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Goods mortgages: updating consumer protection

KEY POINTS

- The Law Commission's proposals, if implemented in their entirety, would go a long way to redressing imbalances to the detriment of consumers existing under the bills of sale legislation.
- The Goods Mortgages Act may disadvantage lenders.
- Any additional costs to lenders using goods mortgages may be passed on to consumers.

In its report 'Bills of Sale' published in September 2016 (the Report), the Law Commission recommends that the Bills of Sale Act 1878 (the 1878 Act) and the Bills of Sale Act (1878) Amendment Act 1882 (the 1882 Act) be repealed, and replaced by a new Goods Mortgages Act (GMA), to apply to England and Wales but not to Scotland. The government has accepted the recommendations subject to some qualifications, so after further discussions the Law Commission is likely to introduce a draft GMA Bill into Parliament to come into force by 2019. As well as updating procedures and reducing the complexity of the archaic Victorian legislation, the proposed changes would offer greater protection to consumers. This article examines the ways in which the proposed GMA seeks to address problems under the existing bills of sale legislation for borrowers and third parties, other than trade or finance purchasers, who unknowingly buy goods which have been used to provide security for a loan (private purchasers).

BILLS OF SALE

Bills of sale are documents which transfer ownership of goods from one person (A) to another in circumstances where A retains possession of the goods. They are regulated by common law rules overlaid with statutory provisions contained in the 1878 and 1882 Acts. There are two types of bills of sale:

- security bills (also known as conditional bills), which are granted to secure the repayment of a loan; and
- absolute bills, which are granted for purposes other than to secure the repayment of a loan.

Absolute bills are rarely used, and would not be governed by the GMA. As the Report recommends deregulating them entirely, this article will not discuss them further. Security bills, however, are used in the context of logbook loans, where the loan is secured on a vehicle owned by the borrower. The number of logbook loans has increased dramatically from below 3,000 in 2001 to over 37,000 in 2015.

With certain exceptions including ships and aircraft, security bills may be registered against any tangible moveable goods, but most are registered against vehicles. A security bill transfers ownership of the borrower's goods to the lender subject to two conditions:

- the lender is only permitted to take possession of and sell the goods for one of four reasons specified in s 7 of the 1882 Act, including default by the borrower on payments under the loan agreement; and
- ownership of the goods is transferred back to the borrower once the loan has been repaid.

By allowing borrowers to retain the goods, bills of sale create the potential for lenders and purchasers to be misled by borrowers granting worthless security on goods they do not own. The 1878 Act therefore requires bills of sale to be entered on a public register held at the High Court which is searchable by lenders and prospective purchasers. The 1882 Act protects borrowers by regulating security bills.

It prescribes a standard form which must meet 12 document requirements, failure to satisfy any of which renders the security bill unenforceable by the lender against the borrower and third parties.

Borrowers who take out logbook loans are in need of protection, typically being on a low income with a poor credit history, and commonly failing to understand key terms of the agreement. Default charges, interest and the costs of the lender taking possession of and selling the vehicle can add significantly to the borrower's account, creating a shortfall between the price achieved on the sale of the vehicle and the amount outstanding under the loan. The Bills of Sale Acts fail adequately to protect borrowers and private purchasers because:

- the language used in the Acts is old-fashioned and difficult to understand;
- although the prescribed standard form for security bills is complex and parts of it are duplicated on separate credit agreements required by consumer credit legislation, lenders are unwilling to simplify the wording in case this renders the security bill void;
- they provide few protective measures to prevent lenders taking possession of goods subject to security bills in the event of default by the borrower, and lenders can take possession of the goods even if the loan has almost been paid off;
- they offer no protection to private purchasers, who acquire no rights to the goods in the circumstances set out above; and
- the High Court register is paper-based and difficult for private purchasers to use, since it can only be searched by the borrower's name and postcode or the number of the security bill.

THE NEW GOODS MORTGAGES ACT

Despite the problems with the existing legislation, the Report concludes that logbook

loans are an important source of credit for many borrowers, allowing access to larger sums over a longer period than payday loans in circumstances where they might otherwise be subject to higher interest rates or be denied credit altogether. It therefore proposes repeal of the bills of sale legislation and its replacement by a new Goods Mortgages Act (GMA). To make the terms easier for consumers to understand, bills of sale would be renamed “goods mortgages” (to include “vehicle mortgages” secured on vehicles).

Goods mortgages would exist where an individual, defined to include consumers and unincorporated businesses such as sole traders or general partnerships, uses goods he already owns as security for a loan or other monetary obligation, while retaining possession of those goods. The definition of “goods” in the GMA would exclude land, ships, aircraft, agricultural charges and intangibles such as shares. The GMA would apply not only where the borrower retained physical possession of the goods, but also where he granted possession of them to a third party. Goods mortgages could be used to secure loans of any amount.

Protecting borrowers

Provisions under the GMA applicable to all goods mortgages

Grounds for possession

Lenders would be unable to take possession of goods subject to goods mortgages except upon:

- default by the borrower on payments under the loan agreement;
- default on maintenance or insurance of the goods;
- the borrower’s offering the goods for sale or moving them in breach of a term of the agreement; or
- the borrower’s bankruptcy.

Goods mortgage document requirements

The requirements for goods mortgage documents would be simpler than those for security bills: they would have to be in writing and signed by the borrower in the presence of a witness. Goods mortgages would be simpler for borrowers to understand, being required to contain only:

- the date of the goods mortgage;
- the names and addresses of the borrower and lender;
- the obligation secured by the goods mortgage;
- a statement that ownership of the goods was being transferred to the lender in order to secure the obligation;
- the name, address and occupation of the witness; and
- a specific description of the goods.

Unlike bills of sale, the goods mortgage document would not be required to state a fixed loan amount or specify the repayment instalments, allowing goods mortgages to be used for securing revolving credit facilities, overdrafts and guarantees. The goods mortgage document would state that ownership of the goods would be transferred to the borrower automatically once the loan had been repaid. Where a goods mortgage document failed to comply with the above requirements, the lender would lose any right to the goods both as against the borrower and as against third parties, although the lender would still be entitled to repayment of the loan.

Prohibitions on goods mortgages over essential household goods and future goods

To ensure that vulnerable borrowers could not be forced to grant goods mortgages over essential household goods, the GMA would introduce a regulation-making power to prohibit the granting of goods mortgages over such goods. It would also prohibit the use of future goods as security for a loan unless the loan was to be used to acquire the goods.

Borrower protections applicable to goods mortgages securing regulated agreements

For borrowers subject to goods mortgages securing regulated credit agreements as defined by Art 60B of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO), the GMA would put in place a number of additional protective measures. These measures would not apply to goods mortgages securing exempt agreements as defined in the RAO, for example:

- loans exceeding £25,000 made wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower; and
- subject to certain exceptions, loans of more than £60,260 made to an individual borrower where the borrower agrees to forgo the protection and remedies available if the agreement were a regulated agreement.¹

The Report concludes that such borrowers are not in need of legislative protection, and that therefore freedom of contract should prevail.

Prominent statements

Goods mortgage documents securing regulated credit agreements would be required to contain two prominent statements explaining that:

- ownership of the goods was transferred to the lender until the loan was repaid; and
- failure to keep up loan repayments could lead to the goods being repossessed.

The statements would not be mandatory for goods mortgages securing exempt agreements.

Requirement for lenders to seek court orders

Borrowers who encounter temporary financial difficulties would be protected by a requirement for lenders to seek court orders in certain circumstances. Currently, s 13 of the 1882 Act provides that the lender must wait five days from taking possession before selling the goods, during which time the borrower may apply for a court order restraining the sale. Logbook lenders who adhere to the Consumer Credit Trade Association voluntary code of practice wait 14 days before selling a vehicle. However, the time frame for borrowers to apply for a court order is short, and applications are likely to succeed only if the loan has been, or is immediately about to be, repaid in full.

Consumer credit legislation offers some further protections to borrowers under regulated agreements: by s 86B CCA 1974 as amended by the CCA 2006, s 7A of the 1882 Act and s 87 CCA 1974, lenders cannot take possession of goods until they have served a notice of sums in arrears and a default notice, and allowed the borrower a 14-day period

Feature

after service of the latter to remedy the default. However, where a valid default notice has been served, consumer credit legislation does not prevent the lender taking possession of the vehicle. Although the borrower may apply to the court under s 129 CCA 1974 for an order requesting more time to pay, the expense and burden of making the application lies with the borrower, who may not be aware of the remedy.

Under the GMA, lenders wishing to take possession from private premises of goods subject to goods mortgages securing regulated agreements would always be required to seek a court order. In all other cases, after the borrower had repaid one third of the total amount of the loan the borrower would be given the choice of opting in to a process requiring the lender to seek a court order to take possession of the goods. Borrowers would be given the chance to opt in by both a default notice and a formal opt-in notice in a prescribed form, which the lender would be required to serve immediately before taking enforcement action. It would be mandatory for lenders to notify borrowers of their right to require a court order on both notices, and to prove delivery of the opt-in notice.

The opt-in notice, which would have to be returned by the borrower within 14 days, would give him the choice between:

- requiring the lender to seek a court order (with an indication of the likely costs);
- voluntarily terminating the goods mortgage in full and final settlement of the loan; or
- indicating a desire to seek debt advice.

Where the borrower indicated such a desire, the lender would be unable to take possession of the goods for six weeks from the date of delivery of the opt-in notice.

On an application by the lender for a court order, the court would have powers to order the borrower to repay the loan in instalments and at such times as the court deemed reasonable. It could also amend the credit agreement in any way it considered just to both parties, such as by reducing the rate of interest. The GMA would specify that lenders' legal fees and other ancillary costs could not be passed on to borrowers unsuccessful in obtaining a court order, although the borrower would be liable for the

court fee. Where the lender took possession of and sold the goods, the borrower would remain liable for any outstanding amounts under the loan agreement.

If the lender wrongly took possession of goods in circumstances where it was required to seek a court order, the credit agreement would be terminated and the goods would be returnable to the borrower, who would have no further liability to pay any outstanding loan amounts. If the goods could not be returned because they had been sold, the borrower would be entitled to compensation. The borrower could also apply to the Financial Ombudsman Service (FOS), which would have power to award compensation up to a maximum of £150,000.²

Right of voluntary termination

To protect borrowers with no realistic prospect of paying off the secured loan, the GMA would provide that borrowers subject to goods mortgages securing regulated agreements would also have the right to terminate the goods mortgage voluntarily in full and final settlement of all amounts outstanding under the loan. The right of voluntary termination would be available unless the goods had sustained intentional damage or the borrower had failed to take reasonable care of them such that their resale value was adversely or significantly affected. It would be available from the time the goods mortgage was granted until court proceedings were issued, or (if a court order was not needed) either repossession agents were instructed or the lender's employees visited the borrower to take possession of the goods, whichever took place first.

Protecting private purchasers

The bills of sale legislation fails to protect private purchasers who buy goods, in particular vehicles, unaware that they are subject to a bill of sale. Unlike hire purchase agreements, where private purchasers in similar situations obtain the right to the vehicle provided that they act in good faith and without notice of the agreement, a private purchaser of a vehicle subject to a security bill does not acquire ownership of it and the logbook lender can take possession of it from the purchaser at will.

The private purchaser of a vehicle subject to a security bill has no legal right to pay only the outstanding amount of the loan: the lender can insist on payment for the vehicle even if the value exceeds the outstanding loan amount. The purchaser's right to recover financial losses from the logbook borrower who sold him the vehicle will be useless if the borrower has disappeared or does not have the financial means to pay compensation. In practice, such purchasers are usually given the choice by logbook lenders of paying off the logbook loan, surrendering the vehicle or buying it at a discount. Although on a relatively small scale, this perceived unfairness to innocent private purchasers has created bad publicity for the logbook loan industry.

Private purchasers acting in good faith and without actual notice

The GMA would extend protection to private purchasers by providing that where they buy goods subject to a goods mortgage, whether or not in connection with a regulated agreement, they would acquire ownership of the goods provided that they act in good faith and without actual notice of the goods mortgage. This right would apply both in relation to sales of goods as defined by s 2(1) of the Sale of Goods Act 1979, and to contracts for the transfer of goods as defined by s 8 of the Consumer Rights Act 2015.

Duty of disclosure for borrowers

The GMA would also impose a legal duty on borrowers to disclose the existence of goods mortgages when selling goods, and require the goods mortgage document to contain a prominent statement warning that a borrower who sells goods subject to a goods mortgage without revealing the goods mortgage to the purchaser may be committing a criminal offence.

Registration of vehicle mortgages

The bills of sale legislation requires security bills to be entered on a register at the High Court, which is searchable only by the name and postcode of the borrower or the security bill number. Logbook lenders also register security bills voluntarily with online asset finance registries, which are easy to search

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by vehicle registration number and widely used for vehicle provenance checks by motor traders and other lenders. Asset finance registries are not commonly searched by private purchasers, however, because of lack of familiarity, high fees and confusion with alternative “text checks” which do not provide information about logbook loans.

Under the GMA there would be no requirement to register vehicle mortgages at the High Court. Failure to register a vehicle mortgage with a designated asset finance registry, however, would render it unenforceable against third parties or trustees in bankruptcy, although it would still be enforceable against the borrower. There would be no statutory time limit for registration, but a third party who acquired an interest in a vehicle before the vehicle mortgage had been registered would take free of the vehicle mortgage. If multiple vehicle mortgages had been granted over the same vehicle, priority as between lenders would be determined by the date and time of submission of the vehicle mortgage for registration.

Registration of goods mortgages other than vehicle mortgages

The Report recognises in the long-term the desirability of establishing an electronic register for goods mortgages other than vehicle mortgages. However, as the government has shown little appetite for this solution, the Report recommends as an interim measure updating and simplifying the High Court registration procedure by:

- allowing filing by email;
- removing the requirement for submission of original documents;
- removing the requirement for a witness affidavit;
- abolishing the time limit for registration;
- no longer requiring the High Court to send goods mortgage documents to local County Courts where the borrower or vehicle is located outside London;
- requiring lenders to remove satisfied goods mortgages from the register;
- allowing borrowers to remove satisfied goods mortgages if the lender refuses to do so; and
- extending the period for re-registration of existing goods mortgages to 10 years.

Mortgages on goods other than vehicles would not be enforceable against a third party unless they had been registered. They would be enforceable as against the borrower whether or not they had been registered.

Greater protection under Consumer Credit legislation

Although not to be included in the GMA, the Report recommends extending protection for private purchasers under Consumer Credit legislation. Lenders under regulated agreements are subject to the FCA and the FOS, which have wide powers to supervise and sanction breaches of consumer credit legislation. Pursuant to the rules and guidance in the Consumer Credit sourcebook (CONC), lenders must treat borrowers in arrears with forbearance and due consideration, and have robust policies in place to deal with customers whose accounts fall into arrears, particularly where those customers are vulnerable.³

The FCA considers that its scope to protect private purchasers is limited to situations where the lender treats the private purchaser as a borrower under the loan agreement,⁴ for example by pursuing the private purchaser in the mistaken belief that he has acquired the borrower’s rights and obligations. The FOS may hear complaints from consumers treated as if they were customers of the lender: it has no jurisdiction where the lender tries to take possession of the vehicle from a private purchaser without trying to recover any payment.

The Report recommends that the jurisdiction of the FCA and the FOS be extended to private purchasers, by amending the definition of a consumer in the FSMA and RAO to include purchasers of goods who are not customers of but are pursued by the lender, either for the payment of money or possession of goods. The Law Commission also raises the possibility of a cap on default charges in relation to logbook loans. However, it considers such a cap to be a matter for the FCA.

CONCLUSION

The Law Commission’s proposals, if implemented in their entirety, would go a long way to redressing imbalances to the detriment

of consumers existing under the bills of sale legislation. However, the GMA may disadvantage lenders. The Law Commission rejected proposals during its consultation process that registration of vehicle mortgages with a designated asset finance registry be deemed to put private purchasers on notice. Nor would High Court registration of goods mortgages other than vehicle mortgages be deemed to give notice. The GMA would therefore fail to give lenders a means of protecting themselves if a borrower fraudulently sold goods subject to a goods mortgage to a private purchaser. Where the borrower disappeared and the private purchaser gained the right to possession of the goods, the lender would be unable to recover either the outstanding amounts under the loan agreement or the security for the loan. Any additional costs to lenders could be passed on to consumers. Further, the Report fails to press for the creation of an electronic register for goods mortgages other than vehicle mortgages, and leaves as a matter for the FCA a possible cap on default fees in relation to logbook loans. Although the proposed GMA would improve the level of protection for borrowers and private purchasers, there would still be more to do. ■

¹ Articles 60C and 60H RAO.

² FCA Handbook, Dispute Resolution: Complaints (DISP), 3.7.

³ CONC Rule 7.2.1.

⁴ Section 1G Financial Services and Markets Act 2000 (FSMA) (as amended by the Financial Services Act 2012), extended in relation to debt collecting by Art 39M(1)(c) Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544 (RAO).

Further reading:

- Bills of Sale: access to credit for unincorporated businesses [2016] 3 JIBFL 156.
- Bills of Sale Acts: ripe for reform? [2013] 11 JIBFL 685.
- LexisNexis Loan Ranger blog: Bills of Sale Consultation paper – a response.