



**Law
Commission**
Reforming the law

From Bills of Sale to Goods Mortgages Summary

**Law Com No 376 (Summary)
November 2017**

INTRODUCTION

- 1.1 Bills of sale are a way in which individuals can use goods they already own as security for loans while retaining possession of those goods. The use of bills of sale has grown from under 3,000 in 2001 to over 30,000 in 2016. They are mainly used for “logbook loans”, where a borrower grants security over their vehicle. The borrower may continue to use the vehicle while they keep up the repayments, but if they default the vehicle can be repossessed, without the protections that apply to hire-purchase transactions.
- 1.2 Bills of sale are currently governed by two Victorian statutes, the Bills of Sale Acts 1878 and 1882. This legislation is archaic and wholly unsuited to the 21st century. The Law Commission recommends that these Acts should be repealed and replaced by a new “Goods Mortgages Act” to govern the way that individuals can use their existing goods as security.
- 1.3 The Law Commission has published a draft Goods Mortgages Bill designed to:
 - (1) protect borrowers, so that goods cannot be repossessed too readily;
 - (2) protect innocent purchasers who buy goods without realising that they are subject to a security interest;
 - (3) save costs caused by unnecessarily complex registration requirements; and
 - (4) remove unnecessary restrictions on secured lending to more sophisticated borrowers, such as high net worth individuals and unincorporated businesses.

History of the project

- 1.4 In September 2014, HM Treasury asked the Law Commission to review the bills of sale legislation and to make recommendations for its reform. We published a consultation paper in July 2015, and a report in September 2016 .
- 1.5 In February 2017, the Government asked the Law Commission to draft legislation to implement our recommendations. We consulted on initial clauses in July 2017 and published an updated version of the draft Bill in September 2017.
- 1.6 This is a summary of a more comprehensive final report which explains our updated recommendations and draft Bill.¹
- 1.7 We have also published a background paper discussing registration of security interests in other systems and in other jurisdictions.²

¹ From bills of sale to goods mortgages: Final report and draft Bill (2017) Law Com No 376, available at <https://www.lawcom.gov.uk/project/bills-of-sale/>.

² Law Commission, Registering a Goods Mortgage: Lessons from Other Systems (2017), available at <https://www.lawcom.gov.uk/project/bills-of-sale/>.

THE NEED FOR REFORM

- 1.8 Lenders and consumer groups alike agree that the law is in urgent need of reform. The current law creates hardship for borrowers and private purchasers, imposes unnecessary burdens on lenders and restricts access to finance for unincorporated businesses and high net worth individuals.

Hardship for borrowers

- 1.9 The great majority of bills of sale are issued for logbook loans, often taken out by borrowers who have difficulty accessing other forms of credit. These borrowers are particularly vulnerable to inadequacies in the existing law.

Confusing paperwork

- 1.10 Research has found that many borrowers do not “really think” about the implications of a logbook loan.³ The statutory form for a bill of sale, set out in the 1882 Act, confuses borrowers rather than helps them to understand the consequences of taking out a loan.

Lack of protection against repossession

- 1.11 The Bills of Sale Acts provide only minimal protection to borrowers against their goods being repossessed if they default on a loan. This contrasts with hire-purchase law. Here, once the hirer has paid one-third of the total hire-purchase price, the lender must seek a court order before repossessing the goods. The court may require an alternative repayment plan or suspend an order while the hirer makes payments.
- 1.12 Under Financial Conduct Authority rules, logbook lenders must have policies to deal with default. The lenders we spoke to emphasised that they would prefer to agree alternative repayment plans, and would only consider repossession as a last resort. However, lenders differ in their approach to repossession. There are complaints that some lenders use the threat of repossession to demand unreasonable and unaffordable sums. In some cases, lenders may repossess vehicles from those in temporary financial difficulties, even if the loan has been substantially paid off and the borrower is making efforts to meet the outstanding payments.

Voluntary termination

- 1.13 Borrowers who find themselves with loans they cannot repay need a clear way of extricating themselves from the situation. Logbook lenders who are members of the Consumer Credit Trade Association subscribe to a code of practice, which gives consumers the right of “voluntary termination”. Borrowers may surrender their vehicle to the lender in full and final settlement of the loan and arrears and walk away from the debt.
- 1.14 However, this is not a statutory right and is not the policy of all lenders.

Hardship for innocent private purchasers

- 1.15 The current law offers no protection to a private purchaser who buys goods which are subject to a bill of sale, even if they act in good faith and without knowledge of the

³ Financial Conduct Authority, *Consumer Credit Research: Payday Loans, Logbook Loans and Debt Management Services* (2014), p 27.

security. Those who buy a second-hand car without realising that it is subject to a bill of sale face an unpalatable choice: pay off someone else's loan, or risk losing the car.

- 1.16 Although the issue appears to be small in volume, some purchasers suffer serious hardship. The issue also generates bad publicity for logbook lenders, bringing the industry into disrepute.
- 1.17 Hire-purchase law provides private purchasers with more protection. A private purchaser who buys a vehicle in good faith without notice of the hire-purchase agreement becomes the owner of the vehicle and takes free of the hire-purchase agreement.

Burdens on lenders

Expensive and cumbersome registration

- 1.18 The Bills of Sale Acts impose unnecessary costs on lenders. All bills of sale must be registered with the High Court, which uses an antiquated, paper-based system. Registration is expensive and lenders complain that the system is cumbersome to operate.
- 1.19 The register is so difficult to search that it is almost never used for checking whether a bill of sale exists over an asset. Instead, logbook lenders routinely register with commercially-run asset finance registries on a voluntary basis. In practice, trade buyers use these registers to find out about vehicle finance arrangements, including bills of sale. However, the price of searching these private registers may deter private purchasers.

Unnecessary document requirements

- 1.20 Where bills of sale are granted as security for a loan, the Bills of Sale Act 1882 requires that the bills of sale document complies with a complex standard form with 12 separate requirements.
- 1.21 Failure to comply with any of the document requirements carries a heavy sanction. Lenders not only lose any rights over the goods, but also lose the right to recover the loan amount owed to them. Given this sanction, lenders are understandably reluctant to change the standard form to make it more accessible for borrowers.

Access to finance for small businesses

- 1.22 There have been many complaints that the technicality of the Bills of Sale Acts restricts the ability of unincorporated businesses to access finance. One technicality, for example, is that bills of sale can only be used for fixed loans, and not for guarantees or revolving credit.
- 1.23 At present, bills of sale are hardly ever used for arrangements that are not loans over vehicles. However, consultees suggested that, with appropriate reform, this could change. Some pointed to a strong demand for art lending, where it would be desirable to allow high net worth individuals to secure loans and guarantees against art works.
- 1.24 Under the current law, some invoice-finance arrangements used by businesses (known as general assignments of book debts) must be registered "as if" they were bills of sale. If not registered, the assignment is invalid on the borrower's bankruptcy. This registration procedure is so complex and expensive that few lenders go through the process.

Instead, lenders structure arrangements in other ways – or, in some cases, take their chances on bankruptcy.

1.25 For more details of these issues, see Chapter 2 of the report.

KEY POINTS IN THE DRAFT BILL

1.26 In this section, we highlight some of the key provisions of the draft Bill. We also provide references to the final report, which provides more detail.

Scope

1.27 The draft Bill applies where an “individual” grants a “charge” over “qualifying goods” which they already own, to secure the performance of a “qualifying obligation”. This involves five concepts:

- (1) **Individual:** This is a human being, as opposed to a corporate entity such as a company. The individual may be acting as a consumer, sole trader or partner in an unincorporated partnership. The draft Bill has no effect on company charges.⁴
- (2) **Charge:** The type of security is characterised as a “charge”, in line with the law of mortgages over land, ships and aircraft. A charge is a limited security right rather than a full transfer of ownership to the lender.⁵
- (3) **Qualifying goods:** The draft Bill applies to things one can touch and move. It does not apply to land or to intangible property such as shares or intellectual property rights. Ships and aircraft are specifically excluded, because they have their own separate mortgage regimes.⁶
- (4) **Ownership:** The individual must be the legal owner of the goods. At present, bills of sale cannot be granted over goods which might be acquired later, and the draft Bill maintains this prohibition for goods mortgages.⁷
- (5) **Qualifying obligation:** In the great majority of cases, a goods mortgage will secure a loan, but it could be used to secure other obligations. Following concern from stakeholders, the draft Bill excludes three obligations, where a goods mortgage might permit abuse. A goods mortgage cannot secure:⁸
 - (a) an employment obligation or one to perform services personally;
 - (b) a guarantee, unless the guarantor is a high net worth individual;
 - (c) running-account credit, such as an overdraft or credit card, unless the borrower is either a high net worth individual, or a business borrowing more

⁴ Clause 2(1) of the draft Bill, discussed from para 4.7 of the final report.

⁵ Clause 2(1) of the draft Bill, discussed from para 4.10 of the final report.

⁶ Clause 4 of the draft Bill, discussed from para 4.60 of the final report.

⁷ Clauses 2(2) and (3) of the draft Bill, discussed from para 4.22 of the final report.

⁸ Clause 6 of the draft Bill, discussed from para 4.103 of the final report.

than a certain amount (which we expect to be £25,000 as discussed below).

- 1.28 The goods mortgage regime sits alongside hire-purchase and conditional sale, which are not affected by the draft Bill. It also makes no changes to the law of pledges or liens, where the lender keeps possession of the goods during the loan period (as in pawn broking).⁹

The new label: a “goods mortgage”

- 1.29 We consulted on a variety of labels to describe this new form of security interest, and concluded that “goods mortgage” was the easiest to understand. The draft Bill therefore uses this label.¹⁰

Exempt and non-exempt mortgages

- 1.30 The draft Bill is intended to provide the legal framework for a wide range of transactions, and needs to protect more vulnerable borrowers while allowing flexibility for the others. It therefore distinguishes between borrowers who may need particular protection (“non-exempt”), and those who have more choices and are able to pay for legal advice (“exempt”).
- 1.31 The Consumer Credit Act 1974 distinguished between “regulated credit agreements” and those which are not regulated, namely:
- (1) loans of more than £25,000 taken out for business purposes; or
 - (2) loans of more than £60,260 to high net worth individuals.
- 1.32 The draft Bill follows this distinction in a simplified form. All goods mortgages are non-exempt (and subject to the full protections of the draft Bill) unless:
- (1) the “high net worth conditions” are met. We recommend that high net worth individuals are those with a net income of at least £150,000 in the past year or with assets of at least £500,000 (excluding the value of their home and pension fund). These figures will appear in regulations, rather than on the face of the draft Bill; or
 - (2) the “business credit conditions” are met. We recommend that these apply to loans which exceed £25,000 made wholly or predominantly for the purposes of the borrower’s business. Again, this threshold will be set out in regulations.
- 1.33 In either case, the borrower would also need actively to “opt out” of the protections. The goods mortgage must include a declaration to this effect.¹¹

⁹ See for example, clauses 8(4) and 8(5) of the draft Bill, discussed from para 4.123 of the final report.

¹⁰ Clause 2(4) of the draft Bill, discussed from para 4.20 of the final report.

¹¹ Clause 26 of the draft Bill, discussed from para 3.20 of the final report.

Document requirements

- 1.34 A goods mortgage is a significant transaction. It will require a written document signed by the borrower (either physically or electronically). However, the document will be simpler than a bill of sale, with fewer requirements about the content. In practice, the mortgage document will sit alongside a credit agreement, and there is no need for it to replicate the information in that document.¹²
- 1.35 All non-exempt goods mortgages will be required to include prominent warnings in a prescribed format. For mortgages on vehicles these will be along the following lines:

YOUR VEHICLE MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR LOAN

YOU MAY BE PROSECUTED FOR FRAUD IF YOU SELL THE VEHICLE OR TAKE OUT ANOTHER LOAN ON IT WITHOUT DECLARING THIS MORTGAGE

- 1.36 Adapted warnings will be required for mortgages on other goods.

Registration

- 1.37 There is an urgent need to reform the system of registration, to make it cheaper and simpler. The draft Bill provides for a new electronic register, held at the High Court, to cover goods mortgages and general assignments of book debts. The register will record the essential details of the transaction, so that anyone who searches the register can find out about a goods mortgage over specific goods or about a general assignment.¹³
- 1.38 In practice, we expect the data will be also be sold to private asset finance registers, so that they can provide their customers with a “one stop shop”. For example, this would allow a vehicle trader to find out about a goods mortgage alongside other information, such as hire-purchase finance and whether the vehicle had been stolen.
- 1.39 If a goods mortgage has not been registered, it will be invalid against a third party or a trustee in bankruptcy.¹⁴

Protection for innocent private purchasers

- 1.40 Under hire-purchase legislation, a purchaser who buys a vehicle for private purposes in good faith and without actual notice of the hire-purchase agreement becomes the owner of the vehicle. This protection does not currently apply to bills of sale, causing real hardship.
- 1.41 The draft Bill provides that private purchasers are not bound by someone else’s goods mortgage, provided that they act in good faith without actual notice of the goods

¹² Clause 5 of the draft Bill, discussed from para 5.29 of the final report.

¹³ Clause 9 of the draft Bill, discussed from para 6.12 of the final report.

¹⁴ Clauses 12 and 14 of the draft Bill, discussed from para 7.16 of the final report.

mortgage.¹⁵ This does not protect trade buyers or lenders.¹⁶ Under the draft Bill, this protection applies to all goods, not just vehicles.

A new duty on borrowers to disclose the goods mortgage

1.42 The draft Bill includes a duty on borrowers to disclose the existence of a goods mortgage if they dispose of the goods or create another mortgage over them. A borrower who dishonestly makes a gain for themselves or another, or causes a loss to the lender by selling or re-mortgaging the goods without disclosing the goods mortgage is liable to be prosecuted under the Fraud Act 2006.¹⁷

Protections on taking possession for all goods mortgages

1.43 The draft Bill provides various protections to prevent a lender from taking possession of the goods too readily. Some apply to all goods mortgages (both exempt and non-exempt), while the opt-in procedure for a court order (described below) applies only to non-exempt mortgages.

1.44 Three protections apply to all borrowers:

- (1) The lender must have grounds for possession. In most cases, the ground will be that the borrower has defaulted on the repayments. However, there are other grounds for possession, including offering the goods for sale or failing to insure them in accordance with the terms of the goods mortgage.¹⁸
- (2) The lender may not enter premises to take possession without either a court order or consent. Consent must be given by the person entitled to authorise entry to the premises.¹⁹
- (3) A lender who has taken possession of goods without a court order must wait five working days before selling the goods.²⁰ This allows the owner to apply to the court for return of the goods, either by showing that they should not have been seized or by tendering the money due. Exempt borrowers may contract out of this protection if they wish.

The “opt-in” procedure

1.45 In the case of hire-purchase agreements, the lender is required to obtain a court order before repossessing goods where the borrower has paid at least one-third of the total loan amount. For borrowers in temporary financial difficulties, the courts have extensive powers to provide more time to pay the arrears and to reduce future interest.

¹⁵ As we discuss at para 7.40 of the final report, case law has determined that “actual knowledge” includes wilful blindness.

¹⁶ Clauses 12 and 13 of the draft Bill, discussed from para 7.24 of the final report.

¹⁷ Clause 11 of the draft Bill, discussed from para 7.5 of the final report.

¹⁸ Clause 15 of the draft Bill, discussed from para 8.3 of the final report.

¹⁹ Clause 16 of the draft Bill, discussed from para 8.24 of the final report.

²⁰ Clause 18 of the draft Bill, discussed from para 8.45 of the final report.

- 1.46 There is general agreement that, where borrowers engage with the court process, a right to put their case to a court is beneficial. However, without engagement, the court process can become an expensive rubber stamp. In the absence of evidence from the borrower about their ability to pay, the court has no alternative but to grant the order. Court fees of several hundreds of pounds are added to the arrears, compounding the borrower's difficulties.
- 1.47 Under the draft Bill, non-exempt borrowers who have repaid at least one-third of the loan amount have the right to demand that the lender obtains a court order – but they must opt in to this right. The draft Bill requires lenders to serve such borrowers with a “possession notice”. This will give the borrower three options: to require the lender to seek a court order, to terminate voluntarily, or to ask for time to seek debt advice.²¹
- 1.48 The additional time to seek advice is particularly important. It is intended to encourage borrowers to obtain help from a debt adviser and resolve problems without recourse to the courts. It is also in line with the policy behind the new Pre-Action Protocol for Debt Claims, which came into effect on 1 October 2017.

Voluntary termination

- 1.49 Court hearings protect borrowers who could pay off the loan if they had additional time to do so. However, they do little to help those with no realistic prospect of repaying the loan. These borrowers need to be able to extricate themselves from the loan by handing back the goods and walking away from the agreement.
- 1.50 Under the draft Bill, non-exempt borrowers will have a new statutory right of voluntary termination. This is modelled on the existing Consumer Credit Trade Association code. The right is available from the start of the agreement but ceases when the lender has either applied for a court order or (if a court order is not needed) has incurred expenditure to repossess without a court order.
- 1.51 The lender must accept ordinary wear and tear to the goods. The borrower only loses the right to voluntary termination if the goods have been damaged deliberately, or the borrower has failed to take reasonable care of them in a way which significantly affects their market value.²²

²¹ Clauses 19 and 20 of the draft Bill, discussed from para 9.4 of the final report.

²² Clause 23 of the draft Bill, discussed from para 10.4 of the final report.