

SUMMARY

1. In 2002, the Department of Trade and Industry asked the Law Commission to consider the case for reforming the law on company charges. This followed a recommendation in the Final Report of the Company Law Review Steering Group. The Group reported that it had received substantial criticism of the current system for registering charges and for deciding priority between them. Radical reform was needed but it had not had time to consult on detailed proposals.
2. We published a consultation paper (CP No 164) in 2002, and a more detailed consultative report (CP No 176) in 2004. These are available on our website: www.lawcom.gov.uk.
3. Here we summarise our main proposals. A fuller summary is available in Part 1 of the report, paragraphs 1.27 – 1.44. Part 1 also provides cross-references to the paragraphs of the report where the issues are discussed in detail.

A NEW SYSTEM OF ELECTRONIC NOTICE FILING

4. The current system of registering charges is unduly cumbersome, slow and expensive. It involves the submission of paper documents, although the register itself is electronic. It requires Companies House staff to check through lengthy legal documents and to issue a conclusive certificate of registration.
5. Under the new scheme we recommend:
 - ◆ Electronic filing will replace the current paper-based system.
 - ◆ To register a charge, it will be necessary only to send brief particulars of the charge in a simple, electronic format. The original charge document will not be sent.
 - ◆ The Registrar of Companies will no longer be responsible for checking the particulars that have been filed and will not issue a conclusive certificate. It will be up to the party who files (normally the lender) to ensure that the financing statement identifies the correct company as debtor and that the description is adequate to cover the property subject to the charge. Provided the financing statement does identify the correct company, the charge will be validly registered in respect of the property listed in the particulars.
 - ◆ The property may be described in general terms, but there will be a facility for parties who wish the description to cover precisely what is in the charge agreement to include the exact terms of the agreement.
 - ◆ Formal responsibility for registration, and the rarely-applied criminal liability for failure to register, will be removed from the company. It will be up to the lender taking the charge to file if it wishes to protect its security. If the company becomes insolvent before the charge is registered, the charge will not be effective against the administrator or liquidator. Unregistered charges will also be vulnerable to loss of priority.

REMOVING THE 21 DAY TIME LIMIT

6. Under current law, unless a registrable charge is registered within 21 days, it is void against a liquidator or administrator. This causes inconvenience: each year, Companies House rejects around 3,000 late applications. Lenders must either re-execute the paperwork or apply to the court to register out of time. If a charge is registered within the 21-day period, its priority depends on when it was created, not when it was registered. A charge-holder that registers first could find itself subject to a charge created up to three weeks earlier that it knew nothing about.
7. Under the new scheme:
 - ◆ The formal time limit for registration (and the need for court applications for late registration) will be removed.
 - ◆ There will be no period of 'invisibility' between submission of the particulars and their appearance on the register. It will be possible to search quickly and reliably on-line.
 - ◆ Lenders may file in advance of the transaction. They may therefore protect their position during negotiations. Similarly, a single filing may cover a number of similar transactions between the same parties, removing the need for multiple filings.

EXTENDING THE LIST OF REGISTRABLE CHARGES

8. The list of charges that need to be registered is out-of-date. The Companies Act 1985 omits some charges which are often used. There is also uncertainty about what should be registered and what should not.
9. Under the new scheme:
 - ◆ All charges are registrable unless specifically exempted.
 - ◆ The principal exemptions will be for some charges over registered land and over financial collateral: see below.

CLEARER PRIORITY RULES

10. The Companies Act 1985 does not lay down clear rules about what happens when two or more creditors have registered charges over the same property. Priority depends on complex common law rules that are not suited to modern financing methods. Priority between a secured lender and someone who buys property that is subject to a charge is also unclear.
11. Under the new scheme:
 - ◆ Priority between competing charges will be by date of filing (unless otherwise agreed between the parties involved). This will simplify the current law and will remove the current '21-day period of invisibility'.
 - ◆ The distinction between fixed and floating charges will be preserved, principally because of its importance in insolvency.

- ◆ In the case of a floating charge, it will be unnecessary to rely on a 'negative pledge clause' to prevent subsequent charges gaining priority. It will also be unnecessary to employ 'automatic crystallisation clauses', with their uncertain effects, to protect property subject to a floating charge from seizure by judgment creditors.
- ◆ The effect of registration on the rights of a person who buys the property without knowing of the charge will be clarified. If the charge is fixed but has not been registered, it will not affect a buyer who does not know of it; if the fixed charge has been registered it will be binding on the buyer.
- ◆ Some charges may also be registered in specialist registers, such as those covering unregistered land, registered aircraft and ships, and intellectual property. The regulations clarify that normally any priority rules set out in the specialist legislation will apply.

LAND

12. At present, a company charge cannot be registered in the Land Registry until it has been registered with Companies House and a certificate of registration has been issued. This causes administrative problems for the Land Registry. The process is delaying the development of e-conveyancing.
13. Under the new scheme:
 - ◆ If a charge over registered land is registered in the Land Registry, it will not need to be registered in the Company Security Register as well. Instead, the Land Registry will automatically forward to Companies House its information about charges over land owned by companies. The information will be available to those searching the Company Security Register.

SALES OF RECEIVABLES

14. 'Receivables' (that is, sums owed to the company by its various debtors) are an important asset and 'receivables financing' is enormously important, especially for small and medium enterprises. At present the law distinguishes between charges over 'book debts', which require registration, and sales of book debts, for example to a factor, which do not have to be registered. The two, however, perform almost identical economic functions. The priority rules are unsuited to modern receivables financing. They mean that a receivables financier must make enquiries of the 'account debtor', and notify the debtor of the arrangement, or risk losing out to a second financier. Restrictions on the assignment of receivables frequently limit the use that companies may make of this efficient form of financing.
15. Under the new scheme:
 - ◆ Sales of receivables of the kind which factoring and discounting agreements cover will be brought within the scheme. This means that they must be registered to be valid on insolvency.
 - ◆ Their priority will be determined by the date of filing.

- ◆ Provisions in the contract generating the receivable that purport to restrict its assignment will no longer be effective against the assignee.

SCOTTISH AND OVERSEA COMPANIES

16. The current provisions requiring registration of charges created by companies registered outside Great Britain over their property in England and Wales have proved highly unsatisfactory. The principal problem is that there is great uncertainty about when a company has a place of business here, so that its charges must be registered. The result is that particulars of many charges are sent to Companies House for registration as a precaution, but the information is not placed on the register and is not available to searchers.
17. Under the new scheme:
 - ◆ Charges created by Scottish and oversea companies over their property in England and Wales will fall within the scheme. The information will be placed on the register and made available to searchers. (The provisions on sales of receivables will only apply to companies registered in England and Wales.)
 - ◆ Charges created by companies registered in England and Wales over their property in other jurisdictions will remain registrable, but without prejudice to rights acquired in those assets by the secured party or third parties according to the law of that jurisdiction.

FINANCIAL COLLATERAL

18. Those taking security over financial collateral such as investment securities and bank accounts need to do so quickly and with certainty. Purchasers of investment securities also need to have confidence that they will not be affected by prior rights over the property without having to conduct elaborate enquiries. At present there is some uncertainty about when charges over financial collateral are exempt from registration under the regulations that implement the European Directive on Financial Collateral Arrangements. There is also uncertainty over the priority rules between competing charges and between chargees and purchasers. This is a particular problem in financial markets, where it is essential that investment property is readily transferable.
19. Under the new scheme:
 - ◆ Registration will not be needed where the chargee has obtained 'possession or control' within the meaning of the Directive, or has 'control' of it as defined by the regulations we propose.
 - ◆ A chargee will have control of financial collateral if the company can no longer deal freely with the assets free of the charge.
 - ◆ The regulations set out ways in which the chargee can obtain control over particular types of financial collateral.

- ◆ A security which is perfected by control will have priority over one merely perfected by filing; priority between charges perfected by control will depend on the order in which control was obtained.
- ◆ Purchasers of securities or securities entitlements for value and without notice of existing security interests will not be affected by them.

THE BUSINESS CASE

20. There is a clear business case for reform. The move to electronic filing, and the abolition of the certificate of registration and the 21-day period for registration, will result in direct savings to lenders, companies and Companies House. The other changes will make the law more certain and reliable. Overall the cost of secured borrowing will be reduced.

FURTHER WORK

Title-retention devices

21. In our Consultative Report we proposed to include title-retention devices such as finance leases, hire purchase and conditional sale agreements within the scheme. This proved controversial. Many people thought it would be illogical to have one set of rules applying to title-retention devices entered into by companies, and another for those involving unincorporated businesses and individuals. The most important reason for requiring title-retention devices to be registered is to protect purchasers. We intend to reconsider this issue in the context of a broader project on transfer of title by non-owners.

Statement of rights and remedies

22. The Consultative Report included a draft statement setting out the rights and duties of the parties to a security agreement, particularly following default. Again this proved controversial, and we are not proceeding with it as part of this scheme. We intend to consult further to see how much support there would be for a restatement of the existing law which would clarify English law for its users and which might serve as a model for European and international harmonisation.

Charges created by unincorporated businesses and individuals

23. Our terms of reference asked us to consider whether any new scheme for company charges should be extended to unincorporated businesses and individuals. At present, charges granted by non-companies must comply with the Bills of Sale Acts 1878-1891. Our consultation paper examined these provisions and concluded that they are out-of-date, unnecessarily complicated and unduly restrict the forms of secured borrowing available to small businesses.
24. We continue to believe that there is a strong case for replacing the Bills of Sale Acts, but in the time available we have not been able to devise detailed recommendations. As far as consumers are concerned, we recommend that the Department of Trade and Industry consider the issue. For unincorporated businesses, we will return to the subject when we know whether our proposals for companies will be implemented.