a fund would not be sufficiently certain to create a trust or a fixed charge, because the identity of the precise property at issue could not be known.³⁵ The

30 See, eg, *Reeve v Lisle* [1902] AC 461; *Samuel v Jarrah Timber Corporation* [1904] AC 323.

31 *Illingworth v Houldsworth* [1904] AC 355, 358, per Lord Macnaghten.

32 *Re Yorkshire Woolcombers Association* [1903] 2 Ch 284; *Illingworth v Houldsworth* [1904] AC 355; *Evans v British Granite Quarries Ltd* [1910] 2 KB 979; *Re Bond Worth* [1980] 1 Ch 228. See now *Buchler v Talbot* [2004] UKHL 9 on the effect of the Insolvency Act 1986, s 175(2)(b) on floating charges.

33 *Royal Trust Bank v National Westminster Bank plc* [1996] BCC 316.

34 *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284, 295, per Romer LJ.

35 *Sprange v Barnard* (1789) 2 Bro CC 585.

alternative analysis of such provisions is then that they create a mere floating charge, such that the person seeking to enforce the arrangement would acquire only a right of a given value which related to a general pool of property without that right attaching to any particular part of it. Such a structure would be weaker than a proprietary trust right in the event of an insolvency because the rightholder could not identify any particular property to which the right attached.³⁶ One means of identifying the difference between a fixed and a floating charge is as follows:

A [fixed, or] specific charge . . . is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to effect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.³⁷

What that statement does not encapsulate, perhaps, is the acid test for the distinction between floating and fixed charges: whether or not the chargor is entitled to deal with the property as though the charge did not exist, something which is a feature of a floating but not a fixed charge.

A floating charge comes into existence by virtue of some contractual provision which grants the chargee rights of a given value over a fund of property which is greater in size than that right, or which contains property the identity of which may change from time to time.³⁸ So, in *Clough Mill v Martin*,³⁹ a supplier of yarn had entered into a contract with a clothes manufacturer under which the supplier was granted proprietary rights in any unused yarn and, significantly, in any clothes made with that yarn until it received payment from the clothes manufacturer. It was held by the Court of Appeal that there was insufficient intention to create a trust of any particular stock of clothing. In part, the court considered the fact that the identity of the property over which the supplier's proprietary rights were to have taken effect changed from time to time and that those proprietary rights took effect over a stock of property larger than the value of the rights which the supplier was to have received. It need not matter that the charge is expressed by contract to be a fixed charge if in fact the court considers that it can only be a floating charge due to the changeability of the fund of property held.⁴⁰

That the rights of the chargee do not bite until the charge itself has crystallised creates a complex form of right.⁴¹ The right is necessarily contingent on the chargor committing some default under the terms of the contract giving rise to the charge. The chargor is able to dispose of the property in the fund and deal with it in the ordinary course of events.⁴² Once that default has been committed, it is said that the charge will

36 *Re Goldcorp* [1995] 1 AC 74.

37 *Illingworth v Houldsworth* [1904] AC 355, 358, *per* Lord Macnaghten.

38 Such as a stock of goods held in a warehouse by a manufacturer, where some of those goods will be shipped out and other goods added to the fund from time to time.

39 [1984] 3 All ER 982.

40 *Re Armagh Shoes Ltd* [1984] BCLC 405; *Re Brightlife Ltd* [1987] Ch 200.

41 *Re Woodroffes (Musical Instruments) Ltd* [1986] Ch 366.

42 *Wallace v Evershed* [1899] 1 Ch 891.

crystallise at that time; but simply as a matter of logic, it is not always clear even then over which property this charge bites. Suppose that there is more property in the fund than is necessary to discharge the value specified in the contract giving rise to the charge: it cannot be the case that the chargee can acquire property rights in that surplus. Similarly, in the event that there is less in the fund than the amount required to discharge the charge and, perhaps, if there were more than one such claim against the fund, it could not be said that the chargee necessarily has property rights in the fund which could take priority in an insolvency. However, the floating charge would give rise to some rights in the holders of those rights against that general fund.⁴³

23.2.4 Charges over book debts

Registration of a book debt as a charge

One particular, recurring problem with taking charges in the context of financial transactions is that of taking charges over book debts. There have been two particular issues in the decided cases. The first issue is how a charge can be taken over a debt, in particular a debt which may only be paid in the future.⁴⁴ The second issue is this: if a bank holds an account for its customer, which is therefore a debt owed by the bank to its customer while that account is in credit, can that bank take a charge over that account even though the account is in itself a debt which it owes to its customer? A 'book debt' need not refer only to bank accounts – although that is the clearest example in relation to financial transactions – but rather can refer to any debt accrued in the course of a business and owed to the proprietor of that business.⁴⁵

The importance of identifying an agreement as being or not being a book debt is that such a charge may require registration under s 860 of the Companies Act 2006. Section 860 of the Companies Act 2006 provides that:

- (1) A company that creates a charge to which this section applies must deliver the prescribed particulars of the charge, together with the instrument (if any) by which the charge is created or evidenced, to the registrar for registration before the end of the period allowed for registration.

Among the categories of charge which requires registration, under s 860(7)(f) of the 2006 Act, is 'a charge on book debts of the company'. Therefore, within the terms of the legislation, 'a charge on the book debts of the company' is caught within those forms of charge which require registration. It has been held that a 'customer's balance with a bank is not within the expression "all book debts and other debts"',⁴⁶ although the authorities which have advanced this proposition have been doubted in general

43 *Cretanor Maritime Co Ltd v Irish Marine Management Ltd* [1978] 1 WLR 966.

44 As has been recognised since the decision of the House of Lords in *Tailby v Official Receiver* (1888) 13 App Cas 523.

45 *Shipley v Marshall* (1863) 14 CBNS 566; *Independent Automatic Sales Ltd v Knowles and Foster* [1962] 1 WLR 974. Cf *McCormack* [1989] LMCLQ 198; *McCormack, Reservation of Title* (2nd edn., Sweet & Maxwell, 1995), 105 *et seq.*

46 *In re Brightlife Ltd* [1987] Ch 200; *Northern Bank Ltd v Ross* [1990] BCC 883.

terms.⁴⁷ Lord Hoffmann in *Re BCCI (No 8)*⁴⁸ refused to rule definitively on the question whether or not an ordinary bank deposit constituted a ‘book debt’ of that bank, but he did not disapprove (and perhaps could be read as having approved) the judgment of Lord Hutton in *Northern Bank v Ross*⁴⁹ to the effect that ‘in the case of deposits with banks, an obligation to register [under s 860] is unlikely to arise’.

Failure to register such a charge under the now-repealed Companies Act 1985 (replaced by s 860) rendered that charge unenforceable⁵⁰ and in consequence the chargee lost its priority in relation to an insolvency.⁵¹ Furthermore, every officer of the company in default is liable to a fine.⁵² In circumstances where at the date of the creation of an agreement there is a charge over property, then that charge is registrable;⁵³ whereas if no charge is created at the time of the creation of the agreement then there will not be a book debt requiring registration as a charge, even if such a charge might be created subsequently.⁵⁴

The question of whether a charge is to be considered a fixed or a floating charge in general terms was considered above and is considered below in relation specifically to charges over book debts.

The particular problem of future book debts

As a consequence, the possibility arises that a registrable charge may be created over future book debts; that is, some obligation which has not yet become payable.⁵⁵ This type of asset include debts which remain uncollected but which are recorded as assets on the company’s books. That rights taken over such uncollected debts could constitute a registrable charge or whether they should grant priority rights in an insolvency are propositions which have caused great difficulty on the case law. At one level the case law has been concerned to distinguish between situations in which such charges are fixed charges or merely floating charges, a question considered above which turns on whether or not the chargor has the right to use the property subject to the charge freely as though its rights were unencumbered by any fixed charge.

At this stage we are concerned with the second issue which related to the particular question of whether or not the chargee could take the benefit of a fixed charge in relation to the priority it accords and yet grant the chargor the right to use the proceeds of the charged property as though there were no charge. The House of Lords in *Re Spectrum Plus Ltd*⁵⁶ has doubted the feasibility of such structures, as considered below. Nevertheless, there was a line of authority which had approved such structures: including the now-overruled decision of Slade J in *Siebe Gorman & Co Ltd v Barclays*

47 See *In re BCCI (No 8)* [1998] AC 214; *In re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680.

48 *In re BCCI (No 8)* [1998] AC 214, 227.

49 [1990] BCC 883.

50 *Re Bond Worth* [1980] Ch 228.

51 *Ibid.*

52 Companies Act 1985, s 399(3).

53 *Independent Automatic Sales Ltd v Knowles and Foster* [1962] 1 WLR 974.

54 *Paul and Frank Ltd v Discount Bank (Overseas) Ltd* [1967] Ch 348.

55 *Talby v Official Receiver* (1888) 13 AC 523; *Independent Automatic Sales Ltd v Knowles and Foster* [1962] 1 WLR 974.

56 [2005] UKHL 41; [2005] 2 AC 680.

*Bank*⁵⁷ So, in *Re Brightlife*⁵⁸ a company purported to grant a fixed charge over its present and future book debts and a floating charge over all its other assets to its bank. While the company was not entitled to factor or otherwise deal with the debts it had collected, it was entitled to pay all uncollected debts into its general bank account. It was held that, on a proper construction of the parties' agreement, this general bank account was outwith the scope of the fixed charge and therefore it was held that the debts paid into the general bank account were subject only to a floating charge.

The decision in *Re Brightlife*⁵⁹ and other cases⁶⁰ created problems for banks and their customers. It was important for the customer that it be free to use all the money in its bank account as part of its circulating capital, but for the banks it became advantageous to have some form of control over the customer's use of its bank account to retain the rights attributable to a fixed charge.⁶¹ In consequence a new form of charge structure was created which purported to create two charges: one which imposed a fixed charge on the uncollected book debts and another one which imposed a floating charge over the proceeds of those debts once collected. In consequence the bank would have a proprietary right in all of the debts which remained to be collected in but the customer would have free use of all of the cash when it had actually been collected in. This was the structure which came before the Court of Appeal in *Re New Bullas Trading Ltd*.⁶² Nourse LJ held that uncollected book debts were more naturally the subject of a fixed charge because they rested immobile on the chargor's books until they were paid off, and that it was only once they were paid off that their cash proceeds were more likely to be applied to the circulating capital of the enterprise and so subject only to a floating charge. In consequence, Nourse LJ held that it was not open to the company to argue that it was entitled to remove the proceeds from the ambit of the fixed charge simply because they were entitled to use them as part of its circulating capital on the terms of the contract with the chargee.

This approach was disapproved of by the Privy Council in *Agnew v IRC* ('*The Brumark*')⁶³ on the basis, *inter alia*, that to identify uncollected book debts as being the natural subject of a fixed charge would be to suggest that unsold trading stock was similarly the natural subject of such a charge because it was resting unused on the company's books. Rather, such assets were identified as being a part of the trader's ordinary cash flow and therefore equally likely to be part of its circulating cash flow and therefore equally likely to be the subject of a merely floating charge.⁶⁴

Significantly the Privy Council in *Agnew v IRC* considered that the suggestion in *Re New Bullas Trading Ltd* that these questions were simply questions of construction of the agreement, to see which category it occupied from case to case, was flawed. Rather,

57 [1979] 2 Lloyd's Rep 142.

58 [1987] Ch 200.

59 *Ibid.*

60 Eg, *Hart v Barnes* [1983] 2 VR 517; *Supercool Refrigeration and Air Conditioning v Howard Industries Ltd* [1994] 3 NZLR 300. Cf *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142; *Re Keenan Bros Ltd* [1986] BCLC 242.

61 It is suggested that some form of *Quistclose* trust, as considered above, would have been a better method of controlling the customer's use of their account.

62 [1994] 1 BCLC 485.

63 [2001] 2 AC 710; [2001] 3 WLR 454; [2001] UKPC 28; [2001] 2 BCLC 188, 199, *per* Lord Millett.

64 *Ibid.*, 200.

Lord Millett advocated a two-step process whereby the court should, first, consider the rights and obligations which the parties granted each other under their agreement and then, secondly, seek to categorise the charge only after such an identification of the true intentions of the parties.⁶⁵ The acid test would then be, on the construction of the agreement, whether the assets were under the free use of the chargor such that they could be subtracted from the security offered to the chargee, or whether they were under the restrictive control of the chargee so that they could not be subtracted from the chargee's security.⁶⁶ To follow the *New Bullas Trading* reasoning would be 'entirely destructive of the floating charge'⁶⁷ by virtue of the fact that, if the contract granted the chargor the right to dispose of the proceeds of the book debts freely as part of its circulating capital, then that right should be upheld by the court and not interpreted of necessity as constituting a fixed charge. The central question is, on analysis of the agreement, whether the chargor is entitled to free use of the proceeds for its own benefit. The approach of Lord Millett in *Agnew* was approved in the House of Lords in *Re Spectrum Plus Ltd*, as considered below.⁶⁸

The book debt and its proceeds capable of being subject to separate security interests

The preceding discussion still leaves open the question whether or not the cash proceeds of a book debt can be subject to a separate charge from the uncollected book debt itself. Importantly, Lord Millett held in *Agnew v IRC* that the '[p]roperty and its proceeds are clearly different assets'.⁶⁹ Thus, it was accepted that a book debt and the proceeds of that book debt are capable of constituting separate items of property and capable of being subjected to charges in different ways. In this instance, one by way of a fixed charge and the other by way of a floating charge. It is suggested that this is a difficult proposition precisely because the book debt's value is necessarily bound up in the cash flow which results from its collection and therefore to take security over the debt and a separate security over the proceeds of the collection of that debt is to take security twice over the same intrinsic value. It is to effect a form of double counting. That contention requires some elucidation.

It is true that English law has accepted that the benefit of even a non-transferable contract has been recognised as constituting an item of property and so can be settled on trust⁷⁰ – that is, the benefit which flows from such a contract can be treated as property distinct from the contract itself – but to do so in relation to non-transferable contracts is to recognise that the contract itself will not be transferred and therefore that the value deriving from it can safely be promised contractually to some other person

65 *Ibid*, 201; where his Lordship drew a parallel with the case of *Street v Mountford* [1985] AC 809 in which the courts look for the true intentions of the parties in the analysis of leases and licences before allocating any particular agreement to either category.

66 *Ibid*, 200.

67 *Ibid*, 201.

68 [2005] 2 AC 680.

69 [2001] 2 BCLC 188, 203; [2001] 2 AC 710; [2001] 3 WLR 454; [2001] UKPC 28.

70 *Don King Promotions Inc v Warren* [1998] 2 All ER 608, affirmed [2000] Ch 291; *Swift v Dairywise Farms* [2000] 1 All ER 320; *Re Celtic Extraction Ltd (in liquidation)*; *Re Bluestone Chemicals (in liquidation)* [1999] 4 All ER 684.

without fear of double counting. The point made by Lord Millett in *Agnew v IRC* is that if a charge is assigned, the assignor receives sale proceeds in consideration for the sale and the charge continues in existence in the hands of its purchaser. By contrast, it is said by his Lordship, when the debt underlying the book debt is collected, that book debt ceases to exist. Therefore, it is said the book debt can be separated from its proceeds when it is assigned because the book debt continues to exist in the hands of the purchaser and so do its sale proceeds in the hands of its seller. However, all that this analysis recognises is that the owner of the book debt has property rights of a given value whether as the owner of the book debt, or of the sale proceeds of the book debt, or of the collection proceeds of that book debt: in any event, the chargor has property of equivalent value whatever form its takes, that much is a staple of well-established principles of property law like tracing since time immemorial. It is not decisive of the question whether or not to accept that the value of the book debt is distinct from the book debt itself.

To talk of the book debt being a separate item of property from the value that attaches to it, whether its future collection value or its assignment value, is not a wholly convincing analysis. Rather, what is done by the attempt to segregate book debts from their value in practice is the following thing: the chargee and chargor agree that the chargee's rights shall attach to any of a number of possible choses in action which the chargor has against its debtors which remain as uncollected book debts, whereas once those debts are collected in or are turned to account by means of assignment (where permitted under contract) those cash proceeds pass into the hands of the chargor in place of the book debt.⁷¹

A 'specific charge' over book debts

The House of Lords in *Re Spectrum Plus Ltd*⁷² considered a transaction in which by means of a debenture the issuing company created a charge 'by way of specific charge' in favour of the National Westminster Bank over the company's book debts to secure the money owed by the company to the bank. The issue arose, *inter alia*, whether this charge over present and future book debts was a fixed charge – as the bank contended – or whether it constituted a floating charge. Significantly, the company was prevented from dealing with the uncollected book debts but, once the debts had been collected, there was no control placed on the company's ability to use those debts in the terms of the debenture. Consequently, it was held that the receipts derived from the book debts held in the company's account were free to be used by the company. Therefore, regardless of the bank's attempts to have the charge drafted so as to appear to be a fixed charge, the charge was properly to be analysed as a floating charge. This decision, quoted above on numerous occasions, approved the decision of the Privy Council in *Agnew v IRC*.⁷³

71 A better analysis of this situation would be to suggest that the chargor holds all of its relevant assets on a contingent trust such that any uncollected book debts are held on trust for the 'chargee' as beneficiary until their collection; whereas once those debts are collected they are held on trust for the 'chargor' as beneficiary from the moment of collection (at which time the book debt ceases to exist); and once segregated to another account those collection proceeds are capable of being declared the absolute property of the 'chargor'. Cf. Goode, 'Charges over book debts: a missed opportunity' (1994) 110 LQR 592.

72 [2005] 2 AC 680.

73 [2001] 2 AC 710.

23.3 THE MORTGAGE AS A SECURITY

A mortgage is a contract of loan. The mortgagee lends money to the mortgagor which that mortgagor is required to repay over the contractually specified period together with periodical amounts of interest. As a contract, the mortgage is governed primarily by questions of contract law as to its formation, its terms, and its termination. The mortgage differs from an ordinary contract of loan in that the mortgagee acquires the rights of a chargee over assets of the mortgagor. The mortgage is also a proprietary interest in the mortgaged property because the mortgagee acquires rights to take possession of that property in the event of some breach of the loan contract and/or to sell that property.

In relation to mortgages of land governed by s 85 of the Law of Property Act (LPA) 1925, the mortgagee acquires both rights of possession at common law and rights of sale under statute. As provided by s 85 of the LPA 1925:

- (1) A mortgage of an estate in fee simple shall only be capable of being effected at law either by a demise for a term of years absolute, subject to a provision for cesser on redemption, or by a charge by deed expressed to be by way of legal mortgage.

The courts have been astute to ensure that there is equity between parties to a relationship where one party takes out a mortgage without the knowledge or informed consent of the other party. The law relating to misrepresentation or undue influence in the creation of a contract as a ground for setting that contract aside is considered in detail in Chapter 29. The courts have held that where one joint tenant takes out a mortgage without the consent of the other joint tenants, that will constitute a severance of the joint tenancy with the effect that the mortgagee's rights will obtain only against the person who took out the mortgage.⁷⁴

Where the mortgagor is subject to some overriding obligation in equity in favour of some other person, the mortgagee may not be able to enforce its rights to repossession or sale against that other person.⁷⁵ In *Abbey National v Moss*,⁷⁶ a mother transferred property into the names of both her and her daughter for them to occupy during their lifetime. The daughter borrowed money secured by a mortgage over the property without her mother's knowledge. When the mortgagee sought to enforce its rights it was held, exceptionally, that there had been a collateral purpose in the purchase of the house to the effect that the mother would live there for her life,⁷⁷ such that the daughter could not grant the mortgagee a right in the property which was greater than the right she had against her mother.

Nevertheless, the mortgagee will be able to force a sale of the property despite the presence of the innocent joint tenant under s 15 of the Trusts of Land and Appointment of Trustees Act 1996.⁷⁸ Section 15(1)(d) of the 1996 Act provides that '[t]he matters to which the court is to have regard in determining an application for an order under s 14 include – . . . (d) the interests of any secured creditor of any beneficiary'.

⁷⁴ *First National Security v Hegerty* [1985] QB 850.

⁷⁵ *Abbey National v Moss* [1994] 1 FLR 307.

⁷⁶ *Ibid.*

⁷⁷ Cf *Jones v Challenger* [1961] 1 QB 176.

⁷⁸ *Lloyds Bank v Byrne* (1991) 23 HLR 472; [1993] 1 FLR 369.

Where the mortgage is part of a sham device by a husband to realise all of the value of matrimonial property by borrowing its value under a mortgage, that mortgage contract will be unenforceable by the mortgagee if the mortgagee was a party to the sham,⁷⁹ but not if the mortgagee was acting in good faith.⁸⁰

23.4 THE EQUITY OF REDEMPTION

The core of the doctrine of the equity of redemption is that the mortgagor must be able to recover unencumbered title in the mortgaged property once the mortgage has been redeemed. This section considers a small selection of cases to demonstrate how this principle operates in relation to different forms of contractual provision. It was the courts of equity which recognised that it would be inequitable for the mortgagee to be able to deny the mortgagor's right to recover unencumbered title in the mortgaged property once the debt had been discharged. Hence the expression 'equity of redemption'.

The first issue relates to provisions which make the mortgage irredeemable. That means that the mortgagor would not be able to recover unencumbered title. So, in *Samuel v Jarrah Timber Corp*,⁸¹ Samuel lent £5,000 which was secured on debenture stock. As part of the mortgage agreement, the mortgagee was given an option to purchase all or part of that stock. It was argued that this would make the mortgage irredeemable because the mortgage contract itself gave the mortgagee the ability to acquire absolute title to the mortgaged property. It was held that the strict rule against irredeemability must be upheld and that, because the mortgagor might not recover unencumbered title, the mortgage was void.

The general rule was set out by Lord Lindley to the effect that 'no contract between a mortgagor and a mortgagee as part of the mortgage transaction . . . as one of the terms of the loan . . . can be valid if it prevents the mortgagor from getting back his property on paying off what is due on his security'. To demonstrate how literally this rule has been interpreted the case of *Reeve v Lisle*⁸² is instructive. In that case, there was a mortgage agreement in which a ship was part of the security. At a later date, an offer was put to the mortgagor that he be granted an option to buy a share in a partnership, that the ship be transferred to the assets of the partnership and that the mortgagor not be required to repay the remainder of the mortgage. It was held that because the two agreements were separate from one another, the mortgage could be valid.

The second form of contractual provision is one that permits a postponement of redemption. The question is: what is the effect if the redemption is postponed for a while rather than being precluded absolutely? In *Knightsbridge Estates Trust v Byrne*,⁸³ a deed of mortgage provided that repayments would be made on half-year days over a period of 40 years and that the agreement would therefore last for a minimum period of 40 years. Only six years after the mortgage agreement had been created, the mortgagor

79 *Penn v Bristol & West Building Society* [1995] 2 FLR 938.

80 *Ahmed v Kendrick* (1988) 56 P & CR 120.

81 [1904] AC 323.

82 [1902] AC 461.

83 [1938] Ch 741.

sought to redeem the mortgage. The mortgagee refused to accept repayment, preferring instead to continue to receive that stream of cash-flow for the remainder of the life of the mortgage. The High Court held that in the abstract, the mortgage ought to be considered to be void because the provision constituted a clog on the equity of redemption on these facts and was onerous on the mortgagor. However, the Court of Appeal held that this provision was not a clog on the equity of redemption on these facts because the parties were commercial people who had been properly advised as to the effect of the contract. Significantly, the Court of Appeal was of the view that the courts could not introduce notions of reasonableness to the agreements of commercial people and that intervention could be permitted only if the terms of the mortgage were 'oppressive' or 'unconscionable'.

Another decision which demonstrates this distinction between cases in which the parties are considered to be of equal bargaining strength and cases where they are not is *Fairclough v Swan Brewery*.⁸⁴ In that case, the mortgagor took out a mortgage with the brewery as part of a larger agreement under which the mortgagor took over the running of licensed pub premises for the brewery. The agreement stated that the loan could not be redeemed; rather, moneys had to be paid in perpetuity throughout the mortgagor's term at the premises, and there was a covenant requiring that beer be bought only from the brewery. It was held that this provision constituted a clog on the equity of redemption. Lord Macnaghten held that 'equity will not permit any contrivance . . . to prevent or impede redemption'. It was held that on the facts of *Fairclough* it was clear that the purpose was to make the mortgage irredeemable.

The third context is that in which the mortgage agreement provides for some collateral advantages. In other words, is the mortgagee able to provide for some advantage to itself which would make it unattractive to the mortgagor to seek redemption of the mortgage? To use the courts' own expression, would this be a 'clog on the equity of redemption'?

A collateral advantage which provided for some benefit during the life of the mortgage was considered in *Cityland and Property Ltd v Dabrah*.⁸⁵ In that case, there was an express provision that if the mortgage were redeemed within six years, the mortgagor was required to pay a premium which was greatly in excess of market investment rates for the time: a rate of 19% per annum, or an effective capitalised rate of 57%. It was held that the premium payable by the mortgagor was so large that it rendered the equity of redemption nugatory. Notably, it was held that there was no general, principled objection to provision for collateral advantages.

On a similar point, in *Multiservice Bookbinding v Marden*,⁸⁶ a mortgage was granted over business premises with a floating rate of interest. It was provided in the mortgage contract that interest was payable on the full capital amount of the mortgage regardless of any redemption during the term. The amount of interest was compounded so that the mortgage could not be redeemed within 10 years and, furthermore, the amount of interest to be paid was linked to movements in the Swiss franc against sterling. This last provision was intended to guard against sterling being devalued against other

84 [1912] AC 565.

85 [1968] Ch 166.

86 [1979] Ch 84.

currencies. In the event sterling plummeted and the rate of interest payable by the mortgagor rose sharply. It was held that a collateral stipulation in a mortgage agreement that does not clog the equity of redemption is permissible unless it can be shown to be 'unfair' or 'unconscionable'. It was held that for the provision to appear to be merely 'unreasonable' was not enough to invalidate it. On these facts it was held that the parties were of equal bargaining power and therefore they should be held to the terms of their contract.

This division between parties of equal and unequal bargaining strength is pursued in relation to cases in which the mortgagee seeks some collateral advantage after redemption of the mortgage (so that the mortgagor might be discouraged from redeeming the mortgage at all). In *Noakes & Co Ltd v Rice*,⁸⁷ the contract contained a covenant that the mortgagor, who was a publican, would continue to buy all its beer from mortgagee even after the redemption of a mortgage. This was found to be a void collateral advantage on the basis that, once the mortgage amount is paid off, there is no obligation on the mortgagor to continue to provide security nor to continue to make payments to the mortgagee. In that context, the court was influenced by the lack of equality of bargaining power between the parties.

By contradistinction, in *Kreglinger v New Patagonia Meat Co Ltd*,⁸⁸ a mortgage was created between wool-brokers who made a loan to a company which sold meat. It was a term of the agreement that the loan could not be redeemed within its first five years. The meat sellers contracted that as part of this agreement they would sell sheepskins to no one other than the lender wool-brokers, even after the expiration of the contract. It was held that this agreement was collateral to the mortgage and was in fact a condition precedent to the wool-brokers entering into the mortgage in the first place; in other words, the wool-brokers would not have lent the money to the meat sellers unless the meat sellers agreed to provide these sheepskins. Further, the parties were both commercial parties and therefore the provision was not a clog on the equity of redemption.

Similarly, contracts in restraint of trade may constitute clogs on the equity of redemption in theory. For example, contracts which require the mortgagor to buy all its services from the mortgagee will be acceptable only where they are for reasonable periods of time.⁸⁹ Under statute, s 137 of the Consumer Credit Act 1974 provides that:

- (1) If the court finds a credit bargain extortionate it may re-open the credit agreement so as to do justice between the parties.

In *Ketley v Scott*,⁹⁰ it was held that a rate of interest of 48% on a mortgage would not be exorbitant.⁹¹

What can be drawn from this survey is the point that equity acts differently in commercial transactions than in non-commercial transactions. In effect the courts are considering the fairness of holding the parties to their bargain if one party may have

87 [1902] AC 24.

88 [1914] AC 25.

89 *Esso Petroleum v Harper's Garage* [1968] AC 269.

90 [1981] ICR 241.

91 See generally Adams, 1975.

been of unequal bargaining strength. This is an issue which is very similar to undue influence, considered in Chapter 29. By the same token, commercial parties acting at arm's length are typically found undeserving of equity's protection because they are expected to be capable of assessing the risks of their bargains. In this sense the term 'equity' refers both to the jurisdiction of the Courts of Chancery, considered throughout this book, and also to an economist's understanding of 'equity' as meaning fairness: as considered at length in Chapter 32.

23.5 EQUITABLE MORTGAGES AND CHARGES

23.5.1 Equitable mortgages

Equity is capable of stepping into the breach and ensuring that the underlying commercial intentions of the parties to a putative mortgage are put into effect. Mortgages effected in this way are referred to collectively as equitable mortgages – although they take a number of forms. As will emerge, the enactment of legislation in 1989 complicated this picture somewhat.

An equitable mortgage can arise in one of four ways. First, it might be that the mortgage is taken out over a merely equitable interest in property. As such the mortgage itself could only be equitable. An example would be the situation in which it is an equitable lease which is used as security for the loan moneys.⁹²

Secondly, it might be that there is only an informally created mortgage: that is, a mortgage which does not comply with the formalities set out in ss 85 and 86 of the LPA 1925 for the creation of a mortgage which constitutes a legal interest in land. Suppose, for example, that mortgagor and mortgagee had entered into a contract that a legal mortgage would be entered into in compliance with s 85 of the LPA 1925. In applying the equitable principle that equity looks upon as done that which ought to have been done, the contract is deemed to grant rights in specific performance to the contracting parties and therefore to create a mortgage in equity in line with the doctrine in *Walsh v Lonsdale*.⁹³ It was required that the money should have been advanced before such a contract would become specifically enforceable as a contract and not merely remediable by payment of damages.⁹⁴

Thirdly, the charge might be created as merely an equitable charge. This might be created, for example, in circumstances in which property is charged by way of an equitable obligation to pay money. Such a charge arises on the cases only in situations in which the charge so created exists to effect discharge of a debt.⁹⁵ The effect of this form of mortgage would be that the court would decree a sale of the property if the moneys were not repaid.⁹⁶

Fourth is the long-standing doctrine of equitable mortgage by way of deposit of title deeds.⁹⁷ Under that doctrine, the deposit of title deeds over property by the mortgagor

92 *Rust v Goodale* [1957] Ch 33.

93 (1882) 21 Ch D 9.

94 *Sichel v Mosenthal* (1862) 30 Beav 371.

95 *London County and Westminster Bank v Tomkins* [1918] 1 KB 515.

96 *Matthews v Gooday* (1816) 31 LJ Ch 282.

97 *Tebb v Hodge* (1869) LR 5 CP 73; *Russel v Russel* (1783) 1 Bro CC 269.

with a mortgagee was, of itself, taken to create an equitable mortgage by dint of being an act of partial performance of that mortgage under s 40 of the LPA 1925 – as considered below.

Further to the enactment of s 2 of the Law of Property (Miscellaneous Provisions) Act 1989, in circumstances in which the parties seek to assert the creation of a contract after 26 September 1989, all of the terms of that contract must be contained in one document signed by the parties before it will be valid. This has the effect of preventing the operation of the old doctrine of part performance under s 40 of the LPA 1925, under which the parties would have been able to contend that an act of partial creation of a mortgage or a memorandum evidencing such creation had the effect of forming an equitable mortgage.⁹⁸ In relation to contracts created after 1989 there is now no possibility of any reliance on part performance. For the doctrine in *Walsh v Lonsdale*⁹⁹ to operate it would also be necessary that the formal requirements set out in s 2 of the 1989 Act had been complied with. This matter is illustrated by *United Bank of Kuwait v Sahib*,¹⁰⁰ which requires that for an equitable mortgage to take effect by deposit of title deeds, the requirements contained in s 2 of the 1989 Act would have to be complied with first.

However, equity will not take such legislative interference lying down. While the 1989 Act has generated new formal requirements for the creation of a contract to transfer an interest in land, the doctrine of proprietary estoppel continues to provide that where an assurance has been made by one party to another and that other party acts to their detriment in reliance on that assurance, then proprietary estoppel gives the court the discretion to award that right to avoid detriment being suffered by the claimant: as considered in Chapter 13. The case of *Yaxley v Gotts*¹⁰¹ has seen the courts uphold a doctrine similar in effect to the old doctrine of part performance by holding that, despite the enactment of s 2 of the 1989 Act, the court will award the property rights sought in order to avoid detriment being suffered by the claimant. In consequence, an equitable mortgage could be effected still if one party could demonstrate that the other party to the putative mortgage had induced that party to suffer some detriment in reliance on the creation of that mortgage. To return to a core discussion of the nature of equity, the question must be asked whether this continued determination of equity to enforce its core doctrines, a little like a stubborn weed continuing to grow through the cracks in the pavement, is a valuable protection of the rights of citizens or a dangerous challenge to the supremacy of Parliament in enacting legislation which sets out formal requirements for the transfer of property rights.

23.5.2 Equitable charges

In defining an equitable charge, in contrast with legal charges and mortgages, the following statement is important:

⁹⁸ *Re Leathes* (1833) 3 Deac & Ch 112.

⁹⁹ (1882) 21 Ch D 9.

¹⁰⁰ [1997] Ch 107.

¹⁰¹ [2000] 1 All ER 711.

An equitable charge may, it is said, take the form either of an equitable mortgage or of an equitable charge not by way of mortgage. An equitable mortgage is created when the legal owner of the property constituting the security enters into some instrument or does some act which, though insufficient to confer a legal estate or title in the subject matter upon the mortgagee, nevertheless demonstrates a binding intention to create a security in favour of the mortgagee, or in other words evidences a contract to do so . . . An equitable charge which is not an equitable mortgage is said to be created when property is expressly or constructively made liable, or specially 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.¹⁰²

An equitable charge, then, grants the secured party some right by virtue of the parties' contract to sell the assets provided by way of security,¹⁰³ whether that property is held at the time of the creation of charge or is only capable of first coming into existence once the specific property comes into the hands of the chargor.¹⁰⁴ The key to that charge being an equitable charge is that it is specifically enforceable by virtue of the contract: it is therefore the equitable remedy of specific performance which gives rise to the right as an equitable right.¹⁰⁵ A floating charge is an example of an equitable charge, arising as it does in equity rather than at common law. The existence of such a charge may be deduced from the circumstances, provided that the property to be subject to the charge, where it is a fixed charge, is sufficiently ascertainable.¹⁰⁶

23.6 THE MORTGAGEE'S POWER OF REPOSSESSION

23.6.1 Introduction

It is a remarkable feature of the law of mortgages that the mortgagee has a right to repossession of the mortgaged property even before the ink is dry on the contract, to borrow a colourful phrase from the cases.¹⁰⁷ A right to repossession entitles the mortgagee to vacant possession of the property either to generate income from that property (perhaps by leasing it out to third parties), or as a precursor to exerting its power of sale over the property (as considered at section 23.7 below).

The rationale for the rule in *Four Maids* operates as follows. The mortgagee has a legal estate in the property¹⁰⁸ from the date of the mortgage and can enter into possession as soon as the ink is dry, unless there is an express contractual term to the contrary.¹⁰⁹ Usually building society mortgages exclude the right to possession until there

102 *Swiss Bank Corp v Lloyds Bank* [1982] AC 584, 594, *per* Buckley LJ.

103 *Rodick v Gandell* (1852) 1 De GM & G 763; *Palmer v Carey* [1926] AC 703.

104 In which case there will be no such right until the property is taken legally into possession by the chargor: *Holroyd v Marshall* (1862) 10 HL Cas 191; *National Provincial Bank v Charnley* [1924] 1 KB 431.

105 *Walsh v Lonsdale* (1882) 21 Ch D 9.

106 *In Re Nanwa Gold Mines Ltd* [1955] 1 WLR 1080. Cf *Moseley v Cressey's Co* (1865) LR 1 Eq 405.

107 *Four Maids Ltd v Dudley Marshall Ltd* [1957] Ch 317.

108 In line with the LPA 1925, s 1(2)(c) if the mortgage complies with s 85 or s 86 of that Act.

109 *Four Maids Ltd v Dudley Marshall Ltd* [1957] Ch 317.

has been some default by the mortgagor. Exceptionally, where the circumstances permit an inference of an implied term to that effect there will not be any such order.¹¹⁰ although in general terms the rights of the mortgagee are enforced by the courts.¹¹¹ So, in *Western Bank*, the mortgagee was held entitled to repossession despite an express term in the mortgage contract that there would be no repayment required on an endowment mortgage within the first 10 years of the life of the mortgage. In *National Westminster Bank v Skelton*,¹¹² this sentiment was expressed so that the mortgagee always has an unqualified right to possession except where there is a contractual or statutory rule to the contrary.

23.6.2 Stay of the power of repossession

Statute, however, does provide the court with a discretionary power to delay (or stay) the operation of such a right of possession where the court considers that the mortgagor would be able to make repayments within a reasonable time. So, under s 36 of the Administration of Justice Act 1970, there is a general power in the court to adjourn or suspend an order where the mortgagor is likely to be able to make good arrears due under the mortgage contract within a 'reasonable time'. Further, under s 8 of the Administration of Justice Act 1973, where it is provided in a mortgage contract that a mortgagor shall repay the principal in the event of default, the court may ignore a provision for such early payment. In practice this means that the mortgagor is required to present himself or herself at court and demonstrate to the court that, on the grounds that he or she is likely to find work at some point in the future, or otherwise be able to find the money to effect repayment, it would not be just to allow the mortgagee to effect repossession over the property.

The question is then as to what is meant by the 'reasonable time' within which the mortgagor must be able to effect repayment. *Cheltenham & Gloucester Building Society v Norgan*¹¹³ considered the meaning of the vexed expression 'reasonable period' in the context of repossession of mortgaged property, for the purposes of s 36 of the Administration of Justice Act 1970 and s 8 of the Administration of Justice Act 1973. Section 36 allows a court to adjourn, stay or postpone a mortgagee's action for possession where it appears that the mortgagor will, within a reasonable period, be able to pay any sums due under the mortgage. Section 8 of the 1973 Act provides that, in the case of mortgages where repayment of the principal sum is by instalments or is deferred, a court shall not exercise its powers under s 36 unless it appears the mortgagor will be able to pay any amounts of outstanding principal and interest within a reasonable period, and be able to meet future payments under the mortgage at the end of that period.

Christina Norgan, the appellant, had lived in a farmhouse with her husband and five children for 20 years. She and her husband had the house transferred into her sole name in return for raising a mortgage to finance her husband's business. The mortgage

110 *Esso v Alstonbridge Properties* [1975] 1 WLR 1474.

111 *Western Bank v Schindler* [1977] Ch 1.

112 [1993] 1 All ER 242.

113 [1996] 1 All ER 449.

provided for the capital sum to be paid at redemption with monthly payments of interest. The mortgage provided that the mortgagee could repossess the property where it fell one month into arrears. Mr Norgan's business fell into trouble. Christina Norgan could not maintain the repayments. The mortgagee sought to repossess the property.

In *Norgan*, the judge at first instance had adopted a period for repayment of four years in exercising his discretion under s 36 of the 1970 Act. Christina Norgan appealed on the basis that the judge had erred in his choice of reasonable period. The Court of Appeal overturned this decision on the basis that the period of four years was unrelated to the mortgage term of 13 years.

The core of the Court of Appeal's decision was that a trial court should take into account the whole of the remaining period of the mortgage in deciding on a 'reasonable period'. Consequently, the common practice of setting a period less than the full term of the mortgage (typically of one or two years) ought to be discontinued. Where the family home is the primary issue in litigation between mortgagee and mortgagor, there are, in this writer's opinion, a number of issues which require to be placed centrally. First, the point at which the mortgagee is entitled to repossession must be made clear. Secondly, private mortgagor-occupiers must not have their homes repossessed except *in extremis*. Thirdly, litigation must be resolved without undue cost and delay.

As set out above, the judge at first instance in *Norgan* had adopted a period for repayment of four years in exercising his discretion under s 36 of the 1970 Act. The Court of Appeal overturned this decision on the basis that the period of four years was unrelated to the mortgage term of 13 years.¹¹⁴

The Court of Appeal was faced with two competing interpretations of 'reasonable period'. The first derived from *First Middlesbrough Trading and Mortgage Co Ltd v Cunningham*.¹¹⁵ This interpretation reads 'sums due' as being the whole of the outstanding amount of the mortgage debt. Thus, a reasonable period in relation to the sums due would be the remaining time to expiry of the mortgage.

The second interpretation is derived from *Western Bank Ltd v Schindler*,¹¹⁶ where the mortgagee was seeking repossession as of right, not because there were any arrears. In the famous phrase used by the Court of Appeal, the mortgagee was seeking to recover possession under the mortgage 'as soon as the ink was dry' on the contract. This interpretation revolved around a reasonable period of time to 'find the necessary money or remedy the default' – which need not necessarily bear any relation to the time to expiry of the mortgage. The 'ink is dry' argument means that repossession would be available immediately and that a reasonable period may be without reference to the remaining period of the mortgage.

The approach set out in *First Middlesbrough* is more in tune with the importance of keeping the owner of property in occupation, as set out above. Where the occupier is

114 It is to be remembered that the mortgagor may want a sale of the property to terminate the obligations owed to the mortgagee. In this context the decision in *National & Provincial Building Society v Lloyd* [1996] 1 All ER 630, which followed the policy set out in *Krausz* below, established that a sale need not take place immediately. In deciding whether a reasonable period required that a sale take place straight away, the court held that it was perfectly possible for a sale to take a year or more without being unreasonable.

115 (1974) 28 P & CR 69.

116 [1977] Ch 1.

given the remainder of the life of the mortgage to make good any payments, that enables the occupier to remain in occupation of that property. To support his decision, Waite LJ referred back to the judgment of Buckley LJ in *Schindler*, where his Lordship had held that ‘the specified period might even be the whole remaining prospective life of the mortgage’. This latter approach complies more closely with the earlier assertion that the law should emphasise the occupier remaining in occupation. While *Schindler* generally takes the view that there is a right to recovery from the moment the ink is dry, there is support for the Court of Appeal’s preference in *Norgan* that the term ‘reasonable period’ should take into account the remaining time left to run on the mortgage.¹¹⁷ More generally, in his Lordship’s opinion, it is not possible in logic to fix a period without reference to the original term of the mortgage. If you are to decide what constitutes a reasonable period, that must be a period which is reasonable ‘by reference to something else’. Therefore, Evans LJ agreed with Scarman LJ in *First Middlesbrough* that there is an assumption that the remainder of the mortgage term is the appropriate reasonable period.

It is suggested that the approach adopted in the *First Middlesbrough* appeal is preferable in principle. As a matter of commercial fact, the lender’s risk management systems will have given a weighting to a term mortgage which takes into account the suitability of the security until the end of the mortgage term. The mortgagee is in no worse position where it retains the same security and has payments in arrears made good to it over the remaining life of the mortgage. As to the effect of movements in the property market, the commercial lender lives and breathes by exactly those calculations in any event.

This short section sets out the discretionary powers of the court under statute and, again, the increasing preparedness of the courts to have recourse to some extra-statutory principle of fairness in the interpretation of mortgage agreements. This discussion serves as a platform for the analysis to follow as to the mortgagee’s power to sell the property and the difficult question as to whether or not the mortgagee will be subject to the duties of a fiduciary in so doing.

23.7 THE MORTGAGEE’S POWER OF SALE

23.7.1 Introduction

The mortgagee acquires statutorily provided powers of sale over the mortgaged property by one of two routes. The first is the specific power of sale set out under s 101 of the LPA 1925 on the following terms:

- (1) A mortgagee . . . shall . . . have the following powers: (i) A power, when the mortgage money has become due, to sell, or to concur with any other person in

117 The issue arose as to whether there ought to be a distinction in principle between the rules relating to term mortgages (where only interest and not the capital sum was due to be repaid during the life of the mortgage) and those for repayment mortgages (where amounts of capital are repaid during the life of the mortgage). As Evans LJ found (at 461), ‘Because this is a term mortgage rather than a repayment mortgage, it is axiomatic that, acceleration provisions apart, the lender has budgeted for the principal sum to remain outstanding until the expiry of the term.’ Therefore, the impact on the lender is altered given the particular risk profile assigned to term mortgages.

selling, the mortgaged property, or any part thereof . . . (ii) A power, when the mortgage money has become due, to appoint a receiver of the income of the mortgaged property or any part thereof.

That power is subject to the provisions of s 103, which require the mortgagee to have given notice of arrears, that arrears have continued for two months, or that there has been a breach of some other provision in the mortgage contract.

The second means of sale is provided by s 91(1) of the LPA 1925, by which '[a]ny person entitled to redeem mortgaged property may have a judgment or order for sale instead . . .'. In short, any person entitled to redemption may apply to the court for the property to be sold – as considered in detail below. In considering s 91 of the 1925 Act, it will emerge that the courts have been active in extending the powers of mortgagees to make their own decisions about whether or not to sell the property immediately after repossession. It is clearly in the interest of the mortgagor to sell a property in a falling housing market, or in situations in which the outstanding mortgage debt will continue to rise as a result of the mortgagee's decision not to sell the property immediately. Therefore, s 91 has generally been used as a defence by the mortgagor. The Court of Appeal has accepted that it is the mortgagee who is entitled to retain control over the business of dealing with the property after repossession.¹¹⁸ This emerges most clearly from the decisions of Phillips and Millett LJ in *Cheltenham & Gloucester Building Society v Krausz*.¹¹⁹ The important subsidiary question is then the extent to which the mortgagee is required to act as a trustee or fiduciary generally in relation to those powers.

23.7.2 Trustee of the sale proceeds

A clear distinction needs to be drawn between the obligations of the mortgagee as trustee *before* a sale is effected and the obligations of the mortgagee as trustee *after* a sale has been effected. As is considered in the next section, the trustee owes no fiduciary obligations to the mortgagor in the manner in which the sale is conducted. However, once the sale proceeds are received by the mortgagee in managing the sale, the trustee does owe such duties on the following terms. Under s 105 of the LPA 1925, in relation to the application of proceeds of sale:

The money which is received by the mortgagee, arising from the sale after discharge of prior incumbrances to which the sale is not made subject, if any, or after payment into court under this Act of a sum to meet any prior incumbrance, shall be held by him in trust to be applied by him, first in payment incurred by him as incident to the sale or any attempted sale, or otherwise; and, secondly, in discharge of the mortgage money, interest, and costs, and other money, if any, due under the mortgage; and the residue of the money so received shall be paid to the person entitled to the mortgaged property, or authorised to give receipts for the proceeds of the sale thereof.

¹¹⁸ *Cheltenham & Gloucester Building Society v Krausz* [1997] 1 All ER 21.

¹¹⁹ *Ibid.*

Therefore, the mortgagee is a trustee only once it has received the sale proceeds.

23.7.3 No trust over the power of sale

That the mortgagee is not a trustee of the manner in which the sale is conducted is illustrated by *Cuckmere Brick v Mutual Finance Ltd*.¹²⁰ In that case a mortgagee exercised its right of sale. The sale was advertised such that the land carried planning permission to build 33 houses, which gave a value of £44,000 for the land. In fact, the land carried planning permission to build 100 flats, for which the estimated price was put at £65,000. The issue was whether the mortgagees were trustees of the manner in which they exercised the power of sale. Such an obligation would have required the mortgagees to obtain the best possible price for the mortgagor, as considered in Chapter 9. It was held by Salmon LJ that the mortgagee is not trustee of the power of sale. The mortgagee has power to sell whenever it wants at the highest price offered, rather than the highest price which could possibly be obtained. The only exception would be where the failure to obtain a higher price is the result of the mortgagee's own negligence. The obligation is to obtain the 'true market value' of the property on the date on which he sells it.

This principle was expressed in *China and South Sea Bank Ltd v Tan Soon Gin*¹²¹ to the effect that it is for the mortgagee to decide when the sale takes place. In that case it was alleged that the mortgagee's delay had caused the price obtained to be less than would otherwise be the case. The court held that the mortgagee was not obliged to sell at any particular time but was entitled to act in its own interest. This is the clearest indication that this line of cases does not consider the mortgagee to be a fiduciary. Similarly, in *Parker-Tweedale v Dunbar Bank plc*,¹²² it was held that the mortgagee owed no independent duty of care to a person for whom the property had been held on the terms of an express trust. Rather, the mortgagee and mortgagor occupy only a relationship of debtor and creditor.¹²³

It would only be in circumstances in which the mortgagee could be demonstrated to have acted in bad faith that any fiduciary liability would attach to the mortgagee. In *Tse Kwong Lam v Wong Chit Sen*,¹²⁴ the mortgagee sold the property at an auction at which the mortgagee's wife was the only bidder. The property was sold for less than the reserve price fixed by the mortgagee. It was held that the mortgagee is required to act as though a 'prudent vendor' and must be able to demonstrate that the sale was in good faith. As such, the mortgagee must show that it took precautions to ensure that the best price was obtained and that it had 'in all respects acted fairly to the borrower'. On these facts, that had not been the case.

The following section considers whether or not the mortgagor has any power to control a sale which is held ostensibly in good faith.

120 [1971] Ch 949.

121 [1990] 2 WLR 56; *AB Finance Ltd v Debtors* [1998] 2 All ER 929.

122 [1991] Ch 12. See also *Corbett v Halifax plc* [2003] 4 All ER 180.

123 *Halifax BS v Thomas* [1995] 4 All ER 673.

124 [1983] 3 All ER 54, PC.

23.7.4 Mortgagor power to control the terms of sale

On the cases, it has been held that the mortgagor has a right to fair treatment on the part of the mortgagee in relation to the decision to sell, but no right to control the terms on which the sale of the mortgaged property is effected. This fine distinction emerges in the wake of the Court of Appeal's decision in *Cheltenham & Gloucester Building Society v Krausz*¹²⁵ which limited the previous judgment of Nicholls VC in *Palk v Mortgage Services Funding plc*.¹²⁶ It would be most useful to begin with the case of *Palk*.

In *Palk* there were mortgagors who fell into arrears in the repayment of their mortgage and arranged the private sale of the mortgaged property for £283,000. At that time, the amount needed to redeem the mortgage was the much larger sum of £358,000. The mortgagee refused to consent to a sale on these terms, preferring to let the property to third parties (so as to generate some income to meet repayments of income) until the housing market improved and the property could be sold at a price which would redeem the full mortgage amount. It was found as a fact that to apply the mortgagee's scheme would result in the mortgagors' debt increasing by £30,000 per annum. The mortgagors sought an order from the court under s 91 of the LPA 1925 to sell the property immediately.

It was held by Nicholls VC that 'there is a legal framework which imposes constraints of fairness on a mortgagee who is exercising his remedies over his security'. In a very significant statement of principle, his Lordship held that the mortgagee's duties have become 'analogous to a fiduciary duty' when considering the power of sale. The result of such a finding would be to alter significantly the quality of the duty owed by the mortgagee to the mortgagor. A fiduciary, as considered in Chapter 14 on the nature of fiduciary duties, would be required to act entirely in the best interests of the mortgagor. Therefore, the mortgagee would be required to act so as to reduce the losses which might be suffered by the mortgagor and also to refrain from making any unauthorised profit from the transaction.

As a consequence, it was held that the sale should be ordered even though it would cause some loss to the mortgagee if the property were sold immediately. It was further held that to do otherwise would prejudice the rights of the mortgagor as a borrower because, in the circumstances, the mortgagor would be forced into the position of a speculator on the price in the housing market while waiting for the price to reach a level capable of discharging the mortgage. It would have been oppressive to expose the mortgagor to such an unattractive, open-ended risk. In consequence, the sale was ordered to protect the mortgagor from the rising debt burden.

The Court of Appeal was furnished with the opportunity to review this decision in the case of *Cheltenham & Gloucester Building Society v Krausz*.¹²⁷ There the mortgagor had borrowed £58,300 secured by way of a mortgage. There was a default in the repayment of the mortgage in July 1991, shortly after which the mortgagor arranged a private sale for £65,000. The mortgagee refused to consent to the sale on the basis that that amount would not have redeemed the mortgage at that time and on the basis that it

125 [1997] 1 All ER 21.

126 [1993] 2 WLR 415.

127 [1997] 1 All ER 21.

considered that the property could be sold for an amount closer to £90,000. By June 1995, the total debt had risen to £83,000. The mortgagor sought an order for sale under s 91 of the LPA 1925, relying on *Palk* to the effect that the mortgagee's intransigence was oppressive of the mortgagor. It was held that such a sale can be ordered where the sale price would be sufficient to discharge the mortgage debt. Significantly, it was held that the rights of the mortgagee were paramount. Phillips LJ held that *Palk* was distinguishable on the basis that it related only to the decision whether or not there should be a sale and not to the terms on which such a sale should take place. More generally Millett LJ held that the decision in *Palk* should not be taken to permit the mortgagor to control the sale: control of the sale remained with the mortgagee provided that it was taking 'active steps' in relation to its powers. Noticeably, in that case, 'active steps' appeared to include a period of four years in which no sale was effected.

The result is that *Palk* is re-interpreted as a case which bears on the conscionability of the mortgagee's treatment of the power of sale. Theoretically, that could apply where the mortgagee decides to refrain from sale because the housing market is depressed, or otherwise. The core question is whether or not the mortgagee's behaviour is oppressive of the mortgagor. Nevertheless, the decision as to the conduct of sale or possession remains within the control of the mortgagee.

23.7.5 Equitable relief from sale

There is one exceptional decision of Lord Denning which asserted a general discretion for equity to refuse to order a sale in favour of a mortgagee if that sale was not being sought so as to enforce or protect the mortgagee's security. So, in *Quennell v Maltby*,¹²⁸ a mortgagor had a house worth £30,000 over which was secured a mortgage of £2,500. The mortgage deed prohibited any letting of the premises but the mortgagor let the premises in contravention of that provision. The result was that the sub-tenant acquired Rent Act protection. Subsequently, the mortgagor sought to sell the property with vacant possession, but could not do so because the sub-tenant continued to rely on its rights under the Rent Act. Therefore, the mortgagor's wife took an assignment of the rights of the mortgagee from the original mortgagee. By this scheme the mortgagor and his wife intended to exercise the mortgagee's right to possession over the property so that he could sell with vacant possession.

It was held that, in general terms, the court was required to look to the justice of the case. Equity would not interfere with the legal rights of the parties but would prevent the mortgagee from exercising its rights to repossession or sale where it would be unconscionable to do so. Rather, a court of equity would only make an order for repossession or sale in circumstances in which the order was sought for *bona fide* protection of the mortgagee's security. As such the order would only be made on conditions which the court thinks it reasonable to impose.

What is clear from all these cases on mortgages is that there is a dialectic at work between the court's desire to achieve fairness between the parties by avoiding unconscionable transactions and the court's desire to protect the rights of the mortgagee

and so maintain a fluid housing market. In essence that is the core nature of equity: to seek to do justice between the parties but always with an eye to the broader context.

23.8 SETTING ASIDE MORTGAGES IN EQUITY

The other mechanism by which occupiers of property have been able to resist the power of sale is by demonstrating that the mortgage was obtained as a result of some undue influence.¹²⁹ This case law is considered in detail in Chapter 29.

¹²⁹ *National Westminster Bank v Morgan* [1985] AC 686; *Barclays Bank v O'Brien* [1994] 1 AC 180.